UPV/EHU

OCW "Companies Accounting"

LECTURE MATERIAL: Topic II

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FORMING JOINT STOCK COMPANIES, INCREASING SHARE CAPITAL, DECREASING SHARE CAPITAL AND TREASURY STOCKS.

TOPIC II

TOPIC II (A)

TOPIC II (B)

TOPIC II (C)

TOPIC II (D)

TOPIC II

TOPIC II (A)

Purpose of the Topic:

- Define the legal aspects the "*Spanish Corporate Enterprises Act*" requires when forming Joint Stock Companies.
- Identify the different Procedures of Forming Corporations and record the entries in accounting.
- Identify monetary and non-monetary contributions and its recording in accounting.

Title II. Formation of Corporate Enterprises[1]

1. FORMING A JOINT STOCK COMPANY [2]

1.1. Legal requirements.

When forming a Corporation, a public document called the deed of incorporation (art. 22 Spanish Corporate Enterprise Act) must be written, signed in the notary public and registered in the Mercantile Registry in which the administrative and management activities or main business establishment are located (art.9)

It is in this particular moment, on the date of registration, when the Corporation is considered as a legal entity, independent from the owners. From this moment the company can start running its business and recording its accounting transactions, following the requirements of the Spanish Accounting Plan.[3]

The deed of incorporation contains information concerning the following (art.22)

- Identity of the founding shareholders
- Identity of the persons that will represent and manage the Company
- Estimated start-up expenses
- By-laws of the Company.

The deed of incorporation can only be registered when the Share Capital has been issued, subscribed, and outlaid in at least a 25% of Par Value of each stock. At least 60,000€ Share Capital shall be subscribed in Joint Stock Companies. In Limited Liability Companies at least 3,000€ Share Capital shall be subscribed and fully outlaid from the beginning.

Ex: BILBO Inc. issues 10,000 stocks 10€/stock Par Value

- ***How much of the Share Capital shall be outlaid when forming a Joint Stock Company?***

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[1] *Royal Legislative Decree 1/2010, of 2 July, approving the consolidated text of the Corporate Enterprises Act.*

[2] We will only consider the articles that have accounting consequences, and deep in the study of the Joint Stock Companies, although we will give some examples in the Limited Liability Companies.

[3] *Royal Legislative Decree 1514/2007, of 16 November, approving the Spanish Accounting Plan.*

Ex: BILBO Ltd. issues 10,000 shares 10€/share Par Value • ***How much at least of the Share Capital shall be outlaid when forming a Limited Liability Company?***

If the Issuing Value is over Par Value, the Share Premium must be totally outlaid.

Ex: BILBO S.A. issues 10,000 stocks 10€/stock Par Value. Issuing Price 100% • ***How much at least of the Share Capital shall be outlaid when forming a Joint Stock Company?***
Ex: BILBO Ltd. issues 10,000 shares 10€/share Par Value. Issuing Price 110% • ***How much at least shall be outlaid when forming the Limited Liability Company?***

The By-laws of the Company must contain items such as the following: (art. 23)

- Company`s name.
- Corporate`s purpose, specifying the activities to reach this purpose.
- Registered office.
- Information about the governance of the Company.
- Information related to shares:
  - Capital and number into which it is divided, their par value, consecutive numbering and whether they are represented by certificates or book entries.
  - Share class (ordinary or privileged) and series (different par value)
  - Proportion of par value outstanding, method and deadline of payment.

Founders and promoters may reserve special financial rights, which cannot exceed the 10% of net book earnings after accounting for the legal reserve. This privilege may not last longer than ten years. These rights may be registered as non-share certificates and their transferability shall be restricted in the by-laws (art 27). This privilege is considered an expense for the company, although it can be determined as a percentage in the profit of the period.

1.2. Procedures of Forming Corporations

Joint Stock Companies can be founded following two different methods: Simultaneously or Successively.

1.2.1. Most of the companies are founded in a single act, this is, *simultaneously.*

The incorporators (individuals or companies), sign the deed of incorporation, subscribe the stocks and pay the contributions, all at a time in the notary public.

1.2.2. Publicly held Joint Stock Companies can also be founded *successively*, through public share offerings made by different financial brokers chosen by the "Corporation in Formation".

The Corporation is represented during this period by the Group of Promoters who must inform and specify the characteristics of the issuing in the Formation Program which must be approved by the National Securities Market Commission and deposit in the Mercantile Registry (art.42) [4].

During the offering, share subscriptions shall be recorded in the "subscription form" issued that contains all details related to the subscriber and contributions, number of shares subscribed, value, outlays,..etc.

Within no more than six months of the date of deposit of the Formation Program in the Mercantile Registry, the promoters shall organize the incorporation meeting for the subscribers to approve their management during the process.

In the month following the date of the meeting, the deed of incorporation shall be formalized and within two months registered in the Mercantile Registry.

Not only newly formed corporations, but also governmental companies that are being privatized (totally or partially) follow this process by launching public offerings of shares representing part of their Share Capital.[5]

1.3. Authorized stocks

The articles of Incorporation usually specify the number of shares the Company is authorized to issue, which are often larger than the shares needed to finance the starting of the business. This authorization is also valid for successive issuing of shares when increasing capital[6].

Once an issued stock has been subscribed it is considered as an outstanding stock.

Authorized Stocks ≥Issued Stocks≥ Outstanding Stocks

1.4. Forming costs to found the Company

Costs which the Company incurs in order to form the Corporation, are called Organization or Formal Costs and Start-up costs.

1.4.1. Formal Costs:

- Property Transfer and Certified Legal Documents Tax (1% of Share Capital and Share Premium)
- Issuing stocks costs, bulletins and printing of prospectus.
- Fees for legal services during the process (lawyers, notary public and registry.)

[4] In Spain Comisión Nacional Mercado de Valores

[5] In January 2015 AENA has launched an Initial Public Offering on the 49% of its Share Capital

[6] "With respect to authorizations given regarding share capital, on May 18, 2011, authorization was given at the Annual Shareholders' Meeting of *Telefónica, S.A* for the Board of Directors, at its discretion and in accordance with the Company's needs, to increase the Company's capital, at one or several times, within a maximum period of five years" ("*Telefónica`s*" Financial Reports ending 2013 Note 11.)

These costs are recorded as less Equity, debiting to the (113) Voluntary Reserves, they do not represent expenses and are not recorded in Income Statement[7]:

Amount	Debit	Date	Credit	Amount
	(113) Voluntary Reserve (472) Input VAT*		(572) Banks	

**when corresponds*

1.4.2. Start-up expenses:

- Personnel training expenses
- Start-up publicity..etc

These costs are recorded as expenses in accounting according to their nature:

Amount	Debit	Date	Credit	Amount
	(64x) Personal expenses (62x) External services …….other…..		(572) Banks	

1.5. Monetary and Non-monetary contributions

Occasionally, corporations issue capital in exchange for assets other than cash. Contributions to corporate enterprises may consist on goods or rights, but may never consist on work performed or services rendered, due to the fact that any contribution must consider the "reality principle" we learnt in topic I under which there must be a real investment that supports the share capital.

1.5.1. Monetary contributions: all contributions made in cash.

If the shareholder contributes with foreign exchange, it will be recorded in the financial statements according to the exchange rate at the date of the subscription.

1.5.2. Non-monetary contributions: contributions different to cash, such as goods, rights or even a business.

- Furniture,
- Property, plant and Equipment
- Rights against third parties (Receivables)
- A business, a part of a business

[7] *"Expenses arising on these transactions, including costs incurred on issuing the instruments – … – shall be accounted for directly in equity as a reduction in reserves."(Measurement Standards Number 9th Spanish accounting Plan)*

An independent expert must determine the fair value of the contributions to consider the number of stocks to assign in exchange.

The appraisal`s report shall contain a description of the contribution, registry data valuation of the contribution and whether it concurs with the par value and, if applicable, the value of the issue premium of the shares issued in exchange therefor (art.67.2) This report is not required for Limited Liability Companies in which the founders are have joint and several responsibility for these kind contributions.

The value attributed to the contribution in the deed of incorporation shall not be higher than the value estimated by the experts. (art.67.3)

An independent expert's report will not be necessary in the next situations: (art.69)

- Contribution of securities listed on regulatory markets Such assets shall be valued at the average weighted trading price on one or various regulated markets during the quarter immediately preceding the date of actual contribution
- Assets other than the mentioned above, appraised in the six preceding months prior to the date of the actual contribution.

An authenticated copy of the expert's report must be deposited with the Mercantile Registry within one month of the actual date of contribution (art.71.1)

Any onerous acquisition of assets worth ten per cent or more of its share capital made at any time between the date of formalization of its deed of incorporation and two years after its registration in the Mercantile Registry, must be approved by the general meeting of shareholders. This requirement in not applied to acquisitions required for ordinary company operations or operations conducted on an official secondary market or through public auction (art.72)

Accounting

Accounts

- *100. Share Capital*
- *110. Share Premium*
- *103. Uncalled Capital*
- *104. Uncalled non-monetary contributions*
- *558. Receivable on called-up Capital*
- *5581 Shareholders in arrears*

<u>Recording the formation of Joint Stock Companies (Simultaneous)</u>

a) Issuing of shares.

Amount	Debit	Date	Credit	Amount
	(190) Shares Issued		(194) Issued Capital *pending registration*	

b) Subscription

b.1) Subscription & outlay (cash contributions)

Amount	Debit	Date	Credit	Amount
	(572) Banks sh. x (**SP**+25%PV) (1034) Uncalled Capital *pending registration*		(190) Shares Issued	

b.2) Subscription & outlay (non-monetary contributions)*

Amount	Debit	Date	Credit	Amount
	(300) Merchandises (211) Building (540) Investments in equity instruments… (XXX)……other assets….. (1044) Uncalled non-monetary contributions *pending registration*		(190) Shares Issued	

**When contributing with a running business, this will materialize in assets and liabilities.*

c) Registration

Amount	Debit	Date	Credit	Amount
	(194) Issued Capital *pending registration*		(100) Share Capital (110) Share Premium (when IP>PV)	
	(103) Uncalled Capital (104) Uncalled non-monetary contributions		(1034) Uncalled Capital *pending registration* (1044) Uncalled non-monetary contributions *pending registration*	

d) Formal Costs

Amount	Debit	Date	Credit	Amount
	(113) Voluntary Reserve (472) Input VAT		 (572) Banks	

Amount	Debit	Date	Credit	Amount
	(113) Voluntary Reserve (472) Input VAT		 (572) Banks	

e) Start-up Expenses

Amount	Debit	Date	Credit	Amount
	(62.) External services (64.) Personnel expenses (472) Input VAT		 (572) Banks	

Ex: *On the 21st of March 2015, a new Company, BRAS Inc. is formed, with the following characteristics:*

- *The forming process will be Simultaneous.*
- *Share Capital 800,000 €, divided into 10,000 shares same Par Value. Issuing price Par Value.*
- *Costs incurred in terms of legal fees, stock issuing and inscription 1,000 €.*
- *Promotional expenses 1,000 €.*
- *Training costs 800€.*

The incorporators agree to outlay the minimum established in the Spanish Law.
On April the 25th of 2015 the Company is registered.

- ***Record the transactions described.***

Ex: "V" Inc. has been simultaneously formed by the issuing of 25,000 shares, 40€/sh. par value. Contributions to the company valuated by independent experts:
Shareholder "A": Machinery 300,000€
Shareholder "B": IT Equipment 500,000€
Shareholders "C": Vehicles 200,000€

- ***Record the transactions described.***

Recording the formation of Joint Stock Companies (Successively[8])

a) Promoters provide cash to cover any expenses incurred during the formation`s period.

Amount	Debit	Date	Credit	Amount
	(57x) Cash		(5511) Current account with equity holders and directors	

[8] We explain the way they companies can record a successively foundation. As the most usual process is the simultaneous, we will not do exercises following this process.

b) Issuing of shares.

Amount	Debit	Date	Credit	Amount
	(190) Shares Issued		(194) Issued Capital *pending registration*	

c) Subscription

Amount	Debit	Date	Credit	Amount
	(192) Subscription of Shares*		(190) Shares Issued	

**It can be for more or less than the Shares Issued*

c.1) Outlays

**when the foundation program establishes that the excess in subscriptions will have to be adjusted to the issuing.*

Amount	Debit	Date	Credit	Amount
	(572) Banks sh. x (**SP**+25%PV)		(192) Subscription of Shares	

Excess of outlays*

Amount	Debit	Date	Credit	Amount
	(192) Subscription of Shares		(572) Banks (Excess of shares subscribed) x (**SP**+25%PV)	

Excess of subscription

**when the foundation program establishes that if there is an excess in subscriptions, new shares can be issued to attend the subscriptions.*

Amount	Debit	Date	Credit	Amount
	(190) Shares Issued		(190) Subscription of Shares	

c.2.) Outlays **when the subscription does not cover the amount issued*

Amount	Debit	Date	Credit	Amount
	(572) Banks sh. x (**SP**+25%PV)		(192) Subscription of Shares	

Adjustment to shares issued

Amount	Debit	Date	Credit	Amount
	(194) Issued Capital *pending registration*		(190) Issued shares	

d) Uncalled Capital

Amount	Debit	Date	Credit	Amount
	(1034) Uncalled Capital *pending registration*		(192) Subscription of Shares	

e) Registration in Mercantile Registry

Amount	Debit	Date	Credit	Amount
	(194) Issued Capital *pending registration*		(100) Share Capital (110) Share Premium (when IP>PV)	
	(103) Uncalled Capital		(1034) Uncalled Capital *pending registration*	

f) Repayment to promoters

Amount	Debit	Date	Credit	Amount
	(5511) Current account with equity holders and directors		(572) Banks	

Ex: *On March the 21st of 2015, a group of promoters start the process to form a new Company, BRAS Inc. following a successive process with the following characteristics:*

- *Shares issues 800,000 sh., 5€/sh. same Par Value each. Issuing price Par Value.*
- *Outlaid Capital 30% par Value.*
- *The foundation program establishes that subscriptions that exceed the shares issued must be adjusted and outlays reimbursed.*
- *Subscribed shares 780,000 sh.*

On April, the 25th of 2015 the Company is registered once the forming Meeting is celebrated and approved the promoters` management.

- ***Record the transactions described.***

1.6. Uncalled Capital

The part of the share not yet outlaid from the Par Value, will be called up by the Company considering what the bylaw determines or following financial needs considered by the managers of the company. It can be called up in one or more stages, and the stockholder can contribute in cash or non-monetary investment.

In case of partial payment of subscribed shares, the incorporation`s act must specify whether the future payments shall be made in cash or kind contributions.

Recording of Capital outlays:

g) Uncalled Capital Called

Amount	Debit	Date	Credit	Amount
	(558) Receivable on called up capital		(103) Uncalled Capital	

h) Outlaying Capital Called

h.1) Outlay (cash contributions)

Amount	Debit	Date	Credit	Amount
	(572) Banks		(558) Receivable on called up capital	

h.2) Outlay (no-monetary contributions)

Amount	Debit	Date	Credit	Amount
	(300) Merchandises (218) Vehicles....etc…		(104) Uncalled non-monetary contributions	

1.7. Shareholders in arrears

Shareholders shall be considered in arrears at any time after the deadline for payment of the capital outstanding.

Shareholders in arrears are deprived of their rights:

- To vote (quorum will be calculated deducting their shares)
- To receive dividends (they may demand payment of unexpired dividends, once paying the sums owed + interests accrued)
- To execute the pre-emptive right to subscribe new shares or convertible bonds.

The company will claim the payment following the next steps:

1. The company may demand payment + legal interest accruing and damages incurred by reason of the arrears, for and at the risk of the shareholders in arrears.
2. When shares must be sold the sale will take place in the official secondary

market by a broker or in the notary public, when it is not publicly held.
3. If no sale materializes, the shares shall be redeemed and the share capital reduced accordingly, and any sums laid out shall be retained by the company.

Recording of Shareholders in arrears:

		Debit	Credit
Claiming Uncalled Capital	(558) Receivable on called up capital	x	
	(103) Uncalled Capital		x
Shareholder in arrears	(572) Banks (called capital attended)	x	
	(5581) Shareholders in arrears	x	
	(103) Uncalled Capital		x
	COMPANY DEMANDS PAYMENT.		
Expenses incurred by company in the process	(5581) Shareholders in arrears	x	
	(572) Banks		x
Shareholder pays (plus interests & damage)	(572) Banks	x	
	(5581) Shareholders in arrears		x
	(778) Exceptional Revenues		x
	If the demand is not attended: alternatives • ***Selling shares*** • ***Decrease in Capital***		
	(55811)Shareholder`s in arrears stocks/Duplicate	x	
	(55812)Cancelled stocks		x
• **Company sells shareholder`s stocks or duplicates**	(572) Banks	x	
	(5581) Shareholders in arrears (selling price<issuing price)	x	
	(55811)Shareholder`s in arrears stocks/Duplicate		x
	(5581) Shareholders in arrears (selling price>issuing price)		x
Liquidation (relationship Shareholder-company)	(55812)Canceled stocks	x	

	(5581) Shareholders in arrears (572) Banks (if the company owes the shareholder)		x x
• **Company cannot sell the shares, *Decrease in Capital***	(100) Share Capital (110) Share Premium (if IP>PV)	X x	
	(55811)Shareholder`s in arrears stocks/Duplicate		x
Liquidation (relationship Shareholder-company)	(55812)Canceled stocks	x	
	(5581) Shareholders in arrears (778) Exceptional Revenues (the money the shareholder outlaid remains in the Company)		X x

Ex: Share Capital of CAPISA: 4,000.000 €; shares 20 € Par Value each; Issuing Price125%. Shareholder C: subscribes 2,000 shares contributing cash and outlaying the minimum established by law. Within a year he is asked to outlay the rest he owes to the Company but he does not contribute. When demanded he satisfies both the sum owed plus 800€ interests accrued.

- ***Record the transactions described.***

Ex: Share Capital of CAPISA: 4,000,000 €; shares 20 € Par Value each; Issuing Price125%. Shareholder C: subscribes 2,000 shares contributing cash and outlaying the minimum established by law. Within a year he is asked to outlay the rest he owes to the Company but he does not contribute. When demanded he does not attend the payment. The company sells the duplicates to a third person who pays a 110% for them.

- ***Record the transactions described.***

Ex: Share Capital of CAPISA: 4,000,000 €; shares 20 € Par Value each; Issuing Price125%. Shareholder C: subscribes 2,000 shares contributing cash and outlaying the minimum established by law. Within a year he is asked to outlay the rest he owes to the Company but he does not contribute. When demanded he does not attend the payment. The company decreases the Share Capital that corresponds to these shares

- ***Record the transactions described.***

TOPIC II (B)

Purpose of the Topic I (B):

- Define the legal aspects the "*Spanish Corporate Enterprises Act*" requires when increasing capital in Joint Stock Companies.
- Define the concept of pre-emptive right and the free of charge allotment right..
- Calculate the theoretical value of the pre-emptive right.
- Identify the different Procedures of increasing capital and record the entries in accounting.

Title VIII. Chapter II. Capital Increases

2. INCREASES IN CAPITAL

Financial resources can be generated in the business by retaining earnings not distributed through dividends, by borrowing money or by the acquisition of additional capital (external resources).

2.1. Reasons why a company wants to increase its capital

- To finance its expansion, both in new markets as in the one it already works on. As corporations grow, they may need additional sums of money to finance their expansion. The first source they can count with are the retained earnings, however they may provide not enough sums for the increasing needs.
- To manufacture new products or increase the volume of its manufacturing.
- To invest in new Property, Plant & Equipment.
- To reduce debt by converting it into Capital.

2.2. Legal Requirements

This transaction needs the amendment of the By-laws after being approved in General Meeting by majority of shareholders, specifying the way the increase will be achieved, the amount increased and the materializing of the transaction.

The General Meeting may also approve authorizing the Board of Directors to increase capital in the dates they consider without the shareholders´ vote. Authorized Capital may not exceed the half of the Capital sum when adopted the decision, stocks must be booked against cash, and the term to use this power must be no longer than five years (art.297)

Following the legal requirements the Corporate Enterprises Act establishes, in order to formalize the transaction, stocks issued must be fully subscribed and outlaid in one fourth of each par value. The premium, when existing, must be fully paid.

Capital increases may materialize in different ways:

- By issuing new stocks (which is the most common way)
- By raising the Par value/existing stock needing the consent of all shareholders to do it this way unless the amount increased is covered by unrestricted reserves. "*Adoption of decisions to increase capital by raising the par value of stakes or shares shall be contingent upon the consent of all partners or shareholders, unless the increase is fully charged to profits or reserves shown on the last approved balance sheet.*"(296.2)

2.3. Dilution of old shares

Increases in Share Capital entail dilution of the shares which can result in:

- **Economical dilution:** reduction in the stock value due to the increase in the number of shares issued when increasing Capital. This happens when the issuing/subscribing price of the new shares does not cover the real value the share has before the transaction occurs.

    - Economical Dilution = Share Value* 1- Share Value 2

    **Share Value can be Market Value (stocks exchanged in the market in Publicly held companies) or Book`s Value (privately held companies)*

- **Political dilution:** reduction in the ownership`s percentage when the number of shares outstanding increases. Each existing stockholder will own a smaller percentage of the Company.

2.4. The pre-emptive right and free of charge allotment right.

When an increase in capital through issuing new shares takes place, the pre-emptive right gives the shareholder of a company the chance to subscribe new shares in proportion to the old ones hold (when the increase is charged to cash contributions), or take the corresponding cost-free allocated shares (when the increase is charged to reserves).

The aim is compensating stockholders the dilution, both economic and political of the shares, by giving them a preference in the offering before they are available to any other potential stockholder.

From the moment the Company declares the issuing of new shares, old shares represent each a pre-emptive right (or free of charge allotment right in covered increases) that lasts till the deadline established to exercise the right (not less than one month from the date of announcement of the offering of new shares in the Official Journal of the Mercantile Registry).

The shareholder can take two options when increasing Capital:

- **Take up the offer.** Subscribe the amount of new shares that correspond to their percentage in the Company, so that they maintain that percentage.
- **Sell the pre-emptive rights** to other shareholders, or to potential new shareholders. In this case, the seller does not maintain the percentage, but they receive their compensation through the money they receive with the price of the right.

Ex: HIGH Inc. was formed with a Share Capital of 150,000 €, totally outlaid consisting of 5 € par value shares. The General Annual Meeting decides the increase of Capital by issuing 1 new stock for every 4 old ones held same par value.
Shareholder "A" holds a 10% in the share capital.

- ***What shall "A" do to maintain his percentage in the company?***

When do shareholders hold pre-emptive rights?

- In increases of capital when issuing new stocks.
- When issuing convertible bonds.

Which shareholders hold the pre-emptive right?

- Old stockholders
- Owners of convertibles bonds

Period of time to take up the offer:

- 15 days minimum in publicly held companies.
- 1 month minimum for the rest since the declaration of issuing new shares.

Stockholders must waive this right when, approved in the general meeting, it is considered to be in the company´s best interests and when the source of the increase in Capital is:

- The conversion of bonds.
- The acquisition of another Company.
- The offsetting of loans
- Non-monetary contributions

The theoretical Value of the Pre-emptive Right equals the value of the Economic Dilution of the stock.

ECONOMICAL DILUTION

Economical Dilution = BV0- BV1 = Pre-emptive Right Value (let`s consider a privately held company. In a publicly held one we would consider the difference in markets values)

N= new stocks
O= old stocks
"IP"= issuing price of the new stocks
BV0= Book`s Value prior to increase in capital
BV1= Book`s Value after increase in capital

Situation (0): BV0

Increase in Capital N x IP

Situation (2) **BV 1 =** $\dfrac{(O \times BV0) + (N \times IP)}{O + N}$

Dilution = **BV0- BV 1** = N(BV0-IP)/N+O = **Pre-emptive right Value**

When the increase in Capital is covered with Reserves, Issuing Price is zero:

Dilution = **BV0- BV 1** = N(BV0)/N+O = **Free of charge allotment right Value**

2.5. Specific situations in increases in Capital

When issuing additional shares these can be booked against:

- **Cash:** it is the most common situation in which previous Capital must be fully paid up or left a 3% maximum of the amount outstanding unpaid (art.299.2). This transaction must take place under same terms as the contribution of cash in founding of companies.

Amount	Debit	Date	Credit	Amount
	(190) Shares Issued		(194) Issued Capital *pending registration*	
Amount	**Debit**	**Date**	**Credit**	**Amount**
	(572) Banks sh. x (**SP**+25%PV) (1034) Uncalled Capital *pending registration*		(190) Shares Issued	

Once registered the transaction

Amount	Debit	Date	Credit	Amount
	(194) Issued Capital *pending registration*		(100) Share Capital **(110) Share Premium (***most common in increases***)**	
	(103) Uncalled Capital		(1034) Uncalled Capital *pending registration*	

Formal costs to carry out the increase in Capital

Amount	Debit	Date	Credit	Amount
	(113) Voluntary Reserve (472) Input VAT		(572) Banks	

- **Offset loans:** situation in which a creditor turns into an owner, shareholder of the company. The law establishes that at least a 25% of the loan must be liquid, mature and receivable and the remaining loans may not mature over five years (art.301.1).

Amount	Debit	Date	Credit	Amount
	(16x)(17x) NC. payables (51x)(52x) C. payables		(100) Share Capital* (110) Share premium	

** Issuing, subscription and contribution*

Ex:"PAY" Inc. will compensate some debts it owes to "OW" company, by turning them into Capital. Characteristics of the debt:
Matured amount ……………………………………..25,000€
Payable in 18 months…………………………….15,000€
- ***Record the transaction described***

- **Convertible bonds**: bonds issued with this purpose that are finally converted into capital. It is a way of offsetting a particular type of loan.

Amount	Debit	Date	Credit	Amount
	(178) NC. convertible bonds and obligations (5091) Redeemed convertible bonds and obligations		(100) Share Capital* (110) Share premium	

** Issuing, subscription and contribution*

Ex: On February the 2nd 2014, ABC Inc. with a Share Capital formed by 20,000 shares 50 € par value each agrees the following in its General Meeting:

- *Convert convertible bonds that are reported in the balance sheet. Characteristics:*
    - *Issued during 2013, they can be converted into shares of the company on the 1st may 2014.*
    - *The total bonds issued correspond to 1,000 obligations that can be exchanged in the proportion of 1 sh. of ABC 50 € par value issued 100 €/each for 2 outstanding obligations.*
    - *On the 1st. the 100% of bondholders take up the offer.*
- ***Record the increase in Capital***

- **Non-monetary contributions**: a report with the description of the contributions must be available for the shareholders, with information about the value, persons that will make the contributions and the number and characteristics of the shares issued.
  This transaction must take place under same terms as the non-monetary contributions in founding of companies.

Amount	Debit	Date	Credit	Amount
	(xxx) Non-monetary contributions		(100) Share Capital* (110) Share premium	

** Issuing, subscription and contribution*

- **Reserves:** an audited balance sheet approved by the general meeting not before six months prior to the approval shall serve as base for the transaction.
    - Totally covered

Amount	Debit	Date	Credit	Amount
	(113)Voluntary Reserves (110)Share premium (112)Legal Reserve		(100) Share Capital	

- Partially covered

Amount	Debit	Date	Credit	Amount
	(113)Voluntary Reserves (110)Share premium (112) Legal Reserve (572) Banks		(100) Share Capital	

Formal expenses incurred in increases

Amount	Debit	Date	Credit	Amount
	(113) Voluntary Reserves			
	(472) Input VAT			
			(572) Banks	

Available reserves to be capitalized are: Unrestricted Reserves, Share Premium and the Legal Reserve in the amount that exceeds the 10% of the increased Share Capital (art. 303.1).

It is quite usual that big corporations remunerate their shareholders through Scrip Dividends. This transaction entails increases in capital charged to reserves[9].

[9] "*BBVA hereby communicates relevant information relating to the free-of-charge capital increase resolved by the General Meeting of BBVA Shareholders held on 13th March 2015, under agenda item four, section 4.1, by which a system of flexible shareholder remuneration called "Dividend Option" is to be instrumented. Accompanying this relevant event notice is an information note related to the referred free-of-charge capital increase*". (www.bbva.com, 2015):

25th March 2015: Communication of the number of rights necessary to receive one new share, and the definitive price at which BBVA has committed to purchase rights.

27th March 2015 (23:59 Madrid (Spain) time): Record date for allocation of rights.

30th March 2015: Rights trading period begins in Spain.

9th April 2015: Deadline for requesting payment in cash (sale of rights to BBVA).

14th April 2015: Rights trading period ends.

17th April 2015: Payment date to shareholders who have requested payout in cash (sale of rights to BBVA).

23rd April 2015: New shares allocated to shareholders.

24th April 2015: Initiation of ordinary trading of the new shares on the Spanish exchanges, subject to obtaining all necessary authorizations.

Finally, it is estimated that, assuming BBVA's Board of Directors approves the execution of the Capital Increase, the approximate purchase price at which BBVA will purchase rights, in accordance with the formula approved by the General Meeting of BBVA Shareholders, will be around 0.13 euros per right.

Madrid, 13th March 2015

2.6. Share Premium

When issuing new shares, any excess in the issuing price over par value is called Share Premium. It must be fully paid up from the beginning (art.298.2)
The Share Premium has its real sense when increasing Capital in corporations, more than in foundations. It is a way of demanding new shareholders to pay for the retained earnings already generated over years by the owners of the company. Old shareholders have renounced to receive dividends in order to contribute to the company´s growth. New buyers of shares pay with the Premium Share for these retained earnings.

It is a way of avoiding the economical dilution of the shares.

Ex: "HELLO" Inc. presents the following accounts that form its Equity:

(100) Share Capital	*650,000*	*(PV = 5 €)*
(112) Legal Reserve	*97,500*	
(113) Voluntary Reserve	*52,000*	
(129) P/L of the period	*25,000*	

Shareholders approve in General Meeting the increase of Capital by issuing 26,000 new stocks with a share premium of 1 €/sh.

- ***Has the Share Premium been enough to satisfy the shareholders?***

TOPIC II (C)

Purpose of Topic I (C):

- Define the legal aspects the "*Spanish Corporate Enterprises Act*" requires when decreasing capital in Joint Stock Companies.
- Identify different situations in which the company must decrease capital and record the entries in accounting.
- Identify and record specific situations when reducing Capital.

TITLE VIII. Chapter III Capital Reductions Corporate Enterprises Act.

3. DECREASES IN CAPITAL

The purpose of reducing the Share Capital in a Corporation is usually the reestablishment of the relation between the Share Capital and Equity, due to the accumulated losses during the preceding years.

It can also be destined to constitute or increase Legal or Voluntary Reserves, pay back shareholder`s contributions or condone uncalled capital.

It is actually compulsory when *(121) "Prior period`s losses"* reach amounts that make the Equity go under the 2/3 of the "Share Capital", and this situation remains for at least one full financial year. (art.327).

3.1. Legal requirements

This transaction (as when increasing capital) needs the amendment of the By-laws after being approved in General Meeting by majority of shareholders, specifying the way the decrease will be achieved, the amount decreased and the materializing of the transaction.

Capital decreases may materialize in different ways:

- By redeeming or grouping stocks (which is the most common way)
- By lowering the Par value/existing stock

If the reduction`s purpose is the cleaning up of losses, a Balance Sheet formulated not before six months prior to the date of the decision to reduce the Capital shall demonstrate the situation. This approved Balance Sheet must be verified by the company`s auditor or an auditor appointed by the Board of Directors when not subject to compulsory audit (art.323).

The decision adopted must be announced in the Official Journal of the Mercantile Registry and in a daily newspaper widely circulated in the province where the company is registered. (art.319)

3.2. Voluntary reductions

Companies may voluntarily decide to reduce their Share Capital in the next situations:

- When there is an excess of own sources.

  These exceed the capital needed for the company´s economic dimension.

  This option does not necessary affect all the shares in the same proportion, but the decision must be adopted by the majority of these shares.
- To stabilize the Balance Sheet by cleaning up accumulated losses and the company is not following a mandatory reduction. Companies cannot decrease their Capital to clean up losses if there is any Voluntary Reserve or the Legal Reserve exceeds the ten per cent of the Capital once reduced.

On the other hand, Companies that have reduced their Capital may not distribute dividends until their Legal Reserve reaches the ten per cent of their Capital.

Ex. The General Meeting of Nieve Inc. approves compensating all losses by using the Legal Reserve in the amount exceeding the 10% of the new share capital. The rest of the losses will be covered by decreasing the Share Capital. Situation of Nieve before the decrease in Capital:
(100) Share Capital 1,000,000
(112) Legal reserve 200,000
(121) Prior period`s losses...(760,000)

- ***Record the transaction***

This situation must affect all shares in equal proportion to their par value and respecting any privilege granted to certain stocks, such as no voting stocks (art. 320).

3.3. Obligatory reductions

Companies must follow the mandatory of reducing their Share Capital in the next situations:

- When accumulated losses lower the equity under two thirds of the Share Capital and the situation is not reestablished in one year`s deadline. After this period, if the situation persists, it is obliged by law to reduce the Share Capital otherwise it will have to be dissolved.

- When the company cannot sell treasury stocks when exceeding the limits established by law.

- When the company cannot sell stocks belonging to shareholders in arrears.

3.4. Creditor`s objection to the reduction. Creditor`s protection.

Creditors that already owned rights against the company before the announcement of the decision adopted by the General Meeting and their receivables do not mature yet, but on a date subsequent to the transaction`s date, can oppose to this decision until their credit is guaranteed. (art.334)

They have a period of one month from the date of the last announcement to exercise their right to object.

The Company will not be consequently able to carry out the transaction till it covers or guarantees the creditor`s right.

Creditors will be excluded from this opposition right in the following situations:

- When the reason to reduce the capital is the reestablishment of the relation between capital and equity, consequence of losses.
- When the reason to reduce the capital is the constitution or increase of the Legal Reserve.
- When the new Reserve *(1142) "Redeemed Capital Reserve"* is constituted by charging unrestricted reserves for the total amount of the par value of the shares redeemed. This is a restricted reserve that can only be used with the same requirements as the Share Capital.
- When the reduction`s purpose is to write off shares that correspond to shareholders in arrears who did not attended the company`s claim.
- When the law obliges the company to write off shares when having exceed the treasury stocks` limits.

3.5. Specific situations in decreases in Capital

Decreases in capital may seek the next purposes:

- The refunding of contributions to shareholders

Amount	Debit	Date	Credit	Amount
	(100) Share Capital		(572) Banks	

- Condoning amounts due on outstanding contributions

Amount	Debit	Date	Credit	Amount
	(100) Share Capital		(103) Uncalled Capital	

In these two previous cases, to avoid opposition from creditors, the decrease can be followed by the constitution of the (1142) "Redeemed Capital Reserve"

Amount	Debit	Date	Credit	Amount
	(129) P/L Period (110) Share Premium (113) Voluntary Reserve (120) Retained earnings		(1142) "Redeemed Capital Reserve"	*(number of shares redeemed x par value)*

- The constitution or increase in Legal Reserve

Amount	Debit	Date	Credit	Amount
	(100) Share Capital		(112) Legal Reserve	

- The constitution or increase of Voluntary Reserve

Amount	Debit	Date	Credit	Amount
	(100) Share Capital		(113) Voluntary Reserve	

- To clean up losses

Amount	Debit	Date	Credit	Amount
	(100) Share Capital		(121) Prior Period`s Losses	

Formal expenses incurred in decrease

Amount	Debit	Date	Credit	Amount
	(113) Voluntary Reserves (472) Input VAT		(572) Banks	

- Reduction through the acquisition of own shares for redemption (*to study in the next part of the topic*)

3.6. Simultaneous Capital Reduction and Increase.

As a consequence of a reduction in capital because of cleaning up losses, the Share Capital can reach amounts under the legal minimum established to be a Joint Stock Company or even get to zero. Therefore, a simultaneous decision to increase the Share Capital to the minimum can be adopted, together with the decision to decrease capital Otherwise the company should transform in another legal entity, such as Limited Liability Company, Limited Partnership…etc.

Both decisions, reduction and of increase of capital must be entered simultaneously in the Mercantile Registry.

(100) Share Capital *(PV=80)*	*8,000,000*
(121) Prior period`s losses	*(7,960,000)*
(171) NC Debts financial institutions	*16,000,000*

"TROLA" Inc. approves in General Meeting the reduction of capital to clean up losses and a simultaneous increase by issuing 10,000 new shares 6 €/each par value.

- ***Record the transactions described***

TOPIC II (D)

Purpose of Topic II (D):

- Define the legal aspects the "*Spanish Corporate Enterprises Act* "requires when operating with treasury stocks in Joint Stock Companies.
- Identify different situations in which the company acquires its own shares and record the entries in accounting.

Title IV. Chapter VI Transactions Involving the Company`s Own Shares.

4. TREASURY STOCKS

We say a Company has treasury stocks when it has reacquired some of its outstanding stocks from its shareholders.

Treasury stock reflects the difference between the number of shares *issued* and the number of shares *outstanding*.

This situation can only take place in a derivate way, but not originally when issuing new shares in the foundation of the corporation nor to increase capital in subsequent moments (art.134). Therefore, only outstanding stocks can be rebought, but can be maintained in the Company under some legal requirements.

These restrictions established by law are a protection to shareholders, who are the ones who can hold shares and receive the rights they offer, as well as to creditors, who can find a risk in receiving their money back if the Company decreases its liquidity by purchasing its own shares.

Under no circumstance may corporate enterprises acquire or subscribe their own stakes or shares or any created or issued by the parent company (art.134).

Shares subscribed in violation of the prohibition contained in the above paragraph shall be owned by the subscribing joint stock company (136.1).

The founding shareholders (simultaneous founding) or promoters (in successive founding) and, in the event of a capital increase, the directors, shall be jointly and severally liable to pay for the shares involved (art.136.2).

Where parent company or shares are taken or subscribed, the directors of the purchasing and parent companies shall be jointly and severally liable to pay for the stakes or shares in question (136.3).

4.1. Reasons to purchase own shares

A corporation may purchase its own shares under the next reasons:

- To reissue them to the Company`s employees in terms of bonus as a compensation plan.
- When stocks are undervalued in the market, to reduce offer and pull up prices.

- To use them as an investment and make profits when selling them.
- To have available shares to pay with when acquiring another company.
- To avoid takeovers.

4.2. Legal requirements

Considering this transaction breaks the reality and completeness principles of Share Capital studied in Topic I, these bought back shares are not considered assets but less Equity.

These stocks are represented by the following accounts:

Accounts

- *108. Own Shares*
- *109. Own Shares for reduction of Capital*

Reported in Equity as follows:

A	***BALANCE SHEET*** ***E + L***
	(100) Share Capital ***(108)(Own Shares)(Acquisition price)*** ***(109)(Own Shares for reduction of Capital)(Acquisition price)***

The Corporation cannot be its own shareholder. Therefore, treasury stocks are suspended from their rights to receive dividends, to vote, to receive any amount when liquidating the company, or to execute pre-emptive rights when increasing capital, with the exception of cost free shares when increasing capital against reserves (art.148).

A consequence of this is the increase in the corporation's earnings per share due to the fact that dividends are distributed among fewer outstanding shares.

> *Ex: "TREAS" Inc. has a Share Capital formed by 10,000 shares 60€/sh. Par Value. It announces the distribution of a 4% dividend.*
> - ***Which is the real profit each outstanding share will receive, considering it has 2,000 treasury stocks?***

4.3. Derivative acquisitions

4.3.1. Conditioned acquisition

As a derivative acquisition, stocks may be acquired (art.144):

- With the authorization of the General Meeting, for a period of no more than five years, establishing:
  - Maximum number of shares purchased

- Minimum and maximum price authorized
- The period of authorization
- Whether the own shares are being purchased to pay or execute option rights for employees or directors

- This acquisition, added to whatever done previously, shall not reduce the equity below the Share Capital plus restricted legal and statutory reserves

Ex: How many own shares can this company acquire? :

a) Considering an acquisition price of 15€/share
b) Considering an acquisition price of 80€/share

Concept	*Amount*
Share Capital (100,000 x 10)	*1,000,000*
Legal Reserve	*200,000*
Statutory Reserve	*200,000*
Goodwill Reserve	*50,000*
Voluntary Reserve	*300,000*
Share Premium	*200,000*
Total Equity	*1,950,000*

- The maximum par value in treasury stock that can be maintained in the company and its subsidiaries or parent company and subsidiaries, both acquired and already owned, cannot exceed the 10% of Share Capital in listed Joint Stock Companies and 20% in the rest.

Stocks hold over these limits should be sold or written off within one year of the date of the first purchase.

4.3.2. Unrestricted acquisitions

Companies can acquire their own shares without following the requirements considered previously in the next situations:

- To be written off in a reduction of capital agreed in General Meeting by the shareholders.

  Acquisition:

Amount	Debit	Date	Credit	Amount
	(109) Own Shares for reduction of Capital		(572) Banks	*(Acquisition price)*

Written off:

Amount	Debit	Date	Credit	Amount
(shares x Par Value)	(100) Share Capital ((113) Voluntary Reserve)*		(108) Own Shares ((113) Voluntary Reserve)*	*(Acquisition Price)*

**Difference between Par Value of shares written off and Acquisition Price*

Formal expenses incurred in decrease

Amount	Debit	Date	Credit	Amount
	(113) Voluntary Reserves (472) Input VAT		(572) Banks	

Constitution of the (1142) "Redeemed Capital Reserve"

Amount	Debit	Date	Credit	Amount
	(129) P/L Period (110) Share Premium (113) Voluntary Reserve (120) Retained earnings		(1142) "Redeemed Capital Reserve"	*(number of own shares x par value)*

- When acquired as a result of a court adjudication in offsetting a company`s loan against the owner who is shareholder at the same time.

Amount	Debit	Date	Credit	Amount
	(108)Own shares		(436) Doubtful receivables	
	(490) Impairment of trade receivables		(794) Reversal impairment trade receivables	

- When acquired as a part of an estate acquired in whole. The acquired company participates previous to the acquisition in the acquiring one.

Amount	Debit	Date	Credit	Amount
	(XXX) Assets (108) Own shares		(XXX)Liabilit	

- When acquired free cost and are fully paid up.

Reception of shares

Amount	Debit	Date	Credit	Amount
	(108) Own shares			
			(941)Income from capital donations and bequest	*(Fair Value)*

Transfer of donation to the Equity

Amount	Debit	Date	Credit	Amount
(Fair Value)	(941)Income from capital donations and bequest		(131)Capital donations and bequests	

In these two last situations, treasury stocks must be sold within three years of the date of acquisition, unless redeemed prior to that date by a reduction of capital, or their par value does not reach more than the 20% of share capital (art.145) If they are not sold in the period established, they must be redeemed and reduced the corresponding capital.

If the corporation sells some of its treasury stock, the difference between selling price and cost price of the own shares goes to an equity account, that is unrestricted reserves. It does *not* go to an income statement account, as there can be no income statement recognition of gains or losses on treasury stock transactions.

Selling Own Shares

Amount	Debit	Date	Credit	Amount
(Selling Price)	(57x) Cash			
(Difference)	*((113) Voluntary Reserve)*		(108) Own Shares	*(Acquisition price)*
			((113) Voluntary Reserv	*(Difference)*

Selling Own Shares freely acquired

Amount	Debit	Date	Credit	Amount
(Selling Price)	(57x) Cash			
(Difference)	*((113) Voluntary Reserve)*		(108) Own Shares	*(Fair Value)*
			((113) Voluntary Reserve)*	*(Difference)*
Amount	**Debit**	**Date**	**Credit**	**Amount**
(Fair Value)	(131)Income from capital donations and bequest		(113)Voluntary Reserve	