ACCOUNTING OF EVENTS AND TRANSACTIONS REGARDING THE SHARE CAPITAL

Ph.D. Lecturer, Corina DUCU
"Constantin Brâncoveanu" University of Pitești,
Faculty of Finance-Accounting, Romania
E-mail: corina_ducu@yahoo.com

Abstract: *Entities constantly need material and monetary resources to carry out their activities. These resources cannot exist without a source of financing. One of the sources of financing, available to the entity, for a period of more than one year, with a stable character, refers to share capital. As an element of equity capital, share capital is the primary source of funding and gives owners rights over the assets of the entity. The reason for addressing the topic was precisely the importance of share capital in an entity, as the first source of financing, necessary for the conduct and development of the entity's business in an economic climate of crisis and uncertainty. As a result, the objective of the research is to present share capital both from a theoretical point of view, through a general overview of the aspects related to the definition, forms and content of share capital, and from an accounting point of view, by presenting individual studies that provide a specific approach to this component of equity capital.*

Key words*: share capital, equity capital, formation, increase, decrease.*
JEL Classification*: M41.*

1. Introduction

In order to function properly, the entity must hold and use a number of economic resources. These resources, which are indispensable to the life of the entity, cannot exist without sources of finance.

The sources of finance available to the entity on a stable basis are called capital. Other sources, which are temporary in nature, are called current liabilities.

According to the way in which they are constituted, capital is grouped into three categories: equity, provisions and long-term liabilities. These three categories of capital form the permanent capital of the entity.

According to OMFP 1802/2014 equity capital represents the residual interest of shareholders or associates in the assets of an entity after deducting all its liabilities.

Equity capital corresponds to the entity's own financing and comprises:

- share capital;
- capital premiums;
- revaluation reserves;
- reserves;
- retained earnings;
- result for the financial year.

2. The accounting operations relating to the recording of share capital

As an element of equity capital, share capital is the primary source of an entity's financing, being built up at its inception by contributions from shareholders or associates, giving rise to owners' rights in the entity.

The share capital constituted at the establishment of an entity is represented by the number of shares or units held by the owners of the capital, depending on its legal form.

The shares or parts of shares held by the owners represent the content of the share capital, and the number of shares or parts of shares generates the size of the share capital.

When an entity is set up, the signature of the memorandum of association by the members or shareholders records their intention to subscribe to the share capital. The entity is legally established only after the shareholders or associates have deposited the subscribed share capital, in whole or in part, in accordance with the legal provisions.

Therefore, in the entity's accounting records, two categories of capital are operated, namely: paid-in and paid-up subscribed capital.

It should also be noted that, after incorporation, share capital may be increased or decreased in various ways, in accordance with the law, the articles of association and the company contract.

When the share capital is entered in the accounts, it is valued on the basis of the nominal value of the shares. As a result, capital premiums must be calculated and shown separately. However, because shares are marketable securities, the nominal value is associated with a number of other value categories, such as market value, return value and asset value.

The accounting operations relating to the recording of share capital will be dealt with in the following through the perspective of several individual case studies, in which the methods of incorporation, the ways of increasing and the means of decreasing share capital are presented.

The formation of share capital covers the expenses of formation, the subscription of share capital, the receipt of subscribed capital and the change in the form of capital.

Therefore, we consider an entity to be incorporated on 01.02.N. under the following conditions:

- The subscribed capital is 100,000 lei, divided into 200,000 shares with a nominal value of 0.50 lei/share.
- The structure of the subscribed capital is as follows: contribution in kind: 100,000 shares, of which: 50,000 shares representing a building and 50,000 shares representing a means of transport; contribution in cash: 100,000 shares.
- The deposit of the contribution is made in two instalments: instalment I, on subscription, when the contribution in kind is deposited in full and 50% of the cash contribution is received; instalment II, on 10.02.N, when the remaining 50% of the cash contribution is received.
- The entity's incorporation costs are 5,000 lei.

The sequence of entries in the entity's accounting records of operations related to the constitution of share capital is as follows:

1. Subscription of the contribution to the share capital:

Value of share capital = 200,000 shares x 0.50 lei/share = 100,000 lei

456 "Equity settlements with shareholders/associates"	=	1011 "Subscribed capital not paid in"	100.000

2. Deposit of the first instalment of the capital contribution:

- contribution in kind: 100,000 shares x 0.50 lei/share = 50,000 lei, consisting of: building: 50,000 shares x 0.50 lei/share = 25,000 lei and means of transport: 50,000 shares x 0.50 lei/share = 25,000 lei
- 50% of the cash contribution: 100,000 shares x 0.50 lei/share x 50% = 25,000 lei

%	=	456 " Equity settlements with shareholders/associates"	<u>75.000</u>
212 "Constructions"			25.000
2133 "Means of transport"			25.000
5121 "Bank accounts in lei"			25.000

3. Change of the form of capital from non-paid-up subscribed share capital to paid-up subscribed share capital:

1011 "Subscribed capital not paid up"	=	1012 "Paid-up subscribed capital"	75.000

4. Deposit of the second instalment of the capital contribution:

- the remaining 50% of the cash contribution: 100,000 shares x 0.50 lei/share x 50% = 25,000 lei

5121 "Bank accounts in lei"	=	456 "Equity settlements with shareholders/associates"	25.000

5. Change in the form of capital from non-paid-up subscribed share capital to paid-up subscribed share capital:

1011 "Subscribed capital not paid in"	=	1012 "Paid-in subscribed capital"	25.000

6. Recording of the formation expenses:

201 "Formation expenses"	=	462 "Sundry creditors"	5.000

As regards the increase in share capital, this is driven by the need to obtain new resources to finance investments and strengthen the entity's financial position.

The ways of increasing share capital used in financial practice are:

- cash contribution;
- contribution in kind;
- internal operations, aimed at incorporating capital premiums, reserves or profits into the capital mass;
- conversion of liabilities into shares.

The accounting treatment of the increase in share capital by cash contribution is illustrated by the following situation:

S.C. Bruno S.A. increases its share capital, as a result of the Shareholders' General Meeting Decision, by issuing 10,000 new shares, with an issue value of 11 lei/share and a nominal value of 10 lei/share. The issue of shares is fully subscribed in cash and the contributions are paid at a later date.

Calculations prior to accounting:

Nominal value = 10,000 shares x 10 lei/share = 100,000 lei

Issuing value = 10,000 shares x 11 lei/share = 110,000 lei

The difference between the issuing value and the nominal value generates an issuing premium of 10,000 lei

The record layout is as follows:

1. Registration of subscription to the issue of new shares:

456 "Equity settlements with shareholders/associates"	=	%	<u>110.000</u>
		1011 "Subscribed capital not paid in"	100.000
		1041 "Share premium"	10.000

2. Recording of capital payments:

5121 " Bank accounts in lei"	=	456 "Equity settlements with shareholders/associates"	110.000

3. At the same time as the capital is paid up, the capital is transferred from unpaid subscribed capital to paid-up subscribed capital:

1011 "Subscribed capital not paid up"	=	1012 "Paid-up subscribed capital"	110.000

The increase of the share capital by contribution in kind implies the following accounting treatment encountered in the situation in which S.C. Orion S.A. increases its share capital, as a result of the Shareholders' General Meeting Decision by issuing new shares, fully subscribed by the shareholders with a contribution in kind represented by a machine. The value of the machine, established by an expert appraiser, is 3,000 lei. The issue price is deemed to be equal to the book value of one share of 0.60 lei/share and the nominal value is 0.50 lei/share.

Calculations prior to accounting:

- No. of new shares issued $= \dfrac{\text{Contribution amount}}{\text{Issue price}} = \dfrac{3.000 \text{ lei}}{0,60 \text{ lei/share}} = 5.000$ shares

- Nominal value of share capital = No. of shares x NAV/share = 5.000 x 0,50 lei/share = 2.500 lei
- Nominal value of share capital = 2.500 lei
- Value of the contribution to share capital = 3.000 lei
- The difference between the contribution value and the nominal value is the contribution premium = 500 lei

The record layout is as follows:

1. Subscription of the capital contribution:

456 "Equity settlements with shareholders/associates"	=	%	<u>3.000</u>
		1012 "Paid-in subscribed capital"	2.500
		1043 "Contribution premiums"	500

2. Submission of contribution:

2131 "Technological equipment (machinery, plant and equipment)"	=	456 "Settlement with shareholders/associates on capital"	3.000

The increase in share capital through internal operations implies the incorporation of other items from the equity category. In order to illustrate this as eloquently as possible, we shall deal with two representative situations.

The first situation starts from the Decision of the General Meeting of S.C. ALFA S.A. by which the company increases its share capital by incorporating the amount of 25,000 lei from the fund of other reserves.

1068 "Other reserves"	=	1012 "Subscribed paid-in capital"	25.000

In the second situation we start from the fact that S.C. BETA S.A. at the time of maturity of the bondholder loan was unable to repay it and, with the consent of the bondholders, decided to convert the loan from the bond issue into share capital, under the following conditions:

- the repayment amount of the loan is 60,000 lei
- the issue value of one new share is equal to the redemption value of one bond, i.e. 6 lei;
- the nominal value of one share is 5 lei.

Calculations prior to accounting:

$$\text{No. of new shares created} = \frac{\text{Reimbursement amount}}{\text{Issue value}} = \frac{60.000 \text{ lei}}{6 \text{ lei/share}} = 10.000 \text{ shares}$$

Nominal value of share capital = No. of shares x NAV/share = 10.000 x 5 lei/share = 50.000 lei

Conversion premium = 10.000 lei

The record chain is as follows:

1. Subscription to capital:

456 "Equity settlements with shareholders/associates"	=	%	60.000
		1012 "Paid-in subscribed capital"	50.000
		1044 "Bond to share conversion premiums"	10.000

2. Submission of contribution:

161 "Loans from bond issues"	=	456 "Equity settlements with shareholders/associates"	60.000

The ways of reducing share capital used in financial practice are as follows:

- covering losses incurred by the entity in previous years, subject to the legal provisions in force;
- repayment of part of the capital to the owners;
- repurchase and cancellation of own shares.

In order to illustrate the accounting treatment related to the reduction of share capital as a result of the losses recorded by the entity in the previous years, we analyse the situation in which S.C. ARIA S.A. proceeds to cover the losses recorded in the amount of 50,000 lei, in accordance with the Decision of the Shareholders' General Meeting, at the expense of share capital.

1012 "Paid-in subscribed capital"	=	1171 "Retained earnings representing undistributed profit or uncovered loss"	50.000

In order to illustrate the situation regarding the reimbursement of a part of the share capital to the owners, we analyze the situation of S.C. TOTAL S.A. in the position in which the shareholder Ion Ionel withdraws and the others do not want to purchase the shares held by him, in the amount of 10,000 lei. From an accounting point of view, his withdrawal involves the following operations:

1. Recording of the repayment obligation:

1012 "Paid-in subscribed capital"	=	456 "Equity settlements with shareholders/associates"	10.000

2. Reimbursement of the value of the shares:

456 "Equity settlements with shareholders/associates"	=	5121 " Bank accounts in lei"	10.000

With regard to the reduction of share capital as a result of the repurchase and cancellation of own shares, we analyse the situation in which the General Meeting of Shareholders of S.C. GAMA S.A. decided to reduce the share capital by repurchasing and cancelling 10,000 own shares. The redemption and cancellation of shares is made under the following conditions: redemption value = 1.5 lei/share; nominal value = 1 leu/share.

Calculations prior to accounting:

Redemption value = 10,000 shares x 1.5 lei/share = 15,000 lei

Nominal value = 10,000 shares x 1 leu/share = 10,000 lei

When the redemption value is higher than the nominal value of the share, the shortfall is covered by reserves.

The record chain is as follows:

1. Repurchase of shares:

1091 "Own shares held on short term"	=	5121 "Bank accounts in lei"	15.000

2. Cancellation of shares:

%	=	1091 "Own shares held on short-term"	15.000
1012 "Paid-in subscribed capital"			10.000
1068 "Other reserves"			5.000

3. Conclusions

The importance of share capital derives precisely from the fact that it represents the primary source of financing at the level of an entity and also, by its composition, it provides a series of rights to the owners.

The accounting for the various transactions carried out on the occasion of the formation, increase and decrease of share capital, presents specific features as we have seen above. Given that this balance sheet structure is vital for the proper functioning of economic entities, we can conclude that from an accounting point of view it must be treated with the utmost care.

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