

A Consultative Document

On Capital Maintenance Rules
and Share Capital :
Simplifying and Streamlining
Provisions Applicable to Shares

by the Corporate Law Reform Committee
for the Companies Commission of Malaysia



SURUHANJAYA SYARIKAT MALAYSIA
COMPANIES COMMISSION OF MALAYSIA

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COMPANY LAW
CORPORATE LAW REFORM COMMITTEE
A CONSULTATIVE DOCUMENT
CAPITAL MAINTENANCE RULES
AND
SHARE CAPITAL: SIMPLIFYING AND STREAMLINING PROVISIONS APPLICABLE TO SHARES
JUNE 2005

The Corporate Law Reform Committee invites comments, by **22 September 2005** on the issues set out in this consultative document.

You are invited to send comments, together with any supporting evidence on any part of this consultation. We would be grateful if you could refer to the recommendation number(s) and/or paragraph number(s) in your feedback, preferably by e-mail, to:

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Section A

FOREWORD

SECTION A - FOREWORD

This Consultation Paper focuses on the first stage of the review work that has been carried out by Working Group B of the Corporate Law Reform Committee ('CLRC') established by the Companies Commission Malaysia to review the Companies Act 1965.

The CLRC, whilst carrying out its current review and making its recommendations as reflected in this Consultation Paper, was guided by two key principles:

- **simplifying company operations with the objective of reducing compliance cost; and**
- **promoting corporate governance.**

With this in mind, the CLRC has proposed to abandon two key concepts that currently mould the rules regulating capital raising by companies. These are the concepts that:

- **shares issued must be issued with par or nominal value; and**
- **companies must be registered with an authorised share capital clause.**

The CLRC believes that its proposal to do away with par or nominal value of shares will, in addition to simplifying company operations, also promote corporate governance. This is because, as will be discussed in the accompanying Consultation Paper, company accounting will be simplified as 'share premium accounts' and 'capital redemption reserves' will be irrelevant. Hence, company accounting will become more transparent and easier to understand.

This Consultation Paper will, amongst other things, provide reasons for the CLRC's recommendations and address some of the concerns that the public may have in respect of the CLRC's recommendations.

The accompanying Consultation Paper is made up to two parts:-

- (a) Part I of the Consultation Paper focuses on the proposals to abolish the requirement to issue shares with par/nominal value and the requirement to register a company limited by shares with an authorised share capital clause; and
- (b) Part II of the Consultation Paper focuses on the proposals to simplify and streamline other provisions that are applicable to shares.

We hope to receive views and comments on the recommendations stated in this Consultation Paper. Please reply to Nor Azimah Abdul Aziz at the Companies Commission of Malaysia (SSM) by **22 SEPTEMBER 2005**.

Thank you.

Yours truly,

Dato' K.C. Vohrah

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Section B

Executive Summary

SECTION B - EXECUTIVE SUMMARY

1. BACKGROUND

1.1 In essence, this Consultation Paper prepared by Working Group B of the CLRC recommends the abandonment of two (2) concepts/requirements that are currently reflected in the Companies Act 1965.

1.2 The requirements proposed to be abandoned are:

First, the requirement that a company limited by shares must state its authorised share capital in its memorandum; and

Second, the requirement that shares issued must have a par or nominal value attached to it.

1.3 In lieu of this, the CLRC proposes that:

- i. **a company limited by shares shall no longer be required to state its authorised share capital in its memorandum¹;**
- ii. **all shares of a company as from the date of Conversion² be deemed to be shares with no par value ('NPV')³; and**

¹ This requirement is currently provided for by section 18(1)(c) of the Companies Act 1965.

² The CLRC proposes that prior to the Conversion from a par value (PV) share environment to an NPV share environment, due and proper notice will be given to all stakeholders. This is to ensure a smooth transition from a par value share environment to an NPV share environment. Hence, a Conversion date will be set by the Minister in consultation with the business community. The specific Conversion date would be gazetted at the appropriate time.

³ This would therefore also mean that a company limited by shares formed on or after the Conversion date can only issue NPV shares.

- iii. **the Conversion from a par value environment to an NPV environment is made mandatory for all companies as at and from the date of Conversion referred to, above.**

2. RATIONALE FOR ABANDONING THE REQUIREMENTS AS SET OUT IN THE PARAGRAPH 1.2

2.1 The CLRC is of the view that abandoning these two (2) requirements and replacing them with the proposals as set out in paragraph 1.3 will simplify the workings of our company law so that conduct of business in Malaysia remains competitive. These proposals will also simplify company operations by reducing compliance cost.

2.2 The consequence of the proposal that a company limited by shares shall no longer be required to state its authorised share capital in its memorandum will result in companies being able to raise their share capital without having to comply with time consuming and costly procedures.

2.3 The consequences of the abandoning of par/nominal value of shares is best articulated in the statement made by the New Zealand Law Commission as set out in its Report No 9 titled 'Company Law Reform and Restatement':

“ We have concluded that no useful function is served by the par value concept. Moreover, it is arbitrary and misleading. Its abolishment would mean that financial accounts can be greatly simplified (share premium accounts and ‘reserves’ are concepts that will no longer be required)⁴.”

2.4 The CLRC is also of the view that abandoning the above two (2) requirements would not be against the interest of shareholders and creditors.

⁴ At p 93 paragraph 381 of its report.



2.5 In addition, the proposal will promote corporate governance by enhancing transparency of the company's financial accounts.

3. CONSEQUENTIAL LAW REFORM OF HAVING ABOLISHED THE REQUIREMENT THAT A COMPANY LIMITED BY SHARES MUST STATE ITS AUTHORISED SHARE CAPITAL IN ITS MEMORANDUM

3.1 The proposal of the CLRC that a company limited by shares shall no longer be required to state its authorised share capital in its memorandum would necessitate amending the current sections 18(1)(c) and 62 of the Companies Act 1965.

4. TRANSITIONAL AND CONSEQUENTIAL LAW REFORM OF HAVING ABOLISHED THE REQUIREMENT THAT SHARES ISSUED MUST HAVE A PAR OR NOMINAL VALUE ATTACHED TO IT

4.1 To ensure that there is a smooth transition from a par value environment to an NPV environment, a Conversion date will be set by the Minister in consultation with the business and professional community.

4.2 Further, after the Conversion date, there will be a transitional period to enable companies to take all necessary steps to comply with the new law. Once again, this transitional period, will be set by the Minister in consultation with the business and professional community.

The Conversion from a par value environment to an NPV environment shall entail the following consequences:

- i. that all new shares issued as at from the Conversion date shall be issued for an issue price that is to be determined by the board of directors;
- ii. that in the case of shares issued prior to the Conversion date the amount paid on the shares is the sum of all amounts paid to the company at any time for the share (but not including premium)⁵;
- iii. that immediately on or after the Conversion date, any amount standing to the credit of the company's share premium account and capital redemption reserve becomes part of the company's contributed capital⁶;
- iv. that as from the Conversion date, any amount standing to the credit of the company's share premium account prior to the Conversion date, shall be permitted during the transitional period only to be utilised for:
 - (a) providing premium payable on the redemption of redeemable preference shares (RPS) issued before that date;
 - (b) writing off preliminary expenses of the company incurred before that date; and
 - (c) writing off expenses incurred, or commissions or brokerages paid or discounts allowed, on or before that date, for any duty, fee or tax payable on or in connection with any issue of the company's shares; and

⁵ In other words, the existing par value of the shares issued shall for the purposes of Conversion, become the issue price of the shares after Conversion.

⁶ As will be discussed below, after the Conversion date, the share premium account and the capital redemption reserve shall become obsolete concepts as shares will no longer have par value. Any amount standing in the credit of the company's share premium account and the company's capital redemption reserve shall be transferred to one account called the '**contributed capital**' account. The company's '**contributed capital**' account is not distributable and this account will be distinguished from the company's retained profit/earning account that remains distributable after the Conversion date.

- v. **that after the Conversion date, companies continue to be permitted to issue RPS but without having to maintain a capital redemption reserve and if the redemption of RPS is made out of available profits, the company be required to transfer the amount redeemed to the company's 'contributed capital' account.**

4.3 The CLRC also recommends that companies in an NPV environment should be permitted to:

- i. **capitalise its profit without having to increase the number of shares owned by a shareholder i.e. without any issue of new shares to shareholders;**
- ii. **capitalise its profits coupled with the issue of new shares to shareholders; and**
- iii. **consolidate and subdivide NPV shares.**

4.4 The CLRC further recommends:

- i. **the removal of the existing section 59 of the Companies Act 1965⁷;**
- ii. **introducing provisions that are designed to ensure that the shareholder's liability for the unpaid portion of shares under the existing par value share environment does not cease to exist after the Conversion date; and**
- iii. **introducing provisions that are designed to preserve the effect of existing contracts and other instruments that have been executed before the Conversion date which refers to par/nominal value of shares.**

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This is because in an NPV environment, par value shall not exist and therefore section 59 shall become redundant.

5. SIMPLIFYING AND STREAMLINING PROVISIONS APPLICABLE TO SHARES

5.1 The CLRC has also reviewed some of the provisions in the Companies Act 1965 that relate to shares. The review process of these provisions was carried out with the objective of ascertaining whether these provisions have continued relevance and applicability in today's business environment.

5.2 The CLRC reviewed the following requirements or provisions:

- (a) power of the company to make payment of certain commissions and prohibition against making payment of other commissions and discounts on the issue of shares: section 58 of the Companies Act 1965;**
- (b) power of the company to make different arrangements for calls and payments for shares: section 56(1) of the Companies Act 1965;**
- (c) bearer shares (share warrants): section 57 of the Companies Act 1965;**
- (d) reserve capital (Reserve liability): section 56(2) of the Companies Act 1965;
and**
- (e) adequacy of consideration for shares.**

5.3 The CLRC recommends, retaining:

- i. the existing regulatory controls on the power of a company to make payment of certain commissions and prohibition against payment of other commissions and discounts on the issue of shares: section 58 of the Companies Act 1965;**

- ii. **the power of the company to make different arrangements for calls and payments for shares: section 56(1) of the Companies Act 1965; and**
- iii. **the prohibition against issuing bearer shares (share warrants): section 57 of the Companies Act 1965.**

5.4 The CLRC recommends, abolishing:

- i. **the requirement of reserve capital (reserve liability) by deleting section 56(2) of the Companies Act 1965 as this subsection serves no practical purpose.**

5.5 In respect to the matter of 'adequacy of consideration for shares', the CLRC recommends that the Companies Act 1965:

- i. **Should not be amended to include a statutory provision that has the effect of regulating the type of consideration that is receivable by a company when a company issues its shares; and**
- ii. **Should not be amended to include a statutory valuation procedure that must be undertaken by companies when non-cash consideration is received by a company in return for issuing its shares.**

5.6 The CLRC is of the view that 'adequacy of consideration for shares' is a matter for directors of the company to deal with as part of their fiduciary duties.

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Section C

Capital Maintenance Rules

SECTION C - CAPITAL MAINTENANCE RULES

1. AUTHORISED SHARE CAPITAL AND PAR VALUE SHARE

BACKGROUND

The requirements that a company limited by shares must state its authorised share capital in its constitution and that shares must be issued with a par/nominal value are entrenched concepts of company law within the common law jurisdiction.

In Malaysia, both these concepts are reflected in our Companies Act 1965 and are regarded to be general principles of Malaysian Company Law.

Par or nominal value of shares refers to the minimum amount of money or monies worth that must be received by the company before the company can allot its shares as fully paid up shares; whilst the authorised share capital of the company imposes a ceiling on the number of shares that can be issued by a company.

In the event a company allots its shares as fully paid up but for an amount less than the shares' prescribed par value, this allotment shall for the purposes of the law be treated as an illegal allotment of shares as the shares have been issued at a discount unless the provisions of section 59 have been complied with. Further, in the event a company issues shares in excess of its authorised share capital, those shares issued shall, for the purposes of the law, be treated as void.

Shares having a par value and companies having an authorised share capital clause are concepts found under English company law and at one time were thought to be concepts that were entrenched whereby it was unthinkable that company legislation can provide otherwise. However, as will be discussed below, the viability of retaining these concepts as part of core company law principles has been questioned or is being questioned. Some Commonwealth company legislation no longer requires shares to have par value. This includes:

- South Africa and some Canadian states' company legislation⁸ that allows its companies to issue shares with par value or with no par value (NPV shares);
- Australia (since 1998) and New Zealand (since 1993) - that only allows its companies to issue NPV shares; and
- Canada, under the Canada Business Corporations Act, shares of a corporation shall be in registered form and shall be without nominal or par value⁹.

Further, Singapore and the UK are proposing to introduce NPV shares.

- The Singapore Companies Legislation and Regulatory Framework Committee (CLRFC) have proposed to amend the Singapore Companies Act (Chapter 50) to reflect such a proposal.
- The UK Steering Committee that is responsible for reviewing the English Companies Act 1985 has proposed for NPV shares to be introduced. However, as the UK is also bound by the European Union (EU) Second Company Law directive, its proposal to introduce NPV shares is currently confined to only private companies.

RATIONALE FOR ABANDONING THE CONCEPTS OF AUTHORISED SHARE CAPITAL AND PAR VALUE

The CLRC noted that before the concepts of nominal value and the authorised share capital are to be abolished, there is a need to consider whether these concepts serve any purpose in the company law. The CLRC further noted that the reasons for the inclusions of authorised share capital and the nominal or par value into the company legislation was for the protection of shareholders and creditors interests.

⁸ See the British Columbia's Business Corporations Act 2004 section 52.

⁹ See Canada Business Corporations Act (R.S. 1985, c. C-44), section 24(1) and (2).



The authorised share capital and the nominal/par value purportedly protect shareholders' interests because:

- (a) authorised share capital purportedly operates to restrict the further issue of shares which may dilute existing shareholders' rights and the value of their existing share holding;
- (b) par value purportedly restricts the company's ability to issue shares at a discount to ensure at there is no dilution in the value of existing shareholding, if shares were permitted to be issued at a discount; and
- (c) par value and authorised share capital ensures that the company receives adequate consideration and has a minimum amount of capital.

The authorised share capital and the nominal/par value principles purportedly protect creditors because this is the amount of capital that the company implicitly warrants it has available to pay creditors. When providing credit to the company, the creditors will refer to the authorised capital as this is the potential maximum capital the company can issue, and to the paid up share capital as this is the amount that cannot be returned or distributed amongst shareholders, hence ensuring that there is a cushion against insolvency.

However, the CLRC noted that the above protections are only illusory as the authorised share capital and nominal/par value are no longer relevant concepts in the present business environment for the following reasons:

- (a) The existence of the authorised share capital which is required by section 18 of the Companies Act 1965 does not mean that a company will indeed issue all the shares it is authorised to issue. In fact, in reality, many companies have a much larger authorised share capital than its issued capital and have no obligation to increase the issued capital up to the authorised capital to meet solvency requirements. Thus, the purported protection to creditors afforded by the authorised share capital principle is illusory and misleading;
- (b) There always remains a possibility that new shares can be issued in excess of the Company's original authorised share capital pursuant to section 62 of the Companies Act 1965. However, before the board can exercise its power to issue such new shares, the board is mandated by law to obtain the prior approval of its members pursuant to section 132D of the Companies Act 1965. Further, it is envisaged, that even in an NPV environment, the board must still obtain its members prior approval as required by section 132D. Dilution of existing shareholders' interests can therefore only be with their consent. Protection against dilution is also provided for by pre-emption rights which are currently provided for by article 41 of Table A. Hence, the concern about any dilution of shareholding that may result from the Conversion of a par value environment to an NPV environment can be addressed by retaining these safeguards. Where there is a new issue of shares, the main concern should be whether the company has received adequate consideration in return for the shares that it has issued and whether or not the directors have the authority to issue such new shares;
- (c) There is no adverse effect on existing shareholders rights because:
- shareholders rights are stated by the Companies Act 1965 and the terms of issue (in the case of any instrument other than ordinary shares of the company) and /or the Articles and Memorandum of Association. It is not

stated law that rights attached to shares is dependent on the price paid on that share;

- where voting rights are concerned, this is based on the number of shares held by a person and not by the amount paid for those shares.

Hence, there is no adverse implication concerning shareholders rights and the possibility of a dilution of existing shareholders rights when new shares of the same class are issued but not at the same nominal or par value.

- (d) The authorised share capital does not ensure that the company has a minimum amount principal of capital adequacy requirement. Even if the company states its authorised share capital, it is not a true reflection of the capital that the company has and whether the same be adequate for its requirements.

The authorised capital clause and nominal or par value of shares, in fact, may be misleading for the following reasons:

- (a) the authorised share capital is not an appropriate indicator of the company's ability to repay debt as not all the shares may have been issued and if the shares have been issued and fully paid up, it is a historical figure and does not reflect the actual worth of the company which may change as the company continues its business and operations;
- (b) nominal value may mislead investors to believe that the company guarantees that the value of the investment in the company's shares is to be always equivalent to the share's nominal or par value. In reality, an informed investor does

not rely on the shares' nominal/par value when deciding whether to invest in the company's shares. Instead, reliance is placed on other financial indicators which will include the NTA (Net Tangible Asset) per share¹⁰; and

- (c) creditors do not rely on the nominal value of shares to grant credit or continue giving credit to a company. Creditors rely on the company's business reputation, its net worth and its cash flow besides the amount contributed by its shareholders. For instance, a company with an issued capital of RM2 may be quite sound in terms of net worth or cash flow. Even if creditors rely on this, the information is historical and does not reflect the actual worth of the company. In most cases, once shares have been issued at a nominal value, the market value, specifically in cases of listed companies, may not bear any resemblance to the historic figure once ascribed to it. As opposed to relying on the company's nominal share capital, creditors place greater reliance on the company's paid up share capital¹¹. On this point, it should be noted, that the Working Group had considered whether to propose to the Steering Committee, the need to introduce a 'minimum paid up share capital' provision as is currently provided for by the English Companies Act 1985 in respect to public companies. However, the Working Group was of the opinion that such a recommendation was not feasible, given the problems of determining what would be an appropriate amount¹².

The NPV environment has its advantages and these are:

- (a) it will simplify the workings of company law so as to ensure that company law facilitates businesses to be competitive and suitable to the needs in the 21st century and beyond. This is due to the fact that the company's accounts can be greatly simplified (share premium accounts and 'reserves' are concepts that will no longer be required);

¹⁰ The other financial indicators include the *PER* (price earning ratio), future prospects, management and the cash flow of the company.

¹¹ In commercial practice, greater reliance is placed on the company's business reputation; its net worth and its cash flow as the company's paid up share capital merely reflect a historical figure.

¹² The Listing Requirements of Bursa Securities and Securities Commission's 'Policies and Guidelines on Issues/Offer of Securities' currently deals with this point.

- (b) it will clarify the misleading perception that because of the authorised share capital and par value, the company will have reserves and be able to pay its debts to creditors; and
- (c) it will enable the company to undertake capital raising exercises with greater flexibility. For example, the company may easily issue new shares without contravening the prohibition on issuing shares at a discount or even capitalise profit without having to issue new shares, which cannot be done in a par value environment.

Nonetheless, the CLRC noted that there are some concerns with the introduction of an NPV environment. The concerns include:

- (a) shares having no par or nominal value may cause investors to be misled as the investor may be of the view that NPV shares have no value¹³;
- (b) the costs of promulgating changes to the law, the Listing Requirements of Bursa Malaysia, the creation of new accounting standards, if any, as well as social costs of familiarising investors, business and companies; and
- (c) the impact of the change on the continued liability to pay for shares issued as partly paid¹⁴.

The CLRC, however, is of the view that these concerns can be addressed and the benefits of converting from a par value environment to an NPV environment outweigh its disincentives.

¹³ Although NPV shares will have no par value it will be issued at an issue price.

¹⁴ This matter is addressed in the paragraph 4.2 at page 43 of this Consultation Paper.

The CLRC noted that if NPV shares are to be introduced for Malaysia, it is necessary to:

- (a) identify and make corollary amendments to existing provisions of the Companies Act 1965 that relies on the concept of par value shares to enable implementation of the 'no par value shares' environment;
- (b) provide for transitional provisions; and
- (c) provide an explanation on the accounting treatment for purposes of reporting in an NPV environment.

2. TREATMENT OF SHARE CAPITAL, SHARE PREMIUM ACCOUNT AND CAPITAL REDEMPTION RESERVE

BACKGROUND

Currently, the Companies Act 1965 permits a company to issue shares in excess of its nominal or par value. This excess is referred to as 'premium'¹⁵. However, in the event shares are issued at a premium, the premium received whether in the form of money or monies worth must be transferred to a 'share premium account' pursuant to section 60(2) of the Companies Act 1965.

For accounting purposes, the capital account and the share premium account are treated differently in the accounts but both in fact constitute the company's paid up and working capital. However, the amount standing to the credit of the share premium account may be applied by the company for certain permitted purposes only as set out in section 60(3) of the Companies Act 1965.

A company is also required to create a capital redemption reserve in the event a

¹⁵ Note that the Companies Act 1965 does not impose a duty on company directors to issue shares at a premium.

company redeems its RPS from distributable profits pursuant to section 61 of the Companies Act 1965. In such an instance, the company is required to transfer a sum equal to the nominal value of the RPS redeemed to the capital redemption reserve. The amount standing to the credit of the capital redemption reserve may be applied by the company in redeeming the RPS or for paying up unissued shares of the company which will then be issued to the company's shareholders as fully paid bonus shares¹⁶. Hence, a share premium account and the capital redemption reserve must be maintained because of the existence of a par value.

Conversion to an NPV environment shall cause both the share premium account and the capital redemption reserve to become obsolete as shares will no longer have a par or nominal value attached to it. As shares will have no par value, shares therefore would not be issued at a premium and this in itself shall cause the share premium account to become obsolete. Instead, NPV shares will be issued for an issue price which will be determined by the company's directors and shareholders.

The share capital account in an NPV environment will be made up of the amount that the shareholders have paid for the shares, namely, the issue price of the NPV shares. The amount received by a company for the issue and allotment of NPV shares will be the company's '**contributed capital**' as against the same being credited as paid up capital and share premium account in a par value regime. Further, in an NPV environment, a company which has made a profit will still maintain a retained profit/earnings account. The amount standing in the company's retained profit/earnings account would remain distributable by way of cash dividend but a company could also decide to capitalise the amount, with or without new shares being issued, and this will be added to the company's '**contributed capital**'.

¹⁶ Refer to section 61(7) of the Companies Act 1965.

RECOMMENDATIONS

The CLRC recommends:

- i. the abandonment of the concept of authorised share capital; and**
- ii. the Conversion from a par value environment to an NPV environment.**

To ensure that there is a smooth transition from a par value environment to an NPV environment, the Minister in consultation with the business and professional community will set the date for the coming into effect of the new law (Conversion date). Further, after the Conversion date, there will be a transitional period to enable all companies to take the necessary steps to comply with the new law¹⁷.

The Conversion from a par value environment to an NPV environment shall entail the following consequences:

- i. that all new shares issued by all companies as from the Conversion date shall be issued for an issue price that is to be determined by the board of directors;**
- ii. that in the case of shares issued prior to the Conversion date the amount paid on the shares is the sum of all amounts paid to the company at any time for the share (but not including premium)¹⁸;**
- iii. that immediately on or after the Conversion date, any amount standing to the credit of the company's share premium account and capital redemption reserve becomes part of the company's contributed capital¹⁹;**

¹⁷ The Conversion date and the transitional period may be provided by way of a New or Amending Act. Refer to page 43 for further discussions on transitional provisions.

¹⁸ In other words, the existing par value of the shares issued shall for the purposes of Conversion become the issue price of the shares after Conversion.

¹⁹ As will be discussed below, after the Conversion date, if applicable, the share premium account and the capital redemption reserve shall become obsolete concepts as shares will no longer have par value. Any amount standing in the credit of the company's the share premium account and the company's capital redemption reserve shall be transferred to one account called the '**contributed capital**' account. The company's '**contributed capital**' account is not distributable and this account will be distinguished from the company's retained profit/earning account that remains distributable after the Conversion date.

- iv. that as from the Conversion date, any amount standing to the credit of the company's share premium account prior to the Conversion date, shall be permitted during the transitional period to be utilised only for:
 - (a) providing premium payable on the redemption of redeemable preference shares issued before Conversion date;
 - (b) writing off preliminary expenses of the company incurred before Conversion date; and
 - (c) writing off expenses incurred, or commissions or brokerages paid or discounts allowed, on or before Conversion date, for any duty, fee or tax payable on or in connection with any issue of the company's shares; and
- v. that after the Conversion date, companies continue to be permitted to issue redeemable preference shares (RPS) but without having to maintain a capital redemption reserve and if the redemption of RPS is made out of available profits, the company be required to transfer the amount redeemed to the company's 'contributed capital' account.

2.1 Treatment of share premium account.

As discussed above, in an NPV environment, the share premium account shall become obsolete. Further, as discussed above, in an NPV environment, money or monies worth received by a company in return for the shares issued and allotted after the Conversion date will be credited to the company's '**contributed capital**' account.

The company's '**contributed capital**' account shall for the purposes of the law be treated as an undistributable reserve. As discussed above, the company's '**contributed capital**' account must be distinguished from the company's retained profit/earning account that remains distributable to the company's shareholders.

This, therefore, means that the company's '**contributed capital**' account shall be treated for the purposes of the law as the company's paid up capital and any proposed reduction of this account otherwise than that permitted by the law shall be treated as an illegal reduction of the company's paid up capital. This restriction on the company's '**contributed capital**' account will ensure that creditors' interests in an NPV environment are safeguarded.

Hence, the CLRC proposes that immediately after the Conversion date, a company shall have only one capital account and this capital account shall be referred to as the company's '**contributed capital**' account.

Comparative jurisdictional study²⁰ in respect to having one capital account

The UK Steering Committee has put forward the suggestion that the separate balance sheet items of nominal capital and share premium account be replaced with 'a single undistributable reserve of subscribed share capital' representing the total proceeds of the shares issued.

The Singapore CLRFC in its draft Companies (Amendment No. 2) Bill 2004 which was circulated for consultation purposes reads as follows:

²⁰ This is limited to relevant jurisdictions that have reviewed or are reviewing their company law in relation to NPV.

“Immediately after the appointed day, any amount standing to the credit of a company’s share premium account and capital redemption reserve becomes part of the company’s share capital²¹.”

South Africa provides that the proceeds of a fresh issue of shares are to be transferred to an account called the ‘stated capital account’.

The New Zealand Companies Act 1993 does not maintain such a distinction. However, this approach was not supported by the New Zealand Securities Commission in their response to the New Zealand Law Reform Commission’s proposal in relation to the introduction of the Companies Act 1993. Perhaps this was because companies in New Zealand are required to comply with a solvency test before a company can make any distribution to its members.

2.2 Treatment of the amount standing to the credit of the share premium account prior to the Conversion date

Subsequent to the conversion to an NPV environment there may be companies with outstanding amounts in their existing share premium account prior to the Conversion date. One of the transitional issues that required the consideration of the CLRC was whether the amount standing to the credit of the company’s share premium account once transferred into the contributed capital account may be utilised for certain purposes.

If the amount standing to the credit of the company’s share premium account were permitted to be utilised for certain purposes after the Conversion date, the problem

²¹ As provided for by section 62 B of the Draft Companies (Amendment No. 2) Bill 2004.



remains as to how to track that amount utilised as the concern is to ensure that the company will not utilise an amount exceeding the amount standing to the share premium account which would be merged with its paid up capital to become the **'contributed capital'**.

The CLRC is inclined to propose that after the Conversion date, but limited to the transitional period as discussed above, the amount standing to the credit of the company's share premium account immediately prior to the Conversion date may be utilised for purposes as set out in recommendation (IV). The CLRC wishes to highlight that this recommendation relates only to the transitional period and would not exclude the provision of section 60 of the Companies Act being pursued by companies prior to the said transitional period.

Therefore, the CLRC recommends that the amount standing to the share premium account immediately prior to the conversion date should still be made available for certain purposes similar to the permitted uses under Australia's Corporations Law.

This means that any expenses incurred after the transitional period in relation to the issue of shares shall be treated as an expense to be deducted from or deducted against the company's income statement (profit and loss account) rather than as a deduction against the company's **'contributed capital'**.

Comparative jurisdictional study in respect to treatment of the amount in the share premium account prior to the Conversion to an NPV environment

The UK Steering Committee proposed to allow the amount standing to the credit of the share premium account to be applied to write off expenses incurred, payments made or discounts allowed prior to the Conversion to an NPV environment.

The Australian Corporations Law allows the amount standing to the share premium account to be used for certain purposes. The permitted uses are:

- (a) premium payable on redemption of RPS issued before commencement;
- (b) writing off preliminary expenses of the company incurred before commencement; and
- (c) writing off expenses incurred, payments made or discounts allowed on or before commencement, in respect of any issue of shares or debentures.

The Singapore CLRFC considered whether this account may be used for a one-off adjustment but decided to adopt the Australian approach in relation to the use of the amount standing to the share premium account and capital redemption reserve.

Although the UK, Singapore and Australia do not expressly provide for this in their respective legislation, the accounting treatment of expenses for corporate exercise after the introduction of NPV shares would be that the expenses will be charged to the profit and loss account.

2.3 Treatment of redeemable preference shares.

In a par value environment, the law on redeemable preference shares is provided for by section 61 of the Companies Act 1965. Upon the Conversion from a par value environment to an NPV environment, the issue that requires consideration is how the redemption of redeemable preference shares will be practised in an NPV environment given the fact that in an NPV environment the capital redemption reserve shall become obsolete or done away with?

The CLRC is of the view that the issue of RPS is still permissible in an NPV environment.

However, after the Conversion date to an NPV environment, the redemption of RPS shall be in the following manner:

- in the case of redemption of RPS issued before the Conversion date, its redemption must be funded out of available profits or from the proceeds of a fresh issue of shares²². However, the premium portion of the RPS can be charged to the amount standing to the credit of the share premium account **but only for the transitional period**. After the transitional period, the premium portion must be funded out of available profits or from the proceeds of a fresh issue of shares made for redemption purposes. Where the redemption is made out of profits, the company transfers the amount redeemed to its **'contributed capital'** account²³;
- in the case of redemption of RPS issued after the Conversion date, its redemption must be funded out of available profits or from the proceeds of a fresh issue of shares²⁴. This is to ensure that the company's **'contributed capital'** is not used to redeem RPS²⁵. If redemption of RPS is made out of available profits instead of from the proceeds of a fresh issue of shares, the company transfers the amount redeemed to the company's **'contributed capital'** account from its available profits; and
- in the case of RPS issued after the Conversion date and it is to be redeemed, it may be redeemed at the issue price or at a price in excess of its issue price (at a premium)²⁶. Redemption at a premium of the issue price must, however, be funded from the company's available profits or from the proceeds of a fresh issue

²² Note this is also the current practice in a par value environment.

²³ This is because as discussed above, the Conversion to an NPV environment shall cause the capital redemption reserve to become obsolete. Pursuant to recommendation (III) in paragraph 2, 'Immediately on or after the Conversion date any amount, standing to the credit of the company's capital redemption reserve shall be transferred to the company's contributed capital account. This was also the approach taken by the Singapore CLRFC and the Australian Transitional provisions.

²⁴ Note this is also the current practice in a par value environment.

²⁵ It also ensures that the company's contributed capital is a creditors' buffer and not paid out in another form to shareholders (Note: contributed capital may be lost from trading).

²⁶ It should be noted that in a par value environment, RPS can be issued for a premium in addition to its par value. However, after the Conversion date, RPS will only be issued for an issue price. No reference will be made to premium as par value no longer exists. Redemption of the RPS that is issued after the Conversion date can be at a price higher than its issue price and it is in this context the word premium is used.

of shares made for redemption purposes. Where the redemption is made out of available profits, the company transfers the amount redeemed to its '**contributed capital**' account from its available profits.

In an NPV environment, it is imperative for the company to specify a redemption value for RPS, or the manner in which the value will be determined. The distinctive features of RPS still remain.

3. CAPITALISATION OF PROFITS, CONSOLIDATION AND SUBDIVISION

BACKGROUND

In a par value environment, it is permissible to capitalise profits. It is also permissible to achieve the result of what is currently understood as consolidation, subdivision or alternation of the company's share capital. Consolidation and subdivision of shares are two concepts that are linked to nominal or par value of shares. The authority to capitalise profits and to consolidate, subdivide or to alter the share capital is provided under section 62 of the Companies Act 1965.

RECOMMENDATIONS

The CLRC recommends:

- i. to allow capitalisation of profit that does not increase the number of shares owned by a shareholder i.e. without any issue of new shares to shareholders.
- ii. to allow capitalisation of profits coupled with issuing new shares to shareholders.

3.1 Capitalisation of profits

In a par value environment, capitalisation of profits without the issuance of new shares is not usually carried out. Thus, new shares would be issued to the existing shareholders when there is a capitalisation of profits. The new issuance of shares means that a shareholder will have more shares in the company. However, this does not necessarily translate to an increase in the value of the shareholders' shareholding in the company.

The CLRC noted that in an NPV environment, capitalisation of profits may be carried out without increasing the number of shares held by a shareholder. This manner of capitalisation of profits may be done by transferring such amounts from the company's retained profits into the company's '**contributed capital**' account. This means that although the number of shares held by the shareholders remains the same, the book value of their shareholding in the company has increased. In such an instance, there could be a perception that there is a loss in the value of the shareholding since no new shares are issued. Thus, the accounting treatment in respect of this kind of capitalisation must be transparent so as to provide assurance to the shareholders that there is no loss in their investment.

In an NPV environment, it is permissible for a company to capitalise its profits coupled with the issuance of new shares. In such a case, there will be an increase in the number of shares held by each shareholder with a corresponding increase in the company's '**contributed capital**'.

It is the view of the CLRC that capitalisation of profits is possible irrespective of whether the shares have or do not have par value. Thus, the CLRC proposes that the concept of capitalisation of profits be clarified so as to permit its use in an NPV

environment either by an issue of new shares or without an issue of new shares and that the existing section 62 of the Companies Act 1965 in relation to the authority to alter a company's share capital be retained but modified to reflect our recommendations.

Comparative jurisdictional study in respect to capitalisation of profits

The UK Steering Committee is of the view that there is no difference between capitalisation of profits accompanied by new issue of shares from a subdivision under section 121(2)(d) of the Companies Act 1985 and therefore recommended that there should not be any special provision for it.

However, section 75 of the South Africa Companies Act 1973 provides that a company may alter the share capital and shares by:

- i. increasing the number of its shares having no par value;
- ii. increasing its share capital constituted by shares of no par value by transferring reserves or profits to the stated capital, with or without a distribution of shares; and
- iii. increasing the number of its issued no par value shares without an increase of its stated capital.

Australia's CSLRC recommended adopting the provisions of the South Africa Companies Act 1973. However, Australia's Corporations Act 2001 provides that a company may issue shares, including (section 254(A)(1)(b)) bonus shares, which are shares for whose issue no consideration is payable to the issuing company. It

also provides that a company may capitalise profits without the issue of new shares under section 254S.

3.2 Consolidation and Subdivision

Consolidation in an NPV environment can be effected by reducing the number of the issued NPV shares. This reduction is, however, not accompanied by any changes to the company's contributed capital account.

The effect of a subdivision (i.e. share split) can also be achieved in an NPV environment. In a par value environment, a subdivision will result in an increase in the number of shares held but there will be no corresponding increase in the company's paid up capital and in the value of the shareholders shareholding. The effect of a subdivision, as explained above, can also be achieved in an NPV environment. In an NPV environment, the effect of a subdivision can be achieved by increasing the number of no par value shares issued but however, this is only limited to fully paid-up NPV shares²⁷.

Comparative jurisdictional study in respect to consolidation and subdivision

The UK Steering Committee made the following conclusions on the continued relevance of statutory provisions in relation to alteration of share capital. They are:

- Section 121(2)(a)²⁸ need not be retained since authorised share capital has been abolished.
- The power to increase the capital of a company is related to the power to

²⁷ The current practice of subdividing partially paid shares as is practised in a par value environment will not be possible in an NPV environment as 'subdivision' in an NPV environment actually is achieved by means of a new issue of shares.

²⁸ The equivalent of section 62 of the Companies Act 1965.

issue shares, which is implicit in the authority conferred on directors to allot shares²⁹ and thus no express provision is required.

- The provision to cancel unissued shares will fall away with the abolition of the authorised share capital.

South Africa however, still maintains and retains the provision on alteration of share capital. Section 75 of the South African Companies Act³⁰, provides that a company may alter its share capital and shares by:

- increasing the number of its shares having no par value;
- increasing its share capital constituted by shares of no par value by transferring reserves or profits to the stated capital, with or without a distribution of shares;
- increasing the number of its issued no par value shares without an increase of its stated capital; and
- consolidating and reducing the number of the issued no par value shares.

4. COROLLARY CHANGES AND TRANSITIONAL PROVISIONS IN RELATION TO THE INTRODUCTION OF NO PAR VALUE SHARES

BACKGROUND

The CLRC noted that corollary changes will have to be made to various concepts and provisions in the Companies Act 1965 in an NPV environment. Our recommendations on the corollary changes are stated below.

²⁹ See section 132D of the Companies Act 1965.

³⁰ Equivalent of section 62 of the Companies Act 1965.



RECOMMENDATIONS

The CLRC recommends:

- i. the deletion of the provision for the issue of shares at a discount.**
- ii. the introduction of transitional provisions in relation to liability for partly paid shares.**

4.1 Shares issued at a discount

As was previously discussed, shares in an NPV environment would be issued for an issue price without reference being made to par value. Hence, the issue of shares at a discount in an NPV environment would cease to be a feature in Company law.

In a par value environment, a company whose shares have a market value below the par value or nominal value can legally issue shares at a discount provided it follows the procedures pursuant to section 59. However, in such an instance, a company will rarely use section 59, as the company does not wish to be seen to be forced to issue shares at a discount. Instead, a company would prefer to create a new class of shares or utilise its share premium account, if there is any, or reserves, to pay for the portion not represented by share subscription money rather than raise capital pursuant to section 59. If a company does not have any share premium or reserves available, its ability to issue shares of the same class with that being traded will be hindered.

The above situation will not apply in an NPV environment.

4.2 Transitional provision

The UK Steering Committee stated that the objective of the transitional provisions would be to preserve the substantive effect of converting from a par value to an NPV environment in the articles and memorandum and in contracts and other documents; and the rights and obligations created by them, unchanged so far as that is practicable. This was also the approach adopted by Australia in relation to the amendment to the Corporations Law 1993 (Company Law Review Act 1998).

The transitional provision should cover the following matters:

- (a) treatment of the amount standing to the share premium account based on the discussion above³¹;**
- (b) liability on partly paid shares;**

If par value is thought to be relevant for determining the liability of contributory upon winding up, an NPV environment acknowledges this view and will state that the liability is up to the unpaid amount of the issue price.

The Conversion of par value to an NPV environment does not mean that the liability for the unpaid portion of shares under the existing par value environment will cease to exist. The UK Steering Committee referred to the Australian Corporations Law on this point and we noted that section 1448 of the Australian Corporations Law deals with liability of shareholders for partly paid shares by recognising the unpaid portion as the unpaid amount of the issue price. The CLRC proposes to adopt the same; and

³¹ Refer to fn 11. Where the company's earnings do not merit an inflated contributed capital account resulting from the Conversion it is advisable that the company should consult their professional advisers as to the appropriate cause of action to be taken during the transitional period.

(c) reference to share capital and par value in contracts or documents entered into or executed prior to the introduction of no par value shares.

The object of this transitional provision is to preserve the effect of existing contracts and other instruments that have been executed before the Conversion date which refers to par or nominal value of shares. An example of such a transitional provision is provided for under section 1449 of the Australian Corporations Law³².

This transitional period will be set by the Minister in consultation with the business and professional community. The CLRC recommends that the transitional period should not exceed two years from the Conversion date.

³² Section 1449 reads as follows:
Section 1449 - **Share capital references in pre-commencement contracts and other documents to par value.**

- (1) This section applies for the purpose of interpreting and applying after commencement
 - (a). a contract entered into before commencement (including a company's constitution); or
 - (b). a trust deed or other document executed before commencement.
- (2) The reference to the par value of a share is taken to be a reference to
 - (a). if the share is issued before commencement - the par value of the share immediately before commencement; or
 - (b). if the share is issued after commencement but shares of the same class were on issue immediately before commencement - the par value that the share would have had if it had been issued then; or
 - (c). if the share is issued after commencement and shares of the same class were not on issue immediately before commencement - the par value determined by the directors.

A reference to share premium is taken to be a reference to any residual share capital in relation to the share.

- (3) A reference to a right to a return of capital on a share is taken to be a reference to a right to a return of capital of a value equal to the amount paid in respect of the share's par value.
- (4) A reference to the aggregate par value of the company's issued share capital is taken to be a reference to that aggregate as it existed immediately before commencement and:
 - (a). increased to take account of the par value of any shares issued after commencement; and
 - (b). reduced to take account of the par value of any shares cancelled after commencement.

This provision was followed by the Singapore Companies (Amendment No 2) Bill 2004.

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Section D

Share Capital:

Simplifying and Streamlining Provisions
Applicable to Shares

SECTION D - SHARE CAPITAL: SIMPLIFYING AND STREAMLINING PROVISIONS APPLICABLE TO SHARES

1. BACKGROUND

In line with the objectives of the Corporate Law Reform Programme, the CLRC has reviewed some of the provisions in the Companies Act 1965 which relate to shares.

The review process of these provisions was carried out with the objective of ascertaining whether they have continued relevance and applicability in today's business environment. Further, in the event the said provisions are considered relevant, to clarify its application, if deemed necessary.

The CLRC reviewed the following requirements or provisions:

- (a) Power to make payment of certain commissions and prohibition of payment of other commissions and discounts on the issue of shares: section 58 of the Companies Act 1965;
- (b) Power of the company to make different arrangements for call and payments for shares: section 56(1) of the Companies Act 1965;
- (c) Bearer shares (share warrants): section 57 of the Companies Act 1965;
- (d) Reserve capital (Reserve liability): section 56(2) of the Companies Act 1965; and
- (e) Adequacy of consideration for shares.

RECOMMENDATIONS

1. The CLRC recommends retaining:

- i. the regulatory controls on the power of a company to make payment of certain commissions and prohibition of the payment of other commissions and discounts on the issue of shares: section 58 of the Companies Act 1965;**
- ii. the power of the company to make different arrangements for calls and payments for shares: section 56 of the Companies Act 1965; and**
- iii. the prohibition against issuing bearer shares (share warrants): section 57 of the Companies Act 1965.**

2. The CLRC recommends abolishing:

- i. the requirement of reserve capital (reserve liability) by deleting section 56(2) of the Companies Act 1965.**

1.1 Retaining the regulatory controls on the power of the company to make payment of certain commissions and prohibition of payment of other commissions and discounts on the issue of shares and the power of the company to make different arrangements for calls and payments

The CLRC is of the view that the current section 58 of the Companies Act 1965 should be retained as it is still a relevant provision. This is because section 58 regulates corporate transactions such as the giving of discounts and payment of commissions which, if left unregulated, would have the effect of reducing the company's share capital and this can be detrimental to the company's creditors.

The CLRC is also of the view that section 56(1) of the Companies Act 1965 that enables a company to make different arrangements for calls and payment should be retained as this provision is relevant in the event a company issues partly paid up shares.

1.2 Prohibiting the issue of bearer shares (share warrants) and abolishing the requirement of reserve capital (reserve liability)

The CLRC noted that section 57 of the Companies Act 1965 currently prohibits the issue of bearer shares (share warrants). Further, the CLRC also noted that it is no longer a commercial practice for companies to issue bearer shares (share warrants).

Today, the transfer of shares other than bearer shares is regulated by transfer procedures that are provided for in the Companies Act 1965³³ and in the company's constitution. In the case of bearer share (share warrants), transfer was by way of mere delivery of the script. This kind of transfer facilitated fraud and hence the issue of bearer shares (share warrants) was prohibited.

The CLRC is of the view that section 57 of the Companies Act 1965 should be retained although the issue of bearer shares is obsolete. The deletion of section 57 may be construed as the law permitting the issue of bearer shares.

The CLRC noted that reserve capital is provided for by section 56(2) of the Companies Act 1965. The section provides that members may pass a special resolution not to call some part of the uncalled capital unless upon the winding up of a company.

The CLRC noted that the UK Steering Committee is of the view that reserve capital is

33 Refer to sections 103 to 106 of the Companies Act 1965.

no longer relevant. Further, other jurisdictions such as New Zealand and Australia do not include a specific provision on reserve capital in their respective company legislation.

The CLRC is of the view that section 56(2) is obsolete as company directors are already provided with the power by virtue of the company articles to call for the uncalled portion of the issued share at any time. This power is rarely interfered with by the shareholders. Further, shares issued today are usually issued as fully paid up shares³⁴.

2. TYPES OF CONSIDERATION AND VALUATION PROCEDURE

BACKGROUND

Shares may be issued for cash and or non-cash consideration. Where shares are issued for non-cash consideration, the concern is whether the consideration received for the shares is adequate.

The CLRC noted that one of the ways to deal with the issue of 'inadequacy of non-cash consideration' is by requiring the prior valuation of the non-monetary consideration³⁵.

³⁴ Companies have the freedom to decide whether to issue its shares as fully paid up or partly paid up. Even in an NPV environment, this freedom will continue to exist.

³⁵ It should be noted that in some jurisdictions, in addition to requiring valuation, the receiving by companies of certain types of consideration in kind in return for the shares issued by the company is also prohibited. For instance, in the UK, a public company is prohibited from allotting its shares for services: section 99(2) of the UK Companies Act 1985.

RECOMMENDATIONS

The CLRC recommends that:

- i. the Companies Act should not be amended to include statutory provisions that will have the effect of regulating the type of consideration that is receivable by the company when the company issues its shares; and
- ii. the Companies Act should not be amended to include a statutory valuation procedure for non cash consideration for shares.

RATIONALE

As noted above, there are jurisdictions that deal with the issue of 'inadequacy of consideration' by regulating the types of non-cash consideration that can be received by a company in return for the shares the company has issued to another.

Further, some jurisdictions also require prior valuation of the non-cash consideration.

Despite this, the CLRC is of the view that in so far as the Companies Act is concerned adequacy of consideration should be dealt with by way of directors' duties and not by the above means³⁶.

Further, the CLRC is of the view that adequacy of consideration by way of valuation for shares issued are primarily a capital markets issue and should therefore be dealt with by capital markets regulations³⁷.

³⁶ It should be noted that general law as well as the Companies Act 1965 requires company directors to act in the best interest of his company. A director who issues company shares for inadequate consideration contravenes this duty and can be made accountable to the company for this contravention.

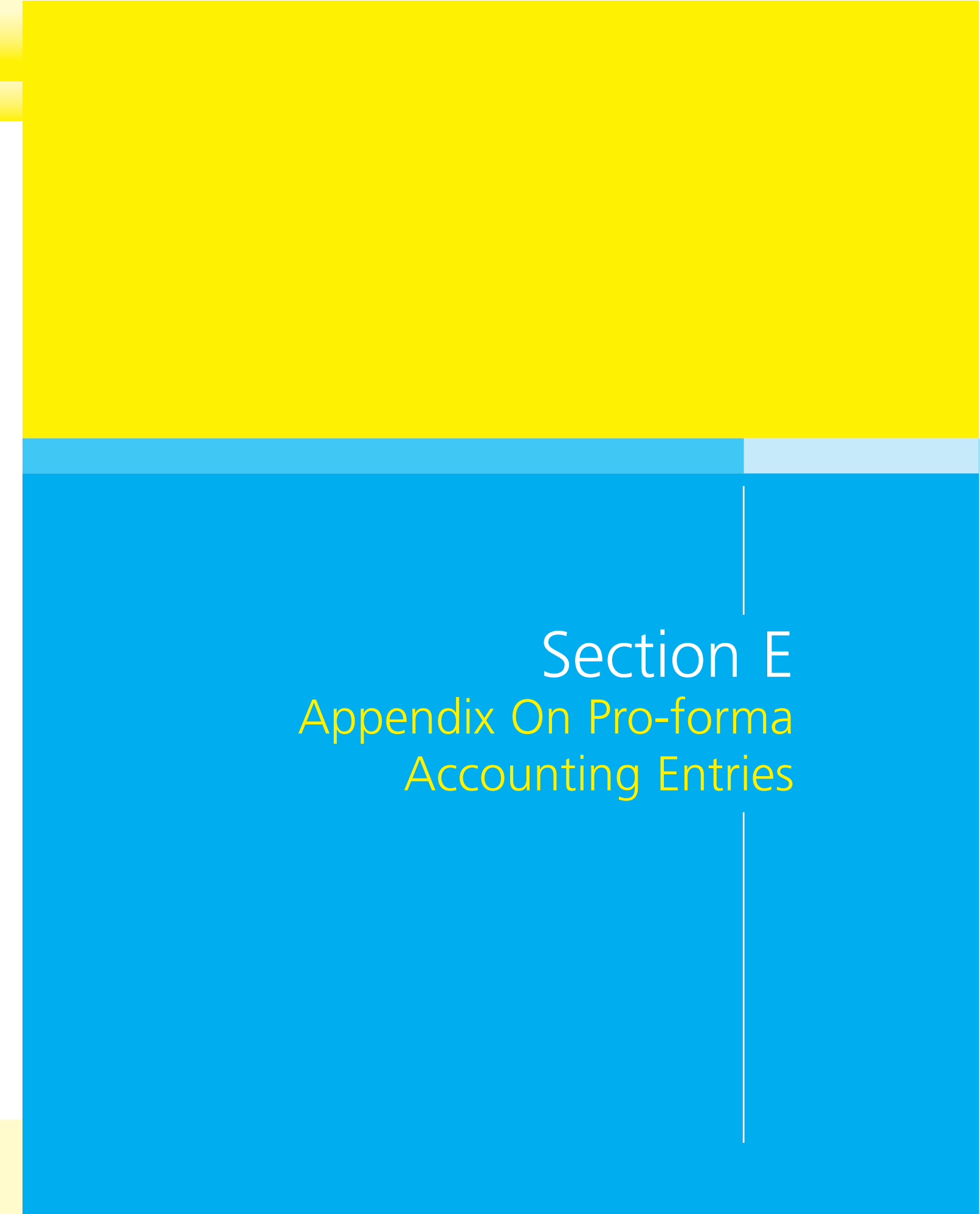
³⁷ These regulations includes among others the Securities Commission's Issues Guidelines and the Listing Requirements of Bursa Securities.

Comparative jurisdictional study

The New Zealand Companies Act 1993 provides that consideration for shares issued may take any form and may be cash, promissory notes, contracts for future services, real or personal property, or other securities of the company: (section 46). However, this provision is merely descriptive and does not stipulate that these are the only types of consideration acceptable by the company law statute.

The UK Companies Act 1985 prohibits a public company from accepting an undertaking by any person that he or another should do work or perform services for the company or any other person in payment for shares to be issued by the public company³⁸. Further, a public company is also prohibited from accepting as payment for the nominal value of the shares or its premium an undertaking to be performed more than five years after the date of the allotment of shares. The prohibition includes a contract where the undertaking is varied after the issue is made³⁹. However, there is no prohibition for private company from accepting an undertaking to render services as consideration for the shares issued.

³⁸ Section 99(2) of the UK Companies Act 1985.
³⁹ Section 102(1) of the UK Companies Act 1985.

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Section E

Appendix On Pro-forma Accounting Entries

SECTION E — APPENDIX ON PRO-FORMA ACCOUNTING ENTRIES

ACCOUNTING ENTRIES ILLUSTRATIONS

Treatment of the Share Premium account

Illustration 1

The diagram below illustrates the accounting entries in a par value (PV) and a no par value (NPV) environment for the following scenarios:-

- (1) Issue of 1,000 ordinary shares at RM1 each for cash.
- (2) Issue of 1,000 ordinary shares at RM3 each for cash.

PV environment (assume PV = RM1)			NPV environment		
	Scenario			Scenario	
	(1)	(2)		(1)	(2)
	RM	RM		RM	RM
Cash	1,000	3,000	Cash	1,000	3,000
Share Capital	1,000	1,000	Contributed Capital	1,000	3,000
Share Premium	-	2,000			
Shareholders' Funds	1,000	3,000	Shareholders' Funds	1,000	3,000
No of Shares (RM1)	1,000	1,000	No of Shares	1,000	1,000
<u>Accounting entries</u>			<u>Accounting entries</u>		
(1)	Dr Cash	1,000	(1)	Dr Cash	1,000
	Cr Share Capital			Cr Contributed Capital	1,000
		1,000			
(2)	Dr Cash	3,000	(2)	Dr Cash	3,000
	Cr Share Capital			Cr Contributed Capital	3,000
		1,000			
	Cr Share Premium				
		2,000			

In a PV environment, "Share Capital" represents the total number of shares issued at the nominal amount and where shares are issued at a premium; the sum equal to the value of the premiums on those shares is recorded in the "Share Premium" account.

In an NPV environment, a single "Contributed Capital" account which represents the total proceeds of the shares issued will replace the "Share Capital" and "Share Premium" account in a PV environment. The "Share Premium" account is no longer applicable since there is no premium payable on the shares in an NPV environment.

Illustration II

The diagram below illustrates the accounting entries in a PV and an NPV environment for the issue of 1,000 ordinary shares at RM5 each by way of cash consideration of RM2,000 and capitalisation of RM3,000 property, plant and equipment (“PPE”) (non-cash consideration), followed by the writing off of expenses in connection with the issue of shares of RM1,000.

PV environment (assume PV = RM1)			NPV environment			
	(I) Issue of shares for cash and non-cash considerations RM	After (I) and writing-off the expenses against Share Premium RM		(I) Issue of shares for cash and non-cash considerations RM	After (I) and expenses Contributed Capital RM	writing-off against Income Statement RM
PPE	3,000	3,000	PPE	3,000	3,000	3,000
Cash	2,000	1,000	Cash	2,000	1,000	1,000
	<u>5,000</u>	<u>4,000</u>		<u>5,000</u>	<u>4,000</u>	<u>4,000</u>
Share Capital	1,000	1,000	Contributed Capital	5,000	4,000	5,000
Share Premium	4,000	3,000	Accumulated Losses	-	-	(1,000)
Shareholders' Funds	<u>5,000</u>	<u>4,000</u>	Shareholders' Funds	<u>5,000</u>	<u>4,000</u>	<u>4,000</u>
No of Shares (RM1)	1,000	1,000	No of Shares	1,000	1,000	1,000
<u>Accounting entries</u>			<u>Accounting entries</u>			
Dr PPE	3,000		Dr PPE	3,000		
Dr Cash	2,000		Dr Cash	2,000		
Cr Share Capital		1,000	Cr Contributed Capital		5,000	
Cr Share Premium		4,000				
Dr Share Premium	1,000		Dr Contributed Capital		1,000	
Cr Cash		1,000	Cr Cash			1,000
			<i>(write-off against Contributed Capital)</i>			
			Dr Expenses - Income Statement		1,000	
			Cr Cash			1,000
			<i>(write-off against Income Statement)</i>			

In a PV environment, the premium arising from the issue of shares by way of cash of RM2,000 and capitalisation of PPE of RM3,000 is recorded in the “Share Premium” account

and the "Share Premium" account may be applied to write-off the expenses in connection with the issue of shares of RM1,000.

In an NPV environment, the total proceeds from the issue of shares of RM5,000 by way of cash of RM2,000 and capitalisation of PPE of RM3,000 is recorded in the "Contributed Capital" account and the expenses in connection with the issue of shares of RM1,000 may be written-off against the "Contributed Capital" account or the Income Statement.

In the case of the former, expenses relating to the issue of shares may be written off against "contributed capital" to a maximum of the balance included in the "share premium" account prior to the conversion from a PV to an NPV environment.

Treatment of redeemable preference shares

Illustration I

Company X has an issued and paid-up ordinary share capital of RM2 comprising 2 ordinary shares of nominal value RM1 each and redeemable preference shares ("RPS") of RM10 comprising 10 RPS of nominal value RM1 each in a PV environment and 2 units of ordinary shares and 10 units of RPS in an NPV environment.

The diagram below illustrates the accounting entries in a PV and an NPV environment in connection with the redemption of the RPS by way of either:-

- (i) Out of profits at RM10;
- (ii) Out of profits at RM100; or
- (iii) New issue of 10 ordinary shares for total cash proceeds of RM10.

PV environment (assume PV = RM1)					NPV environment				
	After Redemption by way of					After Redemption by way of			
	Existing	(i)	(ii)	(iii)		Existing	(i)	(ii)	(iii)
	RM	RM	RM	RM	RM	RM	RM	RM	RM
Cash	312	302	212	312	Cash	312	302	212	312
Share Capital					Contributed Capital				
- Ordinary	2	2	2	12	- Ordinary	2	12	12	12
- Preference	10	-	-	-	- Preference	10	-	-	-
	12	2	2	12		12	12	12	12
Capital Redemption Reserve					Retained Profits	300	290	200	300
Reserve	-	10	10	-	Shareholders' Funds	312	302	212	312
Retained Profits	300	290	200	300					
Shareholders' Funds	312	302	212	312					
No of shares (RM1)					No of shares				
- Ordinary	2	2	2	12	- Ordinary	2	2	2	12
- Preference	10	-	-	-	- Preference	10	-	-	-
<u>Accounting entries</u>					<u>Accounting entries</u>				
(i)	Dr Share capital - Preference shares		10		(i)	Dr Contributed capital - Preference shares		10	
	Cr Cash			10		Cr Cash			10
	Dr Retained profits		10			Dr Retained profits		10	
	Cr Capital Redemption Reserve			10		Cr Contributed Capital - Ordinary shares			10
(ii)	Dr Share capital - Preference shares		10		(ii)	Dr Contributed capital - Preference shares		10	
	Dr Retained profits		90			Dr Retained profits		90	
	Cr Cash			100		Cr Cash			100
	Dr Retained profits		10			Dr Retained profits		10	
	Cr Capital Redemption Reserve			10		Cr Contributed Capital - Ordinary shares			10
(iii)	Dr Cash		10		(iii)	Dr Cash		10	
	Cr Share capital - Ordinary shares			10		Cr Contributed capital - Ordinary shares			10
	Dr Share capital - Preference shares		10			Dr Contributed capital - Preference shares		10	
	Cr Cash			10		Cr Cash			10

In a PV environment, where RPS are redeemed out of profits, a sum equal to the nominal amount of the shares redeemed shall be transferred out of profits to a reserve called the "Capital Redemption Reserve" and any premium payable shall be provided for out of profits or the "Share Premium" account if available (refer Illustration II).

In an NPV environment, the “Capital Redemption Reserve” is not required and where RPS are redeemed out of profits, a sum equal to the subscription amount of the RPS redeemed shall be transferred out of profits to “Contributed Capital.”

Where RPS are redeemed out of proceeds from new issue of shares, the “Share Capital” or the “Contributed Capital” amount before and after redemption remains unchanged.

Illustration II

Company X has an issued and paid-up ordinary share capital of RM2 comprising 2 ordinary shares of nominal value RM1 each and redeemable preference shares (“RPS”) of RM100 comprising 10 RPS of nominal value RM1 each in a PV environment and 2 units of ordinary shares and 10 units of RPS in an NPV environment.

The diagram below illustrates the accounting entries in a PV and an NPV environment in connection with the redemption of the RPS by way of either:-

- (i) Out of profits at RM100; or
- (ii) New issue of 10 ordinary shares at RM100.

PV environment (assume PV = RM1)				NPV environment			
	After Redemption by way of				After Redemption by way of		
	Existing RM	(i) RM	(ii) RM		Existing RM	(i) RM	(ii) RM
Cash	402	302	402	Cash	402	302	402
Share Capital				Contributed Capital			
- Ordinary	2	2	12	- Ordinary	92	102	102
- Preference	10	-	-	- Preference	10	-	-
	12	2	12		102	102	102
Capital				Retained Profits	300	200	300
Redemption				Shareholders' Funds	402	302	402
Reserve	-	10	-				
Share Premium	90	-	90				
Retained Profits	300	290	300				
Shareholders' Funds	402	302	402				
No of shares (RM1)				No of shares			
- Ordinary	2	2	12	- Ordinary	2	2	12
- Preference	10	-	-	- Preference	10	-	-
<u>Accounting entries</u>				<u>Accounting entries</u>			
(i)	Dr Share capital - Preference shares	10		(i)	Dr Contributed capital - Preference shares	10	
	Dr Share Premium	90			Dr Retained profits	90	
	Cr Cash		100		Cr Cash		100
	Dr Retained profits	10			Dr Retained profits	10	
	Cr Capital Redemption Reserve		10		Cr Contributed Capital - Ordinary shares		10
(ii)	Dr Cash	100		(ii)	Dr Cash	100	
	Cr Share capital - Ordinary shares		10		Cr Contributed capital - Ordinary shares		100
	Cr Share premium		90		Dr Contributed capital - Preference shares	10	
	Dr Share capital - Preference shares	10			Dr Contributed capital - Ordinary shares	90	
	Dr Share premium	90			Cr Cash		100
	Cr Cash		100				

In a PV environment, where RPS are redeemed out of profits, a sum equal to the nominal amount of the shares redeemed shall be transferred out of profits to a reserve called the “Capital Redemption Reserve” and any premium payable shall be provided for out of the “Share Premium” account.

In an NPV environment, the “Capital Redemption Reserve” is not required and where RPS are redeemed out of profits, a sum equal to the subscription amount of the RPS redeemed shall be transferred out of profits to “Contributed Capital”.

Where RPS are redeemed out of proceeds from new issue of shares, the “Share Capital” or the “Contributed Capital” amount before and after redemption remains unchanged.

Capitalisation of profits

The shareholders of Company X are Shareholder A, who subscribed for 100 ordinary shares for RM1,000 and Shareholder B, who subscribed for 300 ordinary shares for RM9,000. Company X has retained profits of RM20,000.

The diagram below illustrates the accounting entries in a PV and an NPV environment in connection with the capitalisation of profits as follows:-

PV environment: Bonus Issue of 20 ordinary shares of RM1 for each existing ordinary share held.

NPV environment: Capitalisation of profits of RM8,000 by increasing Contributed Capital:-

- (i) by RM20 per share with no increase in number of shares in issue;
- or
- (ii) issue of 20 new ordinary shares for each existing share in issue.

PV environment (assume PV = RM1)				NPV environment							
				Capitalisation							
				(i) (no issue of new shares)			(ii) (with issue of new shares)				
				Existing		Existing		Existing		Existing	
				RM		RM		RM		RM	
Share Capital (Note (a))		400	8,400	Contributed							
Share premium		9,600	9,600	Capital (Note (a))	10,000	18,000	18,000				
Retained profits		20,000	12,000	Retained profits	20,000	12,000	12,000				
		<u>30,000</u>	<u>30,000</u>		<u>30,000</u>	<u>30,000</u>	<u>30,000</u>				
Note (a):				Note (a):							
Analysis of shareholders				Analysis of shareholders							
	No of	%	No of	%	No of	%	No of	%	No of	%	No of
	shares	equity	shares	equity	shares	equity	shares	equity	shares	equity	shares
- Shareholder A	100	25%	2,100	25%	100	25%	2,100	25%	2,100	25%	2,100
- Shareholder B	300	75%	6,300	75%	300	75%	6,300	75%	6,300	75%	6,300
	<u>400</u>	<u>100%</u>	<u>8,400</u>	<u>100%</u>	<u>400</u>	<u>100%</u>	<u>400</u>	<u>100%</u>	<u>8,400</u>	<u>100%</u>	<u>8,400</u>
<u>Accounting entries</u>				<u>Accounting entries</u>							
Bonus Issue (20 for 1):				(i) Dr Retained Profits							
Dr Retained Profits				Cr Contributed Capital							
Cr Share Capital				8,000							
				8,000							
				(ii) Dr Retained Profits							
				Cr Contributed Capital							
				8,000							
				8,000							

In a PV environment, where shares are issued at a premium, the sum equal to the value of the premiums on those shares is recorded in the "Share Premium" account and profits may be capitalised through issue of bonus shares in proportion to the existing shares.


In an NPV environment, the "Contributed Capital" account represents the total proceeds of the shares issued and profits may be capitalised based on a specific amount per share (without the issue of new shares) which will result in an increase in the "Contributed Capital" without any increase in the number of shares or through issue of bonus shares in proportion to the existing shares which is similar to the PV environment.

Consolidation and Subdivision

In PV environment, consolidation of shares will result in a reduced number of shares with an increase in the PV per share whereas subdivision of shares will result in an increase in the number of shares with a reduction in the PV per share.

In an NPV environment, consolidation and subdivision of shares will result in changes in the number of shares.

The “Share Capital” and the “Contributed Capital” amount in the PV and NPV environment remain unchanged. This is illustrated as follows:-

PV environment				NPV environment			
	Existing	(I) Share consolidation from RM0.10 to RM1	After I Share subdivision from RM1 to RM0.50		Existing	(I) Share consolidation from 10 shares to 1 share	After I Share subdivision from 1 share to 2 shares
	RM	RM	RM		RM	RM	RM
Share Capital	1,000	1,000	1,000		Contributed Capital	1,000	1,000
Retained profits	1,000	1,000	1,000		Retained profits	1,000	1,000
	<u>2,000</u>	<u>2,000</u>	<u>2,000</u>			<u>2,000</u>	<u>2,000</u>
No of shares	10,000	1,000	2,000	No of shares	10,000	1,000	2,000
PV of shares	0.10	1.00	0.50				

Partly paid shares

The diagram below illustrates the accounting entries for the issue of 2,000 ordinary shares for RM6,000 of which RM1,000 is called but unpaid.

	PV environment (assume PV = RM1)		NPV environment
	After issue of partly paid shares		After issue of partly paid shares
	RM		RM
Cash	5,000	→	Cash
Share Capital	2,000		Contributed Capital
Share Premium	4,000		Call-in-Arrears
Call-in-Arrears	(1,000)		6,000
	5,000		(1,000)
	5,000		5,000
No of Shares	2,000		No of Shares
	2,000		2,000

In a PV environment where shares are issued at a premium, the sum equal to the value of the premiums on those shares is recorded in the "Share Premium" account and the RM1,000 which is called but unpaid is recorded in the "Call-in-Arrears" account.

In an NPV environment, the "Contributed Capital" account represents the total proceeds of the shares issued and similar to the PV environment the RM1,000 which is called but unpaid is recorded in the "Call-in-Arrears" account.

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