

## **Treatment of share issue expenses**

*Expenditure on share issues is ideally written off to profit and loss account in the year it is incurred.*

A company raises its funds by issuing shares. Such an issue could be a private placement or a public issue. No matter what mode is adopted, an offer document has to be issued. It could be a statement in lieu of prospectus or the prospectus itself.

Nature of expenses

The company incurs the following expenses at the time of issue of shares:

- Preparation of project report
- Brokerage charges
- Professional fees to company secretaries, auditors, legal advisors and others.
- Payments to merchant bankers – managers to the issue, underwriters, advisors to the issue, and so on.
- Printing and distribution of prospectus, application forms, publicity material, etc,
- Media publicity and advertisement
- Fee paid to the Government such as Ministry of Corporate affairs, Securities and Exchange Board of India. Etc.

## **Borrowing Cost**

AS 16 defines a borrowing cost to be interest and other costs incurred by an enterprise in connection with borrowing of funds with reference to a qualifying asset. The term borrowing implies mobilising of funds which are returnable. Issue of shares does not constitute borrowing by the company as there is no return of funds to shareholders. AS 16 categorically excludes equity capital and preference share capital not recorded as a liability from its purview. Consequently, such expenditure does not qualify to be borrowing costs.

## **Preliminary expenditure**

Preliminary expenditure is the expenditure incurred in connection with the formation of the company. Issue of shares is subsequent to the formation of the company. Therefore, it does not form part of the preliminary expenditure.

## **An intangible asset**

Guidance note of the ICAI on “Audit of Miscellaneous expenditure - 2003” discusses treatment of share issue expenses, which indicates inclusion of share issue expenses under this head.

Thus, the guidance note excludes share issue expenses from the ambit of intangible assets. As per AS 26, an intangible asset is “an identifiable non-monetary asset

without physical substance held for production or supply of goods or services, for rental to others, or for administrative purposes.” As the expenditure does not qualify for any of the above, share issue expenditure is not an intangible asset.

### **Accounting treatment**

Share issue expenditure is ideally written-off to profit and loss account in the year it is incurred, unless there is a reason to expect benefit to be derived in the years to come. If the management is in a position to determine the benefit derived out of such expenditure, it can be carried forward to be written-off over the period in which such a benefit is expected to be derived.

In case a company raises equity to redeem existing preference share capital, the benefit cannot be expected to be determinable over a reasonable period of time. In such a situation, share issue expenses are to be expensed out through the profit and loss account in the year in which the expenditure is incurred.

But, if the issue is made to finance a project, the benefit out of the share issue expenditure is deferred to a reasonable period when the project is commissioned. Such a situation warrants the expenditure be carried in the balance sheet till it is written off.

### **Disclosure in financial statements**

As this item is not preliminary expenditure within the meaning of the Companies Act, it would be improper to disclose it as such. In case it is not expensed out through the profit and loss account, the expenditure is to be carried in the balance sheet.

A guidance note of the ICAI requires such expenditure to be disclosed as a separate head under “Miscellaneous expenditure to the extent not written off”.

### **Tax treatment**

It was held that share issue expenses are capital for income-tax purposes. As a result, it is not deductible from profits. The only exception can be inferred from a reading of Sec.35D of the Income Tax Act, dealing with amortising of preliminary expenses. If the issue is made to finance a project, share issue expenditure constitutes preliminary expenditure for the purposes of this section. Therefore, such expenditure, subject to the limits specified under this section, can be amortised over a period of five years commencing from the year in which the project starts generating income.

### **Audit of share issue expenses**

The auditor should examine whether the rules of relevant statutes (such as Company Law, SEBI) provide for incurring the expenditure. He should examine the agreements with sharebrokers to ensure that the brokerage charges and commission are paid according to the agreements. He should satisfy himself that the underwriting commission does not exceed the limits stipulated by law. Similarly, fee payable to

merchant bankers has to be audited with reference to the agreements and the limit of expenditure permissible by law.

Other expenses may be verified with necessary documents, vouchers and agreements as laid out in the relevant statute.

In case the expense is proposed to be disclosed as miscellaneous expenditure, the auditor should seek a management representation that the benefit is determined to be accruing in future and the basis for such a decision.

The auditor should ensure that the total share issue expenses do not exceed the prescribed limit.

**Source: The BusinessLine**