COMPANY ACCOUNTS

ISSUE OF SHARES

Definitions

Justice James defines a company as

"an association of persons united for a common object".

Chief **Justice Marshall** has defined a company as

"a person artificial, invisible and existence only in the eyes of law".

Section 3 (1) of Indian Companies Act 1956 defines a company as

" a company formed and registered under an Act or an existing Company".

Haney Defined a **Joint Stock Company** as

"*an incorporated association which is an artificial, person created by law having separate entity, with a perpetual succession and a common seal.*

Characteristics of a Company

- Voluntary Association
- Separate Legal Entity
- Perpetual Existence
- Common Seal
- Limited Liability
- Transferability of Shares
- Management
- Statutory Regulations

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Types of Companies

Companies are classified on the basis of

- Incorporation
- Liability and
- Membership

Companies on the basis of incorporation

- **Statutory Companies:** The companies which come into existence through special Acts of Parliament or State Legislatures are known as Statutory Companies.

  Ex: RBI, LIC, SBI

- **Registered Companies:** The companies which are registered under the Indian Companies Act are known as Registered Companies.

Companies on the basis of Liability

- Companies limited by Shares
- Companies limited by Guarantee
- Companies with unlimited liability

Companies on the basis of Membership

- Private Companies
- Public Companies

Types of Capital

- **Authorized Capital:** The capital mentioned in the Memorandum of Association at the time of registration of the company.
- **Issued Capital:** It is that part of authorized capital which is offered to the public for subscription. It is always less than the authorized capital.
- **Subscribed Capital:** It is that part of the issued capital which has been subscribed by the public.
- **Called up Capital:** It means the amount actually called by the company on the shares of the company.

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- **Paid up capital:** It is the amount of money actually paid by the subscribers. The amount not paid by members become calls in arrears.
- **Uncalled Share Capital:** The unpaid portion of the subscribed capital is called uncalled capital.
- **Reserve Capital:** It is that part of the uncalled capital which has been reserved by the company to be called in the event of winding up.

Example

- X Co. Ltd was registered with an authorized capital of Rs. 10,00,000 divided into 1,00,000 equity shares of Rs. 10 each. It issued 80,000 shares for subscription. The public subscribed for 70,000 shares. The shareholders called upon to pay Rs. 8 per share. On 2000 Shares at Rs. 3 was not received. Show how the share capital appears?
- Authorized Capital:
  - 1,00,000 Equity Shares of Rs. 10 each 10,00,000
  - Issued Capital:
  - 80,000 Equity Shares of Rs.10 each 8,00,000
- Subscribed Capital:
  - 70,000 Shares of Rs.10 each at Rs.8 per Share 5,60,000
- Paid up Capital:
  - Called up capital on 70,000 shares
  - @ Rs. 8 per share 5,60,000
  - Less: Calls in arrears (2000x3) 6,000

5,54,000

Meaning of a Share

- *The share capital of a company is divided into **small units** called **shares**.*
- Shares are offered to the public for subscription.
- The person who purchases a share is called “Share holder”.

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Types of Shares

- The shares issued by a company can be broadly divided into 3 classes, namely
  - **Preferences Shares**
  - **Equity Shares**
  - **Deferred Shares**

Preference Shares

- *These shares carry preference over other classes of shares in the* ***payment of fixed rate of dividend*** *and* ***repayment of capital at the time of winding up.***
- These shares may be divided into 4 types
  - Cumulative and Non-cumulative Preference Shares
  - Participating and Non-Participating Preference Shares and
  - Convertible and Non-Convertible Preference Shares
  - Redeemable Preference Shares

Cumulative and Non-cumulative Preference Shares

- The dividend on cumulative preference shares is to be payable to the shareholders whether the company earns profit or not. The right of preference shareholders to receive dividend can be carried forward.
- In case of Non-cumulative preference shares dividend will be paid only when the company earns a profit. The arrears do not accumulative.

Participating and Non-Participating Preference Shares

- A participating preference share is a share which carries the right of sharing profit left after paying equity and preference dividends at specified rates.
- A non-participating preference share is a share which does not carries the right of sharing surplus after paying equity and preference dividends at specified rates.

Convertible and Non-Convertible Preference Shares

- *A convertible preference share is one which can be* ***converted into equity shares****. When it cannot be converted, it is called non-convertible preference share.*

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Redeemable Preference Shares

- These shareholders get back their share capital at the end of stipulated period.
- These shares are redeemed either out of the profits available for dividends or out of fresh issues made for this purpose.
- Those shares which are not redeemed as long as company exists are known as "Irredeemable Preference Shares".

Equity Shares

- These shares are also called as "Ordinary Shares".
- They do not enjoy any special rights.
- The equity shareholders get dividend after the payment of dividend after the payment to pref. shareholders.
- These shareholders possess voting rights and hold control over the affairs of the company.
- The rate of dividend is not fixed.

Deferred Shares

- These shares are also known as "Founders" Shares or "management" Shares.
- These shares are usually issued to promoters or founders of the company I consideration of their valuable services towards the formation of the company.
- These shareholders will receive dividend and capital at the winding up only after preference and equity shareholders.

ISSUE OF SHARES : Journal Entries

Shares issued at par

- For receiving application money

Bank a/c Dr

To Share Application a/c

- For transferring the application money to share capital

  Share Application a/c Dr

  To Share capital a/c

- For the amount due towards allotment

  Share allotment a/c Dr

  To Share Capital a/c

- On receipt of allotment money

  Bank a/c Dr

  To Share Allotment a/c

- For the amount due towards First Call

  Share First Call a/c Dr

  To Share Capital a/c

- On receipt of First Call money

  Bank a/c Dr

  To Share First Call a/c

Note: Similarly entries are made for second and final calls. Each entries are made first for the amount due and then for the amount received.

Calls in Arrears

- It refers to that part of capital which has been called up but not yet paid by shareholders.
- Share Allotment Account and Call Accounts will show debit balances equal to the total unpaid amount.
- Such amount is transferred to special account called Call in Arrears.
- The entry is

  Calls in Arrears a/c Dr

  To Share Allotment a/c

  To Share Call Account a/c

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- The entry is

Calls in Arrears a/c Dr

To Share Allotment a/c

To Share Call Account a/c

When the money is received from defaulting shareholder the following entry is passed

Bank a/c Dr

To Calls in Arrears a/c

Issue of Shares at Premium

- When shares are issued at a price higher than the face value, they are to be issued at premium. The premium is included in the allotment money. In such a case the entry is

Share Allotment a/c Dr

To Share Capital a/c

To Share Premium a/c

- Share Premium a/c appears in the B/S under "Reserves and Surplus".

Issue of Shares at Discount

- When shares are issued at a price lower than the face value, they are to be issued at discount. The discount is treated as a loss of capital nature. It is generally recorded at the time of allotment. The entry is

Share Allotment a/c Dr

Discount on Issue of Shares a/c Dr

To Share Capital a/c

Discount on Issue of Shares is shown in the B/S on the asset side under "**Miscellaneous Expenditure**".

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Forfeiture of Shares

- When a shareholder is called upon to pay call amount by the company, he has to pay on or before the date specified by the Company. If he fails to pay the call, the company has two remedies against the shareholder namely,
  - **It may sue him for amount date.**
  - **It may forfeit his shares subject to the provision of the articles.**
- **Forfeiture of shares means compulsory termination of membership from the register of members.**
- **Note: Shares Forfeited A/c will appear on the liabilities side of Balance Sheet**

Accounting Treatment – Forfeiture of Shares issued at par

- The Entry is

Share Capital a/c Dr

To Forfeited Share a/c

To Calls A/c

(Being forfeiture of _____ shares for non-payment of ____ call)

Accounting Treatment – Forfeiture of Shares issued at Premium

- The Entry is

Share Capital a/c Dr

Share Premium a/c Dr

To Forfeited Share a/c

To Calls A/c

(Being forfeiture of _____ shares for non-payment of ____ call)

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Accounting Treatment – Forfeiture of Shares issued at Discount

- **The Entry is**

Share Capital a/c Dr

To Forfeited Share a/c

To Calls A/c

To Discount on issue of Shares a/c

(Being forfeiture of _____ shares for non-payment of ____ call)

Re-issue of Forfeited Shares

Forfeited shares may be re-issued by the company directors for any amount. The following entry is passed

Bank a/c Dr

To Forfeited Shares a/c

To Share Capital a/c

After re-issue of Forfeited shares, if there is any balance in forfeited shares account it should be transferred to **Capital Reserve a/c**. The following entry is passed

Forfeited Shares a/c Dr.

To Capital Reserve a/c

ISSUE AND REDEMPTION OF DEBENTRES

Introduction

The most usual form of borrowing by a company is by **Issue of Debentures**. Generally companies which need funds for their development and expansion for long periods, issue debentures to the public.

The amount to be raised by way of loan from the public is divided into small units called **"Debentures"**.

A debenture is nothing but the acknowledgement of the borrowing made by the company from the public.

Debenture is a certificate (written instrument) acknowledging a debt issued by the company under its common seal containing provisions regarding the payment of interest, repayment of principal sum, charge on the assets of the company, etc.

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Definition

Debentures has been defined under section 2(12) of the companies act as follows,

"Debenture includes debenture stock, bonds and any other securities of a company whether constituting a charge on the assets of the company or not".

Issue of Debentures

Debentures are issued similar to the issue of shares through prospectus. The company may collect the cost of debenture in one lump sum or in installments on application, allotment and calls.

Features of Debentures

- It is a debt taken by the company from public and financial institution.
- Debenture holders are entitled to receive interest at a fixed rate irrespective of profit.
- Debenture holders are entitled for repayment of the amount lent.
- Debenture holders don't have voting rights.
- Debenture holders have fixed or floating charge on the assets of the company.

Types of Debentures

Registered Debentures

- These debentures are <u>**registered in the books of the company**</u>.
- The names and addresses of these debenture holders are <u>**entered in a register**</u> kept by the company.
- Interest is payable to the registered members only.

Bearer Debentures

- The names and addresses of these debenture holders are <u>**not entered in a register**</u> kept by the company.
- Interest is payable to those persons who produces the coupons attached to such debentures.
- They are transfer by mere delivery.

Secured or Mortgage Debentures

- These debentures are issued <u>with a charge either fixed or floating on the assets</u> of the company.

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- If the company fails to pay these debenture holders, the principal and interest, the debentures holders have the right to sell the mortgaged property with them to recover their dues.

Simple or Unsecured Debentures

- These debentures are issued **without giving any security for repayment of capital or interest.**
- If the company fails to pay these debenture holders can sue the company for repayment.

Redeemable & Irredeemable Debentures

- Redeemable debentures are repayable at the end of a stipulated period mentioned in the bond.
- Irredeemable debentures will be repayable at the option of the company or at the time of liquidation of the company. Interest is paid regularly.

Convertible Debentures

- These debenture holders **are given an option to convert their debentures into Pref. Shares or Equity Shares** under certain conditions after a certain period.
- If they exercise the right of conversion they become members of the company.

Differences B/W Shares and Debentures

Shares	**Debentures**
A share is an indication of ownership. Shareholders are the owners of the company.	A debenture is borrowing made by the company. Debenture holders are creditors to the company.
Dividend is payable out of profits only.	Interest is to be paid irrespective of profits is earn or not.
Rate of dividend is variable.	Rate of interest is fixed.
Shareholder is entitled to vote	Debenture holder has no right of voting.
Shares are not redeemable during the existence of the Co.	Debentures can be redeemed after the stipulated period.
Shares are not covered by any charge on the assets of the company.	Debentures may have a fixed or floating charge on the assets of the company.
When a Company wound up, the right of shareholders rank only after the claims of the debenture holders and other creditors have been fully satisfied.	When a Company wound up, the debenture holders have prior claim on the assets of the company.

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Accounting Treatment for Issue of Debentures

Issue of Debentures at par

- When Debentures cost is payable on application

    Bank a/c Dr

    To Debentures a/c

- When Debentures cost is collected in installments
    - When application money is received

        Bank a/c Dr

        To Debentures Application a/c

    - When application money is transferred

        Debenture Application a/c Dr

        To Debentures a/c

- When Debentures are over subscribed and the amount received on application is refunded

    Debentures Application a/c Dr.

    To Bank a/c

- When Debentures issued are over subscribed and the amount received is adjusted to allotment

    Debenture Application a/c Dr

    To Debentures Allotment a/c

- When allotment money is due on Debentures

    Debenture Allotment a/c Dr

    To Debentures a/c

- When allotment money is received

    Bank a/c Dr.

    To Debenture Allotment a/c

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- When First Call money is due on Debentures

  Debenture First Call a/c Dr

  To Debentures a/c

- When First Call money is received

  Bank a/c Dr.

  To Debenture First call a/c

Note: Similarly entries are made for second and final calls. Each entries are made first for the amount due and then for the amount received

Issue of Debentures at premium

- When Debentures are issued at premium and repayable at par the following entry is passed

  Bank a/c Dr

  To Debentures a/c

  To Debentures Premium a/c.

Issue of Debentures at discount

- When Debentures are issued at discount and redeemable at par the following entry is passed

  Bank a/c Dr

  Loss on issue on debentures a/c Dr

  To Debentures a/c

Issue of Debentures

- When Debentures are issued at par and redeemable at premium the following entry is passed

  Bank a/c Dr

  Loss on issue on debentures a/c Dr

  To Debentures a/c

  To Premium on redemption of Debentures a/c.

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- When Debentures are issued at discount and redeemable at premium the following entry is passed

Bank a/c Dr

Loss on issue on debentures a/c Dr

To Debentures a/c

To Premium on redemption of Debentures a/c.

Redemption of Debentures

Debentures may be redeemed in the following ways:

<u>Redemption of debentures after fixed period:</u>

Under this method, the entire amount is paid to the debenture holders in Lump sum either **<u>out of capital or out of profits</u>**.

<u>Redemption out of profits:</u> The following entry is passed if there is no Sinking Fund:

P & L Appropriation a/c Dr

To Debenture Redemption Reserve a/c

Redemption by Purchase of Own Debentures in the open market

- A Co. may redeem its debentures prior to maturity by purchasing them in the stock exchange, when it funds that the market price is favourable to the Co.
- The Co's Act allows purchase of own debentures in the market.
- The purchase of such Debentures may be
  - For immediate cancellation or
  - May be kept as investment called "own Debentures".

The reason for canceling debentures before maturity date is to **save the Co. from making future interest payments.** Generally, this is done when the interest rate on the debentures in considerably higher than the current market interest rate

When Debentures are purchased immediately after the payment of Interest.

Debentures A/c Dr.

To Bank A/c

To Profit on Redm. Of Deb. A/c

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When Debentures are purchased to be kept as Investment

Own Debentures A/c. Dr

To Bank A/c

Interest on Own Debentures: The portion of Interest on own debentures will be credited to Interest on Own Debentures A/c.

Debentures Interest A/c Dr.

To Bank A/c

To Interest on Own Debentures A/c

Debentures Purchased on a date other than the date of Interest

- Ex-Interest & Cum-Interest:
- The terms "Cum-Interest" and "Ex-Interest" relate to the purchase and sale of debentures.
- "Cum-Interest" can be expanded as inclusive of interest.
- "Ex-Interest" can be expanded as exclusive of interest.

Redemption by Conversion

- The Company may convert the debentures into Equity Shares or Pref. Shares or New class of Debentures after a stipulated period at the option of the debenture holders. The following entries will be passed at the time of Conversion.

1. Debentures (Old) A/c Dr.

   Premium on Redemption of Deb A/c

   To Debenture holders. A/c

2. Debenture holders. A/c Dr.

   Discount on Issue of Share/Deb A/c Dr.

   To (New) Share/Deb A/c

3. Debenture holders. A/c Dr.

   To (New) Share/Deb A/c

   To Premium on Issue of Share/Deb A/c

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Underwriting of Shares and Debentures

- In case of Public Limited Companies the minimum subscription must be received in order to get certificate of commencement of business.
- Companies in order to ensure minimum subscription, resort to underwriting.
- Underwriting is an agreement whereby the underwriters (persons or institutions) ensure the company that in case the shares and debentures offered to the public, are not subscribed by the public to the extent, the balance of shares and debentures will be taken up by the underwriters. For ensuring this, underwriters charge an agreed commission.

Types of Underwriting

- <u>Complete Underwriting:</u> Underwriting of all issue of shares and debentures.
- <u>Partial Underwriting:</u> If part of the issue of shares and debentures is underwritten.
- <u>Firm Underwriting:</u> When an underwriter agrees to buy a definite no. of shares or debentures in addition to that of underwriting agreement

Marked or Unmarked Applications

- Shares or Debentures issued by a company are usually underwritten by two or more firms of underwriters in an agreed ratio.
- Generally the forms are stamped with the name of the underwriters to distinguish the forms of one underwriter from that of others.
- Such stamped applications when received are known as **<u>marked applications</u>**.
- The application forms received without any name of the underwriter are called as **<u>unmarked applications</u>**.
- In case of the whole issue is <u>underwritten by more than one underwriter</u>, the unmarked applications are divided among the various underwriters in <u>the ratio</u> of the gross liability for underwriting.

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