CHAPTER 10

Company Accounts

UNIT - 1 INTRODUCTION TO COMPANY ACCOUNTS

1.1 INTRODUCTION

The **unceasing human aspiration** for continual growth has **led to** the rapid **increase in the number of businesses. Consequently**, there **arises a demand to increase operational scales** in order to meet the escalating **requirements** of an expanding **consumer base. This expansion necessitates substantial res**ources such as

(a) financial investments,

(b) advanced technology, and

(c) extensive human involvement.

Accommodating these requirements proves **challenging under proprietorship** or **partnership** structures as **the amount** of **funds needed cannot be met by 1** or **50 people .**

In response to this challenge, the idea of a 'Company' or 'Corporation' emerged.

Simultaneously, the **necessity to distinguish management** from **ownership** led to the establishment of an organizational form now recognized as the 'Company.'

The **organizational structure known as the company** is a remarkable product of human ingenuity, **facilitating businesses in conducting wealth creation activities through the efficient utilization of resources.** Over time, the company structure has evolved into a significant institutional form for business enterprises, establishing a prominent role in both business operations and the wealth-generating functions of society.

1.2 MEANING OF COMPANY

The term 'Company,' in everyday usage, commonly refers to a gathering of individuals for social, companionship, or fellowship purposes. In an organizational context, **'company' signifies a collective of individuals who voluntarily agree to establish a company.**

The term **'company'** has its roots in the Latin words 'com,' meaning with or together, and 'pany,' meaning bread.

Originally, it denoted an association of individuals or merchants discussing matters and sharing meals.

According to this legal definition, a company is formed when a group of individuals agrees to establish it under the law. Once formed, it becomes a distinct legal entity with perpetual succession, its own unique name, and a common seal. Its existence remains unaffected by changes in its membership.

The concept of a company, rooted in law, denotes an organization comprising individuals, known as shareholders by virtue of holding company shares. These shareholders are legally authorized to elect a board of directors, allowing the company to function as a separate legal entity. Typically, a company's capital is represented by transferable shares, and its members have limited liabilities.

1.3 SALIENT FEATURES OF A COMPANY

Here are the distinctive features of a company

1. **Incorporated Association:** A company is brought into existence through legal processes, requiring registration under the Companies Act. Without such registration, a company cannot be formed. As a creation of law, it is considered an artificial legal entity.
2. **Separate Legal Entity:** A company possesses a distinct legal identity and remains unaffected by changes in its membership. As a separate business entity, it can enter into contracts, initiate legal actions, and be subject to legal actions in its registered name and capacity.
3. **Perpetual Existence:** Due to its independent existence from its members, a company continues to exist despite changes in membership, including deaths, insolvencies, or other alterations.
4. Common Seal: As a non-natural entity, a company cannot sign documents in the manner of a natural person. To address this, a legal instrument known as the 'Common Seal' is provided. Originally, the Companies Act, 2013 mandated the use of the common seal on certain documents (e.g., bills of exchange, share certificates). However, recent changes have made the use of the common seal optional. Documents that previously required the common seal can now be signed by two directors or one director and a company secretary. Additionally, every registered company in India is required to obtain a unique Corporate Identification Number (CIN) assigned by the Registrar of Companies.
5. Limited Liability: The responsibility of each shareholder in a company is confined to the agreed-upon amount payable on the shares allocated to them. When shares are fully paid-up, shareholders bear no further liability.
6. **Distinction between Ownership and Management:** Due to the extensive number of shareholders, often spread across different locations, managing the day-to-day operations becomes challenging. This necessitates the separation of ownership and management.
7. **Not a Citizen:** Despite being created by legal processes, a company does not hold citizenship rights and duties comparable to those enjoyed by natural persons. It exists legally but lacks the citizenship attributes of individuals.
8. **Transferability of Shares:** Shareholders contribute capital through share subscriptions, and these shares are generally transferable, with the exception of certain restrictions imposed on transferability in the case of a private limited company.
9. **Maintenance of Books:** Legal requirements mandate a limited company to maintain a specific set of accounting books. Failure to comply with this obligation results in penalties.

10. **Periodic Audit:** A company is obligated to undergo periodic audits conducted by chartered accountants appointed for this purpose by shareholders upon the recommendation of the board of directors.

11. **Right of Access to Information:** Shareholders have the right to inspect the company's account books, as governed by the Articles of Association. This right extends to participating in company meetings and accessing periodic reports to obtain information from the directors.

1.4 TYPES OF COMPANIES

1. Government Company

As per the definition provided in Section 2(45) of the Companies Act, 2013, a "Government company" is defined as a company wherein at least fifty-one percent of the paid-up share capital is owned by either the Central Government (CG) or a State Government (SG), or multiple State Governments (SG), or in a combination of the Central Government (CG) and one or more State Governments(SG). This definition includes a company that functions as a subsidiary of such a Government company.

2. Foreign Company

As outlined in Section 2 (42) of the Companies Act, 2013, a "Foreign company" is defined as any company or body corporate incorporated outside India that meets the following criteria:

(a) Possesses a place of business in India, either directly or through an agent, whether physically or via electronic means; and

(b) Engages in any business activity in India through any other method.

3. Private Company

In accordance with Section 2(68) of the Companies Act, 2013, a 'Private company' is delineated as a company whose articles:

(a) Impose limitations on the right to transfer its shares;

(b) Set a restriction on the number of its members limited to 200, with the exception of a One Person Company (OPC),.

(c) Prohibits any public invitation for the subscription of the company's securities. Additionally, shares of a Private Company are not publicly listed on the Stock Exchange.

> **Note: w.r.t to Point No. ii**
>
> that in cases where two or more individuals jointly hold shares in a company, they are considered a single member for the purposes of this provision.

Furthermore, it is stipulated that:

(i) Individuals currently employed by the company; and

(ii) Individuals who, having been previously employed by the company, were members of the company during their employment and have continued as members after their employment ceased, are not to be counted in the total number of members;

4. Public Company

Section 2(71) of the Companies Act, 2013 defines a Public Company as a company that:

(a) which is not a private company; and

(b) Possesses a minimum paid-up share capital as stipulated by regulations.

However, it is important to note that a company, which is a subsidiary of a public company company, is considered a public company under this Act, even if the subsidiary continues to be classified as a private company in its articles.

A company classified as a listed public company, if it becomes unlisted, will still be considered a public company.

Note wrt to point (b)

The Companies Act, 2013 has eliminated the previous minimum paid-up share capital requirements of INR 1,00,000 (for private companies) and INR 5,00,000 (for public companies). Consequently, there are no longer minimum paid-up capital prerequisites for the incorporation of both private and public companies in India.

5. One Person Company

According to Section 2(62) of the Companies Act, 2013, a "One Person Company" is characterized as a company that comprises only one individual as a member.

6. Small Company

As per Section 2(85) of the Companies Act, 2013, a "Small company" is defined as a company, excluding a public company, meeting the following criteria:

(A) The paid-up share capital does not surpass four crore rupees (4Cr.) or the prescribed higher amount, not exceeding ten crore rupees (10 Cr.).

(B) The turnover, based on the last profit and loss account for the immediately preceding financial year, does not exceed forty crore (40 Cr.) rupees or the prescribed higher amount, not surpassing hundred crore rupees (100 Cr.).

However, the provisions of this clause do not apply to:

(i) A holding company or a subsidiary company.

(ii) A company registered under section 8.

(iii) A company or body corporate governed by any special Act.

7. Listed Company

In accordance with Section 2(52) of the Companies Act, 2013, a "listed company" is defined as a company that has its securities listed on any recognized stock exchange.

Conversely, a company whose shares are not listed on any recognized stock exchange is referred to as an "Unlisted Company."

It's important to note that an unlisted company can fall into either the category of a public company or a private company.

8. Unlimited Company

As per Section 2(92) of the Companies Act, 2013, an "Unlimited company" is characterized as a company where there is no restriction on the liability of its members.

9. Company limited by Shares

According to Section 2(22) of the Companies Act, 2013, a "Company limited by shares" is described as a company wherein the liability of its members is restricted by the memorandum to the amount, if any, unpaid on the shares they hold.

10. Company limited by Guarantee

As outlined in Section 2(21) of the Companies Act, 2013, a "company limited by guarantee" is defined as a company where the liability of its members is restricted by the memorandum to the amount that the members individually commit to contributing to the company's assets in the event of its winding up.

11. Holding Company

As per Section 2(46) of the Companies Act, 2013, the term "Holding company," controlling one or more other companies, refers to a company of which those companies are considered subsidiary companies.

12. Subsidiary Company

According to Section 2(87) of the Companies Act, 2013, a "subsidiary company" is defined as a company where the holding company:

(i) Governs the composition of the BOD; or

(ii) Exercises or controls more than half of the total share capital either on its own or collectively with one or more of its subsidiary companies.

A company is considered a subsidiary of the holding company even if there is indirect control through subsidiary companies.

The control over the composition of the subsidiary company's Board of Directors implies the exercise of authority to appoint or remove all or a majority of the directors of the subsidiary company.

1.5 MAINTENANCE OF BOOKS OF ACCOUNT

As outlined in Section 128 of the Companies Act, 2013, each company is required to create and maintain, at its registered office, books of account, along with other pertinent books, papers, and financial statements for every financial year. These records must present an accurate and comprehensive depiction of the company's state of affairs, including any branch office(s), elucidating transactions conducted both at the registered office and its branches. The accounting entries in these books should adhere to the accrual basis and be in accordance with the double-entry system.

Additionally, the company is permitted, as specified further, to maintain these books of account or relevant papers in electronic format, following the prescribed manner.

1.6 PREPARATION OF FINANCIAL STATEMENTS

As per Section 129 of the Companies Act, 2013, the financial statements are required to present an accurate and comprehensive depiction of the company's state of affairs. They must comply with the notified accounting standards and be presented in the format as prescribed in Schedule III, which may vary for different classes of companies. It is the responsibility of the Board of Directors to present these financial statements at each annual general meeting of the company.

In accordance with Section 2(40) of the Companies Act, 2013, Financial Statements includes various components, including but not limited to:

i. A balance sheet reflecting the financial position at the end of the financial year;

ii. A statement of profit and loss ,or in the case of a company engaged in non-profit activities, an income and expenditure account for the financial year;

iii. A cash flow statement (CFS) for the financial year;

iv. A statement of changes in equity, where applicable; and

v. Notes to A/c forming part of any document mentioned in sub-clauses (i) to (iv).

> **Note:** FST for a One Person Company (OPC), small company, and dormant company may, under the provided condition, exclude the cash flow statement.

REQUISITES OF FINANCIAL STATEMENTS

It is required to present an accurate and comprehensive depiction of the company's state of affairs as of the conclusion of the financial year.

1. Provisions Applicable

Specific class of company such as –

(a) Insurance companies

(b) Banking companies

(c) Companies involved in the generation or supply of electricity

(d) Any other class of company prescribed

The above mentioned company shall follow prescribed Form of balance sheet or Profit and loss account is mandated under the relevant Act governing them.

(2) For all other companies:

The Balance Sheet should adhere to the format outlined in Part I of Schedule III, and the Statement of Profit and Loss should follow the guidelines set out in Part II of Schedule III.

COMPLIANCE WITH ACCOUNTING STANDARDS

In accordance with Section 129 of the Companies Act, adherence to the accounting standards notified by the Central Government on a periodic basis is obligatory.

Schedule III of the Companies Act, 2013

According to Section 129 of the Companies Act, 2013, it is required that financial statements provide an accurate and comprehensive depiction of the state of affairs of the company or companies. They must also adhere to the accounting standards notified under Section 133 and be presented in the form or forms as specified for different classes of companies in Division I of Schedule III under the Act.

PART I – FORMAT OF BALANCE SHEET

Name of the Company........................

Balance Sheet as at..........................

Particulars			Notes No.	Figures as at end of the current reporting period	Figures as at end of the previous reporting period
	EQUITY AND LIABILITIES				
1.	Shareholders' funds				
	a.	Share capital (A)		xxx	xxx
	b.	Reserves and Surplus (B)		xxx	xxx
	c.	Money received against share warrants		xxx	xxx
2.	Share application money pending allotment			xxx	xxx
3.	Non-current liabilities				
	a.	Long-term borrowings (C)		xxx	xxx
	b.	Deferred tax liabilities (Net)		xxx	xxx
	c.	Other long term liabilities		xxx	xxx
	d.	Long-term provisions (D)		xxx	xxx
4.	Current liabilities				
	a.	Short-term borrowings (E)		xxx	xxx
	b.	Trade Payables total outstanding dues of micro enterprises and small enterprises; and total outstanding dues of creditors other than micro enterprises and small enterprises.]		xxx xxx	xxx xxx
	c.	Other current liabilities (F)		xxx	xxx
	d.	Short-term provisions		xxx	xxx
	Total			xxx	xxx

	ASSETS					
1.	Non-current assets					
	a.	i.	Property, Plant and Equipment		xxx	xxx
		ii.	Intangible assets (H)		xxx	xxx
		iii.	Capital Work-in-progress		xxx	xxx
		iv.	Intangible assets under development		xxx	xxx
	b.	Non-current investments (I)			xxx	xxx
	c.	Deferred tax assets (Net)			xxx	xxx
	d.	Long-term loans and advances (J)			xxx	xxx
	e.	Other non-current assets			xxx	xxx
2.	Current assets					
	a.	Current investments (K)			xxx	xxx
	b.	Inventories (L)			xxx	xxx
	c.	Trade receivables			xxx	xxx
	d.	Cash and cash equivalents (M)			xxx	xxx
	e.	Short-term loans and advances			xxx	xxx
	f.	Other current assets			xxx	xxx
	Total				xxx	xxx

Some items are to be clarified as follows (the list is not exhaustive):

A. SHARE CAPITAL

For every category of share capital, the following considerations should be taken into account:

- **i.** The authorized number and amount of shares.
- **ii.** The number of shares that are issued, subscribed, and fully paid, as well as those issued, subscribed but not fully paid.
- **iii.** The par value per share.
- **iv.** Reconciliation of shares outstanding at the beginning and end of the reporting period.
- **v.** Unpaid calls.
- **vi.** Forfeited shares.

B. RESERVES AND SURPLUS

Reserves and surplus may be allocated among the subsequent sub-headings:

- **i.** Capital reserves
- **ii.** Capital redemption reserves
- **iii.** Securities Premium
- **iv.** Debenture Redemption reserve

v. Revaluation reserve
vi. Surplus; the balance as per profit and loss statement
vii. Other reserves (specify the nature and purpose)

C. LONG TERM BORROWINGS

Long-term borrowings can be categorized within the subsequent sub-headings::

i. Bonds/Debentures
ii. Term loans
iii. Deferred payment liabilities
iv. Deposits
v. Long term maturities of finance lease obligations
vi. Loans and advances from related parties
vii. Other loans and advances (specify nature)

D. LONG TERM PROVISIONS

This can be categorized as follows:

i. Provisions for employee benefits such as gratuity, provident fund, etc.
ii. Other provisions (please specify the nature).

E. SHORT TERM BORROWINGS

Short-term borrowings can be categorized within the subsequent sub-headings::

i. Loans repayable on demand
ii. Loans and advances from related parties
iii. Deposits
iv. Other loans and advances (specify the nature)

F. OTHER CURRENT LIABILITIES

Some of the additional current liabilities can be organized as follows::

i. Interest accrued but not/and due on borrowings
ii. Income received in advance
iii. Unpaid dividends
iv. Application money received for allotment of securities and due for refund and interest accrued thereon
v. Other current liabilities (specify the nature)

G. PROPERTY, PLANT AND EQUIPMENT

Property, Plant and Equipment can be categorized in the following manner :

i. Land
ii. Buildings
iii. Plant and Equipment

iv. Furniture and Fixtures
v. Vehicles
vi Office equipment
vii. Others (specify the nature)

A comprehensive report detailing additions, disposals, acquisitions through business combinations, and other adjustments, along with amounts related to depreciation, impairment losses, revaluation, etc., must be furnished for each category of asset.

H. INTANGIBLE ASSETS

Intangible assets can be categorized as follows:

i. Goodwill
ii. Brands/trademarks
iii. Computer software
iv. Mining rights
v. Publishing titles
vi. Copyrights, patents and other intellectual property rights, services and operating rights.
vii. Licence and franchise
viii. Recipes, models, designs, formulae and prototypes
ix. Others (specify the nature)

An in-depth report illustrating additions, disposals, acquisitions through business combinations, and other adjustments, along with amounts associated with depreciation, impairment losses, revaluation, etc., is required for each category of asset.

I. NON-CURRENT INVESTMENTS

Investments can be categorized as under:

i. Investments in property
ii. Investments in equity instruments
iii. Investments in preference shares
iv. Investments in governments or trust securities
v. Investments in debentures or bonds
vi. Investments in mutual funds
vii. Investments in partnership firms
viii. Other non-current investments (specify the nature)

J. LONG TERM LOANS AND ADVANCES

It may be categorized within the subsequent sub-groups::

i. Capital advances
ii. Security deposits

iii. Loans and advances to related parties
iv. Other loans and advances (specify nature) \

The aforementioned shall also be further classified as follows:

i. Secured, considered goods
ii. Unsecured, considered goods
iii. Doubtful

K. CURRENT INVESTMENTS

It may be categorized as follows:

i. Investments in equity instruments
ii. Investments in preference shares
iii. Investments in government or trust securities
iv. Investments in bonds or debentures
v. Investments in mutual funds
vi. Investments in partnership firms
vii. Other investments (specify the nature)

L. INVENTORIES

Inventories may be categorized as follows:

i. Raw materials
ii. Work-in-progress
iii. Stores and spares
iv. Finished goods
v. Loose tools
vi. Stock in trade
vii. Goods in transit
viii. Others (specify the nature)

L. CASH AND CASH EQUIVALENTS

The following head may be categorized as follows :

i. Balances with banks
ii. Cheques, drafts in hand
iii. Cash in hand
iv. Others (specify the nature)

PART II – FORMAT OF STATEMENT OF PROFIT AND LOSS

Name of the Company........................

Profit and Loss Statement for the year ended .... (`in...)

Particulars		Note No.	Figures for the current reporting period		Figures for the previous reporting period	
I.	Revenue from operations			xxx		xxx
II.	Other income			xxx		xxx
III.	Total Revenue (I + II)			xx		xx
IV.	Expenses: Cost of materials consumed Purchases of Stock-in-Trade Changes in inventories of finished goods, Work-in-Progress and Stock-in-Trade Employee benefits expense Finance costs Depreciation and amortization expense Other expenses			x xx x xx x xx x xxx xx x xx x xx x xxx		x xx x xx x xx x xxx xx x xx x xx x xxx
Total expenses				xxx		xxx
V.	Profit before exceptional and extraordinary items and tax (III-IV)		xx	xxx	xx	xxx
VI.	Exceptional items		x		x	
VII.	Profit before extraordinary items and tax (V-VI)		xx	xxx	xx	xx
VIII.	Extraordinary Items			xxx		xx
IX.	Profit before tax (VII-VIII)			xxx		x xxx
X.	Tax expense: 1. Current tax 2. Deferred tax			xxx		xxx

Xi.	Profit (Loss) for the period from continuing operations (VII-VIII)			xxx		xxx
XII.	Profit/(Loss) from discontinuing operations			xxx xxx		xxx xx x
XIII.	Tax expense of discontinuing operations			xxx		xx x
XIV.	Profit/(Loss) from discontinuing operations (after tax) (XII-XIII)			xxx		xx
XV.	Profit (Loss) for the period (XI + XIV)			xxx		x
XVI.	Earnings per equity share: (1) Basic (2) Diluted			xxx xxx		xx x xx x xx x

TEST YOUR KNOWLEDGE

True and FalseO

1. Every public company is a listed company. (ICAI Study Material)

Sol. False .Listed companies are those that have their shares listed on a stock exchange, making them accessible to the general public. While every listed company is considered a public company, it's important to note that not every public company is necessarily listed.

2. Shares of a private company are not listed on the stock exchange. (ICAI Study Material)

Sol. True . Shares of a company become listed on the stock exchange only if it is a public company. Therefore, every listed company is, by definition, a public company.

3. It is not mandatory to incorporate a company under the companies act. (ICAI Study Material)

Sol. False . Under the Companies Act, it is obligatory to formally establish a company through incorporation. Without undergoing this process, a company cannot be brought into existence.

4. Company is an artificial, legal person created by law. (ICAI Study Material)

Sol True . A company is brought into existence through the legal process and is recognized as a distinct entity separate from its members.

5. Death, insolvency or change of members affects the existence of a company. (ICAI Study Material)

Sol. False .A company is an independent legal entity established by law, and its existence remains unaffected by factors such as death, insolvency, or changes in membership.

6. If the shares are fully paid-up by the shareholder, he is subject to no further liability. (ICAI Study Material)

Sol.True. The liability of shareholders is confined to the extent of the unpaid share capital. Therefore, if the shares are fully paid-up, the shareholder incurs no additional liability.

7. Public limited companies have restrictions on transferability of shares. (ICAI Study Material)

Sol. False . Shares of a public company can be freely transferred, while in a private limited company, there are restrictions on the transferability of shares.

8. Financial statements of a company show the financial position of the business. (ICAI Study Material)

Sol. True. The financial statements provide an accurate and comprehensive depiction of the company's state of affairs. These financial statements encompass items such as the profit and loss account, balance sheet, and other relevant components.

9. Schedule I gives proforma of Balance Sheet. (ICAI Study Material)

Sol. False . Part I of Schedule III delineates the proforma of the Balance Sheet.

10. Schedule III prescribes the format of Directors' Report . (ICAI Study Material)

Sol. False . Part I of Schedule III details the proforma of the Balance Sheet and Profit and Loss.

11. Financial statements need to be true and correct as per Companies Act. (ICAI Study Material)

Sol. False . According to Section 128, each company is required to prepare financial statements for every financial year that provide an accurate and comprehensive representation of the company's state of affairs.

MULTIPLE CHOICE QUESTIONS

1. Which of the following statement is not a feature of a Company? (ICAI Study Material)
   (a) Separate legal entity
   (b) Perpetual Existence
   (c) Members have unlimited liability
   (d) All of the above

Sol. (c) Members have unlimited liability

2. In a Government Company, the holding of the Central Government in paid-up capital should not be less than – (ICAI Study Material)
   (a) 25% (b) 50 %
   (c) 51% (d) 100%

Sol. (c) 51%

3. *Which of the following statements is true in case of a Foreign Company? (ICAI Study Material)*
   (a) A Company incorporated in India and has place of business outside India.
   (b) A Company incorporated outside India and has a place of business in India.
   (c) A Company incorporated in India and has a place of business in India.
   (d) None of the Above

Sol. *(b) A Company incorporated outside India and has a place of business in India.*

4. *Which of the following statements is not a feature of a private company? (ICAI Study Material)*
   (a) Restricts the rights of members to transfer its shares.
   (b) Does not restrict the number of its members to any limit.
   (c) Does not involve participation of the public in general.
   (d) None of the Above

Sol. *(b) Does not restrict the number of its members to any limit.*

5. Under Schedule III of *the Companies Act, assets and liabilities* are to be disclosed based on: *(ICAI Study Material)*
   (a) Current/ non-current.
   (b) Financial /non-financial.
   (c) Owned /not-owned.
   (d) All of the Above

Sol. *(a) Current/ non-current.*

6. *Schedule III of the Companies Act prescribes the format and content of : (ICAI Study Material)*
   (a) Balance sheet and statement of profit and loss
   (b) Auditors' report.
   (c) Directors' report.
   (d) None of the Above

Sol. *(a) Balance sheet and statement of profit and loss*

7. *A company is required to maintain its books of accounts at : (ICAI Study Material)*
   (a) its registered office.
   (b) its largest branch office.
   (c) Managing Director's residence.
   (d) All of the above

Sol. *(a) its registered office.*

8. *Cash flow statements are not required for: (ICAI Study Material)*
   (a) Private company.
   (b) One person company.
   (c) Public company.
   (d) All of the Above

Sol. *(b) One person company.*

9. The presentation and disclosure requirements of a company are prescribed by : (ICAI Study Material)
   (a) Schedule III. (b) Schedule II.
   (c) Schedule I. (d) None of the Above

Sol. (a) Schedule III.

10. Following is an example of current assets: (ICAI Study Material)
   (a) Inventories.
   (b) Property, Plant & Equipment.
   (c) Intangible Assets.
   (d) All of the Above

Sol. (a) Inventories.

11. Earnings per share (EPS) is to be disclosed in which of the following sections of the financial statements ? (ICAI Study Material)
   (a) Balance Sheet.
   (b) Statement of Profit and Loss.
   (c) Cash Flow Statements.
   (d) All of the above

Sol. (b) Statement of Profit and Loss.

12. Following is NOT an example of a company under Companies Act, 2013 : (ICAI Study Material)
   (a) Small company.
   (b) Private company.
   (c) Large company.
   (d) All of the Above

Sol. (c) Large company.

THEORY QUESTIONS

1. Explain salient features of a company in brief. (ICAI Study Material)

Sol. Here are the distinctive features of a company:

Incorporated Association: A company is brought into existence through legal processes, requiring registration under the Companies Act. Without such registration, a company cannot be formed. As a creation of law, it is considered an artificial legal entity.

Separate Legal Entity: A company possesses a distinct legal identity and remains unaffected by changes in its membership. As a separate business entity, it can enter into contracts, initiate legal actions, and be subject to legal actions in its registered name and capacity.

Perpetual Existence: Due to its independent existence from its members, a company continues to exist despite changes in membership, including deaths, insolvencies, or other alterations.

Common Seal: As a non-natural entity, a company cannot sign documents in the manner of a natural person. To address this, a legal instrument known as the 'Common Seal' is provided. Originally, the Companies Act, 2013 mandated the use of the common seal on certain documents (e.g., bills of exchange, share certificates). However, recent changes have made the use of the common seal optional. Documents that previously required the common seal can now be signed by two directors or one director and a company secretary. Additionally, every registered company in India is required to obtain a unique Corporate Identification Number (CIN) assigned by the Registrar of Companies.

Limited Liability: The responsibility of each shareholder in a company is confined to the agreed-upon amount payable on the shares allocated to them. When shares are fully paid-up, shareholders bear no further liability.

Distinction between Ownership and Management: Due to the extensive number of shareholders, often spread across different locations, managing the day-to-day operations becomes challenging. This necessitates the separation of ownership and management.

Not a Citizen: Despite being created by legal processes, a company does not hold citizenship rights and duties comparable to those enjoyed by natural persons. It exists legally but lacks the citizenship attributes of individuals.

Transferability of Shares: Shareholders contribute capital through share subscriptions, and these shares are generally transferable, with the exception of certain restrictions imposed on transferability in the case of a private limited company.

Maintenance of Books: Legal requirements mandate a limited company to maintain a specific set of accounting books. Failure to comply with this obligation results in penalties.

Periodic Audit: A company is obligated to undergo periodic audits conducted by chartered accountants appointed for this purpose by shareholders upon the recommendation of the board of directors.

Right of Access to Information: Shareholders have the right to inspect the company's account books, as governed by the Articles of Association. This right extends to participating in company meetings and accessing periodic reports to obtain information from the directors.

2. Write short note on:

(i) Foreign company.

(ii) Small company.

(iii) Company limited by guarantee. (ICAI Study Material)

Sol. *(i)* Foreign Company

As outlined in Section 2 (42) of the Companies Act, 2013, a "Foreign company" is defined as any company or body corporate incorporated outside India that meets the following criteria:

(a) Possesses a place of business in India, either directly or through an agent, whether physically or via electronic means; and

(b) Engages in any business activity in India through any other method.

(ii) Small Company

As per Section 2(85) of the Companies Act, 2013, a "Small company" is defined as a company, excluding a public company, meeting the following criteria:

(i) The paid-up share capital does not surpass four crore rupees or the prescribed higher amount, not exceeding ten crore rupees.

(ii) The turnover, based on the last profit and loss account for the immediately preceding financial year, does not exceed forty crore rupees or the prescribed higher amount, not surpassing hundred crore rupees.

However, the provisions of this clause do not apply to:

(A) A holding company or a subsidiary company.

(B) A company registered under section 8.

(C) A company or body corporate governed by any special Act.

(iii) Company limited by Guarantee

As outlined in Section 2(21) of the Companies Act, 2013, a "company limited by guarantee" is defined as a company where the liability of its members is restricted by the memorandum to the amount that the members individually commit to contributing to the company's assets in the event of its winding up.

CHAPTER

00

Issue, Forfeiture and Reissue of Shares Updated

INTRODUCTION

Funds injected by the owner(s) into a **business** are **known as capital**.

In a **sole proprietorship business**, the **proprietor contributes capital**. **In** contrast, in a **partnership** where there are multiple proprietors known as partners, the **partners infuse capital into** the **firm**.

Given that the number of **members in a partnership is limited**, the **capital** available is **also restricted** in such business forms. **Additionally**, the **liability** of the **proprietor / partner** is **unlimited (exception LLP)**

Capital funding process for different types of business forms can be summarised as follows:

Business Organisation	Ownership	Type of Capital	Liability of Owners
Sole - Proprietorship	Proprietor - He alone is the owner of business	Capital	Unlimited
Partnership	Partners	Partners' Capital	Unlimited
Company	Shareholders	Share Capital	Limited to issue price of shares held

Non-corporate entities **(Sole-Proprietorship / Partnership) found it challenging to manage the intensified capital requirements and high risk levels of business. Consequently**, this **gave rise to the adoption of the corporate form of organization known as company**.

SHARE CAPITAL

The **company's** entire **capital** is **divided into numerous small units, each of a predetermined amount, referred to as shares**.

The **printed value on** the **share certificate, known as nominal/par/face value**, represents the fixed value of a share. It is **important to note** that a **company** has the **option to offer shares at a price distinct from the face value** .

The **liability of shareholders**, who are the holders of shares, is **confined to** the **acquisition price** of the shares they own.

How are shares priced in an IPO..???

The issue price is not mandated to align with the market price of the share. In contemporary practices, **shares are commonly priced using the book-building process**.

In this method, the **company establishes a price range for its shares**, and the **issue price is ultimately determined based on bids received from** prospective **investors within this price band.**

(Book building is a process by which a company establishes its share prices.)

The **company's capital is distributed into shares, collectively known as 'Share Capital.' During** the issue of shares, it is **mandatory for every company to comply with SEBI Regulations**.

The share capital of a company is categorized as follows:

(**i) Authorized Share Capital or Nominal Capital:** This represents the **maximum capital requirements estimated by a company**, specified in the 'Capital Clause' of the 'Memorandum of Association' registered with the Registrar of Companies. **It imposes a limit on the amount of capital** authorized **to be raised during the company's lifetime**, known as 'Authorized Capital.' It is presented in the Share Capital schedule in the financial statements following the prescribed format at face value.

(ii) Issued Share Capital: A company is not obligated to issue its entire authorized capital. The **portion of the share capital actually issued out of Authorized** by the company is termed 'Issued Capital.' Issued capital encompasses the nominal value of shares issued for cash and consideration other than cash to promoters and others. It is also **presented in the balance sheet at nominal value**.

The **remaining portion of the authorized capital** that is not issued, either in cash or consideration, may be termed as **'Unissued Capital.'** This is **not disclosed in the balance sheet**.

(iii) Subscribed Share Capital: This is the **part of the issued** share capital **subscribed by the public**, i.e., applied by the public **and allotted by the company**. It also includes the face value of shares issued by the company for consideration other than cash.

(iv) Called-up Share Capital: Companies usually receive the issue price of shares in installments. The **portion of the issue price** of shares that a company has **demanded or called from shareholders** is **known as 'Called-up Capital,'** and the **balance**, which the company has decided to demand in the future, may be referred to as **Uncalled Capital**.

(v) Paid-up Share Capital: This is the **portion of called-up capital paid by the shareholders**. Installments in arrears refer to the amount not paid, although it has been demanded by the company as payment towards the issue price of shares. To calculate paid-up capital, the amount of installments in arrears is deducted from called-up capital. Call-in-advance is the portion of capital yet to be called by the company but has already been paid by the shareholder. In the financial statements, called-up and paid-up capital are shown together.

(vi) Reserve Share Capital: According to **Section 65 of the Companies Act, 2013, a company may decide,** through a reSol., that a certain **portion of its subscribed uncalled capital shall not be called up except in the event of winding up** of the company. **This portion** of the uncalled capital, which a company has decided to call only in the case of liquidation, is **termed Reserve Capital**.

Reserve Capital is distinct from Capital Reserve, as **Capital reserves are part of 'Reserves and Surplus'** and refer to those reserves **not available for the declaration of dividends**.

Reserve Capital, on the other hand, is a portion of the **uncalled capital to be called up only in the event of the company's winding up**, and it differs in nature from Capital Reserve, which is created out of capital profits only.

TYPES OF SHARES

Shares issued by a company can be categorized as follows:

- **Preference Shares:** As per Section 43 of the Companies Act, 2013, individuals holding preference shares, known as preference shareholders –
- **are guaranteed a preferential dividend at a fixed rate throughout the company's existence**.
- They **also hold** a **preferential right over equity shareholders to receive payment first in the event of the company's winding up.**

Typically, holders of these shares **do not have voting rights**.

Companies opt for this **financing method as it is more cost-effective than raising debt**. The dividend is usually cumulative and may not be paid every year in the case of a deficiency in profits.

Preference shares are typically Redeemable, Cumulative, Non-Convertible and Non-Participating unless expressly stated otherwise.

Types of Preference Shares

Preference shares can assume various types, including:

(a) **Cumulative Preference Shares:** These shares entitle the holder to a **fixed dividend or a dividend at a fixed rate**.

If the current year's profits are insufficient, then unpaid dividend accumulates, and if **arrears exist for** a **continuous two years, holders gain the right to participate and vote on reSol.s** in general body meetings.

(b) **Non-cumulative Preference Shares:** These shares grant the right to a fixed dividend, but if no dividend is declared in a year, the right to receive it expires.

(c) **Participating Preference Shares:** Despite having a fixed dividend, **these shares allow the holder to participate in surplus profits after equity** shareholders **are paid a stipulated rate** of dividend. They also confer a predetermined proportion of surplus in the event of the company's winding up.

(d) **Non-participating Preference Shares:** These shares only receive a fixed rate of dividend without additional rights in profits or surplus on winding-up, unless otherwise specified.

(e) **Redeemable Preference Shares:** These shares are issued with the condition that the company will **repay them after a fixed period or earlier** at the company's discretion, governed by Section 55 of the Companies Act, 2013.

(f) **Non-redeemable Preference Shares:** Preference shares without a redemption arrangement are termed Non-redeemable Preference Shares. **Section 55 prohibits companies from**

issuing irredeemable preference shares or preference shares redeemable after 20 years, except for specified **infrastructure projects.**

(g) **Convertible Preference Shares:** These shares **give the holder the option to convert them into equity** shares according to the terms and conditions of their issue.

(h) **Non-convertible Preference Shares:** Shares **without the right to convert into equity** shares are termed Non-convertible Preference Shares.

- **Equity Shares:** Equity shares refer to those **shares that are distinct from preference shares, lacking preferential rights in terms of dividend payment or capital repayment**.

The **dividend rate** on equity shares is **determined by the Board** of Directors and is subject to change based on the company's dividend policy and available profits after meeting the references of preference shareholders. **Equity shares come with voting rights**.

The Companies Act, 2013 allows the issuance of equity share capital with varying rights concerning dividend, voting, or other aspects in accordance with specified regulations.

A company has the option to issue shares either –

- for **cash** or
- for **consideration other than cash**.

ISSUE OF SHARES FOR CASH

To issue shares, **private companies rely on 'Private Placement'** of shares, while **public companies issue a 'Prospectus' to invite the general public for share subscriptions**.

For the purpose of discussing **accounting treatment**, the **focus will be on public companies** that invite the general public to subscribe to equity shares. The same accounting treatment is applicable in other scenarios. **However, when recording journal entries for** the **issue of preference shares**, the **term 'Equity' is replaced with 'Preference'**.

Process in Issue of Share to Public by the company:

1st Step: Issue of prospectus to invite the general public to subscribe to its shares

2nd Step: Interested parties deposit applications, along with the cash amount payable at the time of application.

Note: The **initial installment** paid with the application is termed as **'Application Money'. As per Section 39 of the Companies Act, 2013, application money must be at least 5% of the Face Value (i.e. Nominal Value) of shares.**

However, SEBI regulations stipulate that the **minimum application money**, along with the application money, **shall not be less than 25%** of the **issue price**.

Matters related to the **issue and transfer of securities, as per Section 24 of the Companies Act, 2013, are administered by SEBI, not the Company Law Board**.

Following the closing date of the issue (the last date for submitting applications), the company, in consultation with SEBI and the relevant stock exchange, determines the allotment of shares. According to the **Companies Act, 2013, a company is not permitted to proceed with the allotment of shares unless it has received the minimum subscription (i.e. 90%).**

The **minimum subscription amount disclosed in** the **prospectus** by the Board of Directors is **determined by considering various factors**, including:

(a) Preliminary expenses of the company,

(b) Commission payable on the issue of shares,

(c) Cost of fixed assets already purchased or intended to be purchased,

(d) Working capital requirements of the company, and

(e) Any other expenditure necessary for the day-to-day operation of the business.

However, **In accordance with** the Securities Exchange Board of India **(SEBI) guidelines**, the **minimum subscription amount** to be received in an issue **must not be less than 90%** of the offer through the offer document.

If the **company fails to secure** the **minimum subscription of 90% of the issue**, all application **funds received will** be **refunded** to the applicants **within**:

(a) **fifteen days of** the **closure of the issue for non-underwritten issues, and**

(b) **seventy days of** the **closure of the issue for underwritten issues where** the **minimum subscription,** including devolvement obligations **paid by the underwriters**, is **not received within sixty days of the issue's closure.**

The company typically receives the issue price of shares in installments, and these installments are commonly referred to as:

First installment	....	Application Money
Second Installment	....	Allotment Money
Third Installment	....	First Call Money
Fourth Instalment	....	Second Call Money and so on.
Last Installment		Final Call Money

JOURNAL ENTRIES FOR ISSUE OF SHARES FOR CASH

Upon the issuance of share capital by a company, the following entries are recorded in the financial records:

- Upon the receipt of the application money

Bank Account Dr. (With the actual amount received.)

To Share Application Account

(Being received application money)

- On allotment of share

Share Allotment Account Dr. (With the amount due on allotment.)

Share Application Account Dr. (With the application amount received on allotted shares.)

To Share Capital Account (With the amount due on allotment and application.)

(Being the amount payable on allotment and the transfer of application funds to the capital account)

- On receipt of allotment money

Bank Account Dr. (With the amount actually received on allotment.)

To Share Allotment A/c

(Being allotment money received)

- On a call being made

Share Call Account Dr. (With the amount due on the call)

To Share Capital Account

(Being share call made due at ₹...)

- On receipt of call money

Bank Account Dr. (With the due amount actually received on call)

- To Share Call Account

(Being share call money received)

SUBSCRIPTION OF SHARES

The accounting treatment for the issuance of shares varies based on the subscription type. When a company opts to offer shares to the public, it solicits subscriptions by publishing a prospectus. **It is not mandatory for the company to receive applications matching the number of shares issued**.

Three scenarios may arise:

Full Subscription

The **issue** is considered fully subscribed when the **quantity of shares** presented for subscription **matches** the **number of shares actually subscribed by** the **public**. To initiate the discussion on the accounting treatment for share issuance, let's assume that the issue is fully subscribed.

Under Subscription

It implies that the **quantity of shares issued exceeds the number of shares subscribed by the public subject to 90% as discussed in "Minimum Subscription Para"**.

Over Subscription

In practice, share issue are often either under-subscribed or over-subscribed. In cases of oversubscription, certain applications may be declined, resulting in the refund of application money. For other applications, only a portion of the requested shares may be allotted, and any surplus funds received can be utilized for allotment or upcoming call payments. The entries are:

- On refund of application money to applicants to whom shares have not been allotted: Share Application A/c Dr.

To Bank Account

(Being application money refunded to the applicants)

- When only a part of shares applied for are allotted. Share Application A/c Dr.

To Share Allotment* A/c (With the application money accepted for allotment)

To Share Calls-in-Advance* A/c (With the amount received in advance)

To Bank A/c (With any excess amount to be refunded) (Being excess application money adjusted)

*Credited to Share Capital A/c subsequently.

(**Note:** This type of share allotment is termed as Pro-rata allotment discussed later)

SHARES ISSUED AT DISCOUNT

Shares are considered to be **issued at a discount when** the **issue occurs at an amount lower than** the nominal or par value or **face value** of the shares. The difference between the nominal value and the issue price represents the discount on the shares.

Section 53 of the Companies Act, 2013 stipulates that a **company is not allowed to issue shares at a discount, except** in the case of the **issuance of sweat equity shares** (shares issued to employees and directors). **Consequently, any issuance of shares at a discount is considered void**.

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SHARES ISSUED AT PREMIUM

When a **company issues its securities at a price higher than the face value**, it is termed as an issue at a premium. Premium represents the surplus of the issue price over the face value of the security.

It is a **common practice for financially robust and well-managed companies to issue shares at a premium**, i.e., at an amount exceeding the nominal or par value of the shares.

Example: if a share with a face value

In cases where the issue is at a premium, the **premium amount may technically be called at any stage** of share capital transactions. **However, in practice, premium is usually called along with** the amount due on **allotment, occasionally with the application money**, and **rarely with** the **call money.**

ACCOUNTING TREATMENT

When shares are issued at a premium, the **premium** amount is **recorded in** a distinct account known as the **"Securities Premium Account,"** as **it does not constitute a part of the share capital. Instead, it signifies a "capital gain" for the company.**

As a credit balance, the Securities Premium Account is presented under the "Reserves and Surplus" category. However, 'Reserves and Surplus' is classified as 'shareholders' funds' in the Balance Sheet according to Schedule III.

Section 52 of the Companies Act, 2013, **specifies** that the **Securities Premium Account can be utilized** by the company **for the following purposes**:

(a) Issuing unissued shares of the company as **fully paid bonus shares** to its members.

(b) **Writing off preliminary expenses** incurred by the company.

(c) **Writing off expenses**, commission, or discounts **related to any share or debentures of** the **company**.

(d) **Adjusting premium on** the **redemption of** redeemable **preference shares or debentures**.

(e) **Purchasing** the company's **own shares or other securities**. **(Buy-Back of Shares)**

When shares are issued at a premium, the following journal entries are passed :

- **Premium amount called with Application money**

Bank A/c Dr. [Total Application money + Premium Amount]

To Share Application A/c [Amount received] (Being Application Money received on Shares @ ₹ per share including premium)

Share Application A/c Dr. [No. of Shares Applied for x Application Amount per share]

To Securities Premium A/c [No. of Shares allotted x Premium Amount per share]

To Share Capital A/c [No. of Shares allotted x Nominal value per share for capital]

- **Premium Amount called with Allotment Money**

Share Allotment A/c Dr. [No. of Shares Allotted x Allotment and Premium Money per share]

To Share Capital A/c [No. of Shares Allotted x Allotment Amount per share]

To Securities Premium A/c [No. of Share Allotted x Premium Amount per share]

(Allotment money due of shares @ ₹ per share including premium)

Bank A/c Dr.

To Share Allotment A/c (Allotment Money received including premium).

OVER SUBSCRIPTION AND PRO-RATA ALLOTMENT

Over subscription occurs when the **application money received exceeds the number of shares issued to the public by a company**.

This typically happens with well-received issues and is influenced by factors such as investor confidence, economic conditions, and issue pricing.

In the event of oversubscription, the company faces the challenge of deciding how to allocate the shares among the applicants. The company has the discretion to reject some applicants entirely, refunding their application money. Multiple applications from the same individuals are usually not considered. Alternatively, the company may choose to allot shares in full to some applicants based on their requested quantity.

Another option is to allocate shares on a pro-rata basis, meaning in proportion to the shares applied for. For instance, if a company offers 10,000 shares and receives applications for 12,000 shares, the pro-rata ratio might be 12,000:10,000 or 6:5. In this scenario, an applicant who applied for 6 shares would be allotted 5 shares.

Under pro-rata allotment, any excess application money received is adjusted against the amount due on allotment or future calls. Surplus funds, after adjusting for future calls, are returned to the applicants. The details of the allotment process are communicated to the applicants through advertisements in prominent newspapers.

In cases of pro-rata allotment, an applicant's total application money exceeds the exact amount due on application. The excess amount is considered an advance against allotment or any forthcoming calls. The net amount due on allotment or future calls is the difference between the amount due on allotment or future calls and the excess amount received during the application process.

Accounting Entries

- For rejected applications:

Share Application AccountDr.

To Bank Account

(Being application money refunded for rejected applications)

- For pro-rata allotment:

Share Application AccountDr.

To Share Allotment Account

(Being excess application money adjusted against allotment money)

ALLS-IN-ARREARS AND CALLS-IN-ADVANCE

Calls-in-Arrears

On occasion, **shareholders may default on payment for allotment or calls**. The aggregate unpaid sum for one or more installments is referred to as Calls-in-Arrears or Unpaid Calls. This amount signifies the outstanding capital yet to be collected from shareholders. Therefore, it is reflected as a deduction from the 'called-up capital' to determine the paid-up value of the share capital.

The following journal entry is recorded for recording 'Calls-in-Arrears' :

Calls-in-Arrears A/c	Dr.	[Amount of Unpaid Calls]
Bank A/c	Dr.	[Amount received]
To Share Allotment A/c		[Total allotment money due]
To Share Calls A/c		[Total Call money due]

(Being call money/ allotment money received on .... shares at ₹ per share.)

Note: Call in arrears cannot happen on Application Stage

Calls-in-Advance

Occasionally, **certain shareholders may remit a portion or the entirety of the uncalled amount**. This sum is referred to as Calls-in-advance.

The following entry is recorded for recording 'Calls-in-Advance' :

Bank A/c Dr. [Call amount received in advance] To Call-in-Advance A/c

When calls become actually due, the calls-in-advance account is adjusted at the time of the call. For this the following journal entry is recorded:

Calls-in-Advance A/c Dr. [Call amount received in advance]

Bank A/c Dr. [Remaining call money received, if any] To Particular Call A/c [Call money due]

(Being call in advance adjusted and call money duly received)

INTEREST ON CALLS-IN-ARREARS AND CALLS- IN-ADVANCE

Interest on overdue calls is collectible, while for advance calls, it is payable, in accordance with the stipulations outlined in the company's articles. The rates are either specified in the articles or determined by the directors within the boundaries set by the Articles. **Table F designates 10% and 12% per annum as the maximum rates for call-in-arrears and call-in-advance calls**, respectively.

Interest on Calls in Arrears	Interest on Calls in Advance
It is payable by shareholders to company **(i.e. receivable for company)** on	It is **payable by the Company** to
the calls due that are Outstanding and unpaid.	Shareholders for the call money received in advance that is not yet due.
As per Table F , the maximum prescribed rate is 10%.	**As per Table F, the maximum prescribed rate is 12%.**
Time Frame considered : From the due date of call money to the date when the funds are received.	Time Frame considered: From the day the money was received to the day the call was ultimately deemed due.
Directors have authority to waive such interest on a **case-by-case basis at their own discretion.**	**Shareholders** are **not eligible for any dividends on advance calls because dividend is calculated on Paid Up Capital which is called by the company**
It is a nominal account and is **credited** to the income statement **as revenue**.	It is a nominal account in nature with interest being an **expense for the company**.

The following journal entries are passed for calls-in-arrears :

- For interest receivable on calls-in-arrears

Shareholders' A/c Dr.

To Interest on calls-in-arrears A/c

(Being interest on calls in arrears made due at the rate of ...%)

- For receipt of interest

Bank A/c Dr.

To Shareholders' A/c (Being interest on calls in arrears received)

The following is the accounting treatment of interest on Calls-in-Advance:

- Interest Due

Interest on Calls-in-Advance A/c Dr. [Amount of interest due for payment]

To Shareholder's A/c

(Being interest on calls in advance made due)

- Payment of Interest

Shareholder's A/c Dr. [Amount of interest paid]

To Bank A/c

(Being interest on calls-in-advance paid)

FORFEITURE OF SHARES

The **term 'forfeit' essentially refers** to the **confiscation** of property **due to a breach of a condition.**

It is not uncommon for **one or more shareholders** to default **on the payment of** their **allotment and/or calls** on the scheduled dates. Non-payment **of allotment and/or calls** money **leads to the forfeiture** of shares. **Forfeiture** of shares **involves** the **company taking action to cancel the shares**.

Typically, the Articles of Association **(AOA) empower the directors to forfeit such shares** by issuing proper notice to the defaulting shareholder(s). When **shares are forfeited**, the **ownership rights of the shareholder are terminated, also the amount paid** to date **is not refunded**. The shareholder then loses any further claim on the company.

The power to forfeit must be exercised strictly **in accordance with** the rules outlined in the Articles of Association **(AOA)**, and it should be done **in good faith for the benefit of the company.**

Directors also retain the right to cancel such forfeiture before the forfeited shares are re-issued.

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- Forfeiture of Shares which were issued at Par

In this scenario, the Share Capital Account will be debited with the called-up value of the forfeited shares. The Allotment or Calls Account will be credited with the amount due but not paid by the shareholder(s). Alternatively, the Calls-in-Arrears Account can be credited for the entire amount due if it was transferred to the Calls-in-Arrears Account. The Forfeited Shares Account or Shares Forfeiture Account will be credited with the amount already received for those shares.

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Share Capital Account Dr. [No. of shares x called-up value per share]

To Forfeited Shares Account [Amount already received on forfeited shares]

To Share Allotment Account [If amount due, but not paid]

To Share First Call Account [If amount due, but not paid]

To Share Final Call Account [If amount due, but not paid]

If all amounts due on allotment, first call, and final call have been transferred to the Calls-in-Arrears Account, the entry will be:

Share Capital Account Dr. [No. of shares x called-up value per share] To Calls-in-Arrears Account [Total amount due, but not paid]

To Forfeited Shares Account [Amount received]

- Forfeiture of Shares which were issued at a Premium

In this scenario, the Share Capital Account will be debited with the called-up value of forfeited shares. If the shareholder has not paid the premium on such shares, the Securities Premium Account will be debited to nullify it (if it was credited previously). The Allotment, Calls, and Forfeited Accounts will be credited as usual.

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If the company has already received the premium, it cannot be nullified even in the event of future forfeiture of shares.

If premium not received		
Share Capital A/c	Dr.	[Called-up value]
Securities Premium A/c	Dr.	[Amount of Security premium not received]
To Share Allotment Account		[If amount due, but not paid]
To Share First Call Account		[If amount due, but not paid]
To Share Final Call Account		[If amount due, but not paid]
To Forfeited Shares Account		[Amount received on forfeited shares]

If premium received		
Share Capital A/c	Dr.	[Called-up value]
To Share Allotment Account		[If amount due, but not paid]
To Share First Call Account		[If amount due, but not paid]
To Share Final Call Account		[If amount due, but not paid]
To Forfeited Shares Account		[Amount received on forfeited shares]

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- Forfeiture of Fully Paid-Up Shares

The forfeiture of shares can occur due to various reasons, including non-payment of calls, premium, or the outstanding portion of the face value. However, in cases where shares are fully paid-up, forfeiture may take place as allowed by the Articles for the purpose of recovering the shareholder's debts.

RE-ISSUE OF FORFEITED SHARES

A forfeited share is essentially a share that the company can sell and is retained by the company for this specific purpose. The reissuance of forfeited shares is not an allotment but rather a sale. Following forfeiture, the company is obligated to sell these shares. Typically, forfeited shares are sold through an auction. These shares can be reissued at any price, provided that the total amount received (from both the initial allottee and the subsequent purchaser) for those shares is not less than the amount in arrears on those shares.

Accounting Entries :

Bank Account Dr. [Actual amount received] Forfeited Shares Account Dr. [Loss on re-issue]

To Share Capital Account

(Being re-issue of....shares @ ₹ .... Each)

Forfeited Shares Account Dr.

To Capital Reserve Account

(Being transfer of profit on re-issue to capital reserve).

- Points for Consideration

In relation to the re-issuance of forfeited shares, the following considerations are significant:

- The loss on re-issuance should not surpass the forfeited amount.
- If the loss on re-issuance is less than the forfeited amount, the surplus should be transferred to Capital Reserve.
- The forfeited amount on shares (originally paid-up) not yet reissued should be indicated under the heading 'share capital.'
- When only a portion of the forfeited shares is re-issued, the profit from the re-issuance of that specific portion of shares should be transferred to Capital Reserve.
- In the case of shares being re-issued at a loss, the loss should be debited to the "Forfeited Shares Account."
- If the shares are re-issued at a price exceeding the face value, the excess amount will be credited to the Securities Premium Account.
- If the combined re-issued and forfeited amount surpasses the face value of the shares re-issued, there is no obligation to transfer such an amount to the Securities Premium Account.

- Calculation of Profit on Re-Issue of Forfeited Shares

Students should understand that the credit balance in the Forfeited Shares Account is not considered a surplus until the re-issued shares have been successfully re-issued.

This is because, during re-issuance, the company may offer a discount to the new purchaser equal to the amount credited in the Forfeited Shares Account.

To illustrate, if 120 shares with a nominal value of Rs.10 were forfeited, with Rs.5 per share paid up and transferred to the Forfeited Shares Account, and later 50 shares were re-issued with Rs.6 per share collected to make them fully paid up, Rs.200 (50 shares x Rs.10 - 50 shares x Rs.6) would be credited to the Share Capital Account to cover the deficiency on re-issued shares.

Additionally, Rs.50 (50 shares x Rs.5 - Rs.200) would be transferred to the Capital

Reserve Account as the surplus on the re-issuance of the 50 shares. The remaining balance in the Forfeited Shares Account, equivalent to the amount collected on the remaining 70 forfeited shares (i.e., Rs.350), would be carried forward until these shares are re-issued.

It's important to note that the example assumes a uniform amount paid up on all 120 forfeited shares. In practice, shares may be forfeited with varying amounts outstanding. For instance, if in the given case, 70 shares were forfeited with Rs.5 paid up and 50 shares with Rs.7.50 paid up, the calculation would be adjusted accordingly.

Share Forfeited Account Balance = (70 x 5) + (50 x 7.50)

= Rs.725

Thus if 50 shares with Rs.7.50 paid up are re-issued for Rs.6 per share then Capital Reserve balance will be as follows:

Rs.(7.50 + 6 -10) x 50 shares = Rs.175

ISSUE OF SHARES FOR CONSIDERATION OTHER THAN CASH

Public limited companies typically issue shares for cash and utilize **the proceeds to acquire various types of assets** required for their business operations. **However, there are instances where a company may opt to issue shares directly in exchange for assets** such as land, buildings, or other resources.

Additionally, shares might be issued as compensation for services provided by promoters or legal professionals involved in the formation of the company.

"It is essential to present these shares separately under the 'Share Capital' category"

According to accounting standards, when an asset is acquired, either wholly or partly, **through the issuance of shares or other securities**, the **cost of acquisition** is **determined by the fair value of the securities** issued.

This **fair value**, in relevant cases, may be **indicated by** the **issue price** as determined by statutory authorities **and may not necessarily align with the nominal or par value of the securities issued**.

- **Accounting Entries**

When assets are purchased in exchange of shares Assets Account Dr.

To Share Capital Account

TEST YOUR KNOWLEDGE

True and False

1. Liability of a holder of shares is limited to the face value of shares acquired by them. (ICAI Study Material)

Sol.– False. The shareholder's liability is limited to the acquisition price of the shares they hold.

2. Authorized capital appears in the balance sheet at face value. (ICAI Study Material)

Sol.– True. Authorized capital is the capital amount specified in the 'capital clause' of the 'Memorandum of Association.' Authorized capital is considered a representation and is not included in the total balance sheet.

3. The rate of dividend on preference shares may vary From year to year. (ICAI Study Material)

Sol.– False. The rate of preference dividend is not always fixed.

4. A company may issue shares at a discount to the public in general. (ICAI Study Material)

Sol.– False. According to Section 53 of the Companies Act, 2013, issuing shares at a discount is allowed in the case of sweat equity shares (issued to employees and directors).

5. Sweat equity shares are those which are issued to employees & directors at a discount. (ICAI Study Material)

Sol.– True. According to Section 53 of the Companies Act, 2013, issuing shares at a discount is generally not allowed, except in the case of sweat equity shares.

6. As per table F, rate of interest on calls in arrears is 12%.(ICAI Study Material)

Sol.– False. As per Table F, the rate of interest on calls in arrears is typically 10%.

7. As per Table F, rate of interest on calls in advance is 10%.(ICAI Study Material)

Sol.– False. As per Table F, the rate of interest on calls in advance is usually 12%.

8. Non-participating preference shareholders enjoy voting rights. (ICAI Study Material)

Sol.– False . A share that receives a fixed rate of dividend without additional rights in profits or surplus on winding-up is termed 'Non-participating Preference Shares.' Non-participating preference shareholders usually lack voting rights.

9. Forfeited shares are available to the company for the purpose of resale. (ICAI Study Material)

Sol.– True . Reissue of forfeited shares is considered a sale rather than an allotment of shares.

10. Loss on reissue should exceed the forfeited amount. (ICAI Study Material

Sol.– False . Loss on re-issue should not surpass the forfeited amount.

11. Reserve Capital and Capital Reserve have identical definitions.

Sol. False: Reserve Capital pertains to the uncalled up portion of share capital, only accessible in the event of winding up. Capital Reserve, on the other hand, is a reserve generated from capital gains.

12. In accordance with Table F, the minimum interest rate permissible for Calls-in-arrears is 10% per month, and the minimum interest rate allowed for calls-in-advance is 12% per month.

Sol.– False: According to Table F, the highest interest rate that can be levied on Calls-in-Arrears is 10% per annum, while the highest interest rate permitted on calls-in-advance is 12% per annum.

13. Re-issue of forfeited shares is allotment of shares but not a sale. **[May 2018, 2 Marks]**

Sol.– False: A forfeited share is merely a share available to the company for sale and remains vested in the company for that purpose only. Reissue of forfeited shares is not allotment of shares but only a sale as they have already been allotted earlier.

14. Since company has existence independent of its members, it continues to be in existence despite the death, insolvency or change of members. **[Nov. 2019, 2 Marks]**

Sol.– True: A company has a separate legal entity i.e. its existence is independent of its members. The company is consequently able to enjoy perpetual succession and continues in existence irrespective of death/insolvency/change of members, until it is wound up by law.

15. In the balance sheet of X Limited, preliminary expenses amounting to ₹ 5 lakhs and securities premium account of ₹ 35 lakhs are appearing. The accountant can use the balance in securities premium account to write off preliminary expenses.

[Nov. 2020, 2 Marks]

Sol.– True: Section 52 of the Companies Act, 2013 allows that preliminary expenses may be written off through Securities Premium Account.

16. Re-issue of forfeited shares is allotment of shares but not a sale. **[Jan. 2021, 2 Marks]**

Sol.– False: Reissue of forfeited shares is treated as sale of shares not as allotment of shares.

17. A Company is not allowed to issue shares at a discount to the public in general.

[July 2021, 2 Marks]

Sol.– True: According to Section 53 of the Companies Act, 2013, a company cannot issue shares at a discount to general public.

18. A person holding preference shares of a company cannot hold equity shares of the same company. **[July 2021, 2 Marks]**

Sol.– False: A person can hold both equity and preference shares of the same company as per Companies Act, 2013.

19. Non-participating preference shareholders enjoy voting rights. **[Dec. 2021, 2 Marks]**

Sol.– False: No voting rights are conferred on Preference Shares irrespective of whether participating or non-participating

Multiple Choice Questions

1. The excess price received over the par value of shares, should be credited to _.

(ICAI Study Material)

(a) Calls-in-advance account
(b) Share capital account
(c) Securities premium account
(d) None of the Above

Sol.– (c) Securities premium account

2. The Securities Premium amount may be utilized by a company for _.

(ICAI Study Material)

(a) Writing off any loss on sale of fixed asset
(b) Writing off any loss of revenue nature
(c) Writing off the expenses/discount on the issue of debentures
(d) All of the Above

Sol.– (C) Writing off the expenses/discount on the issue of debentures

3. When shares are forfeited, the share capital account is debited with ______ and the share forfeiture account is credited with _. (ICAI Study Material)

(a) Paid-up capital of shares forfeited; Called up capital of shares forfeited
(b) Called up capital of shares forfeited; Calls in arrear of shares forfeited
(c) Called up capital of shares forfeited; Amount received on shares forfeited
(d) None of the Above

Sol.– (C) Called up capital of shares forfeited; Amount received on shares forfeited

4. T Ltd. proposed to issue 6,000 equity shares of Rs.100 each at a premium of 40%. The minimum amount of application money to be collected per share as per the Companies Act, 2013 (ICAI Study Material)

(a) Rs.5.00
(b) Rs.6.00
(c) Rs. 7.00
(d) None of the Above

Sol. – (a) Rs.5.00

5. Dividends are usually paid as a percentage of _. (ICAI Study Material)

(a) Authorized share capital

(b) Net profit

(c) Paid-up capital

(d) All of the Above

Sol.– (c) Paid-up capital

6. As per the SEBI guidelines, on issue of shares, the application money should not be less than : (ICAI Study Material)

(a) 2.5% of the nominal value of shares

(b) 2.5% of the issue price of shares

(c) 25.0% of the issue price of shares

(d) 5% of the nominal value of shares

Sol.– (c) 25.0% of the issue price of shares

7. G Ltd. acquired assets worth ₹ 7,50,000 from H Ltd. by issue of shares of ₹ 100 at a premium of 25%. The number of shares to be issued by G Ltd. to settle the purchase consideration = ? (ICAI Study Material)

(a) 6,000 shares

(b) 7,500 shares

(c) 9,375 shares

(d) 6,500 Shares

Sol.– (a) 6,000 shares

8. Securities Premium is presented as a part of : (ICAI Study Material)

(a) Reserves & Surplus

(b) Share Capital

(c) Liabilities

(d) None of the Above

Sol.–(a) Reserves & Surplus

9. Schedule III of Companies Act 2013 prescribes the format for : (ICAI Study Material)

(a) Financial statements

(b) Directors' Report

(c) Auditors' Report

(d) All of the Above

Sol.– (a) Financial statements

10. Dividend on __________ shares have to be paid before dividend on shares.

(**IC**AI Study Material)

(a) Equity, Preference

(b) Preference, Equity

(c) Convertible, Non-Cumulative

(d) None of the Above

Sol. – (b) Preference, Equity

11. Preference shares are unless expressly stated otherwise. (ICAI Study Material)

(a) Non-participating

(b) Convertible

(c) Interest-bearing

(d) None of the Above

Sol.– (a) Non-participating

Theory Questions

1. Write short notes on:

Utilization of securities premium account

Re-issue of forfeited shares. (ICAI Study Material)

Sol.–

(i) When shares are issued at a premium, the premium amount is recorded in a distinct account known as the "Securities Premium Account," as it does not constitute a part of the share capital. Instead, it signifies a capital gain for the company.

As a credit balance, the Securities Premium Account is presented under the "Reserves and Surplus" category. However, 'Reserves and Surplus' is classified as 'shareholders' funds' in the Balance Sheet according to Schedule III.

SectioOn 52 of the Companies Act, 2013, specifies that the Securities Premium Account can be utilized by the company for the following purposes:

(a) Issuing unissued shares of the company as fully paid bonus securities to its members.

(b) Writing off preliminary expenses incurred by the company.

(c) Writing off expenses, commission, or discounts related to any securities or debentures of the company.

(d) Providing for the premium on the redemption of redeemable preference shares or debentures. (e) Purchasing the company's own shares or other securities.

(ii) A forfeited share is essentially a share that becomes available for the company to sell and is retained by the company for this specific purpose. The reissue of forfeited shares does not constitute an allotment of shares; rather, it is regarded as a sale. Once forfeited, the share held by the company comes with the responsibility to be sold. Typically, forfeited shares are auctioned in practice. These shares can be reissued at any price, as long as the total amount received (from both the original allottee and the second purchaser) for those shares is not less than the outstanding amount on those shares.

2. Distinguish between:

Calls-in-Arrears and Calls-in-advance

Issue of shares for cash and Issue of Shares for Consideration other than Cash

(ICAI Study Material)

Sol.–

(i) Calls-in-Arrears: On occasions, shareholders may neglect to fulfill the payment obligations on allotment or calls. The aggregate outstanding amount on one or more installments is referred to as Calls-in-Arrears or Unpaid Calls. This sum signifies the unreceived portion of capital from the shareholders and is displayed as a deduction from the 'called-up capital' to determine the paid-up value of the share capital.

Calls-in-advance: In certain instances, shareholders may choose to make a partial or full payment of the yet-to-be-called-up amount. This sum is termed Calls-in-advance.

(ii) A company has the option to issue shares either in exchange for cash or for consideration other than cash. Typically, public limited companies opt to issue shares for cash, utilizing the proceeds to acquire diverse assets essential for their business operations. Nevertheless, there are instances where a company may choose to issue shares directly in exchange for assets such as land, buildings, or other non-monetary considerations.

3. Can a company issue shares at discount? (ICAI Study Material)

Sol.- In adherence to Section 53 of the Companies Act, 2013, a company is prohibited from issuing shares at a discount, except in the scenario of issuing sweat equity shares, which are allocated to employees and directors. Consequently, any attempt to issue shares at a discount is deemed void.

CHAPTER

10 Company Accounts

UNIT – 3 ISSUE OF DEBENTURES

3.1 INTRODUCTION

Due to the escalating and ongoing demands for corporate expansion and development, depending solely on equity financing proves insufficient. As a result, companies resort to debt financing through various channels. One such avenue involves issuing debt instruments to the public for subscription, serving as a means to fund business activities.

Debt financing contributes to shaping the company's optimal capital structure. Among the commonly employed debt instruments for fundraising is the issuance of debentures by companies.

3.2 MEANING

The primary method of increasing a company's available capital involves the issuance of debentures.

A debenture, is a bond issued by a company under its seal, acknowledges a debt and includes provisions for the repayment of principal and interest.

3.3 FEATURES OF DEBENTURES

1. It is a written record that signifies a loan extended to a company.
2. It is a secure, interest-bearing financial instrument with interest payments due on specific dates.
3. The interest is payable at a predetermined fixed rate, irrespective of the company's profit levels.
4. The principal amount is repaid at a designated future date, or it is converted into shares
5. It may or may not establish a claim on the company's assets as collateral.
6. Typically, it is tradable on the stock exchange, with the option to buy or sell at a price either above or below its nominal value.

3.4 DISTINCTION BETWEEN DEBENTURES AND SHARES

Debentures	Shares
1. Debenture holders function as the company's creditors.	1. Shareholders of the company are the owners of the business.
2. Debenture holders lack voting rights, thereby posing no threat to the existing control structure of the company.	2. Shareholders possess voting rights, thereby exercising control over the overall affairs of the company.
3. Debenture interest is typically paid at a predetermined fixed rate, regardless of the company's profitability. Debentures take precedence over all types of shares for the payment of due interest.	3. Dividends on equity shares fluctuate based on company profits (while dividends on preference shares are fixed).
4. Interest on debentures constitutes charges against profits and is deductible as an expense when determining the company's taxable profit.	4. Dividends represent an appropriation of profits and are not deductible when calculating the taxable profit of the company.
5. On the Company's Balance Sheet, debentures are categorized under "Term Borrowings."	5 The company's Balance Sheet includes shares categorized under "Shareholder's Fund," detailed in the 'Share Capital' section of the Notes to Accounts.
6. Debentures have the option to be converted into other debentures or shares based on the terms specified during the debenture issuance.	6. Shares are not convertible into other shares under any circumstances.
7. Debentures cannot be forfeited due to non-payment of call moneys.	7. Shares may be forfeited if allotment and call moneys are not paid.
8. Upon maturity, debenture holders receive their invested capital in accordance with the stipulated terms and conditions of redemption.	8. Equity shareholders cannot reclaim their investment before the company undergoes liquidation (unlike preference shareholders who have that privilege).
9. In the event of liquidation, debenture holders are repaid before shareholders.	9. During liquidation, shareholders receive payment last, after settling obligations to debenture holders, trade payables, and other liabilities.

3.5 TYPES OF DEBENTURES

The following are the types of debentures issued by a company. They can be classified on the basis of:

1. **Security**

   (a) **Secured Debentures:** These debentures are backed by a charge (claim on asset if amount is not paid) on some or all of the company's assets.

   There are two categories of charges:

   (i) **Fixed charge:** A fixed charge represents a mortgage on specific assets, and these assets cannot be sold without the consent of the debenture holders

   (ii) **Floating charge:** A floating charge typically includes all of the company's assets, including those acquired in the future.

   (b) **Unsecured or "Naked" Debentures:** These debentures lack security through any charge on assets. The company simply commits to paying interest on specified dates and repaying the principal amount on the maturity date. Such debentures carry a high level of risk from the perspective of investors.

2. **Convertibility**

   (a) **Convertible Debentures**: These represent debentures that undergo conversion into equity shares, either at par, premium, or discount, after a specified period from the date of their issuance. Convertible debentures may be fully or partially convertible, providing debenture holders with an opportunity to become shareholders of the company in the future.

   (b) **Non-Convertible Debentures:** In contrast, non-convertible debentures are not eligible for conversion into shares in the future. According to the terms of issuance, these debentures are repaid without the option of conversion.

3. **Permanence**

   (a) **Redeemable Debentures**: These debentures are scheduled for repayment in accordance with the terms specified during issuance, such as after 8 years from the date of their release.

   (b) **Irredeemable Debentures:** Irredeemable debentures, also known as perpetual debentures, do not have a repayment schedule during the company's lifetime. They are only repaid at the time of liquidation.

4. **Negotiability**

   (a) **Registered Debentures:** These debentures are repayable to a registered holder whose details, including name, address, and holding particulars, are documented in the Register of Debenture holders. They are not easily transferable, and compliance with the provisions of the Companies Act, 2013 is necessary for the transfer of these debentures.

   However,Debenture interest is disbursed either to the order of the registered holder, as indicated in the warrant issued by the company, or to the bearer of the interest coupons.

(b) **Bearer Debentures:** These debentures can be transferred by delivery and are negotiable instruments payable to the bearer. The company does not maintain any record of the holders of such debentures. Consequently, interest is paid to the holder without consideration of identity, and no transfer deed is required for the transfer of such debentures.

5. **Priority**

   (a) **First Mortgage Debentures:** Payment of these debentures takes precedence over other claims on the charged property.

   (b) **Second Mortgage Debentures:** Payment of these debentures occurs after satisfying the claims of the first mortgage debentures

3.6 ISSUE OF DEBENTURES

3.6.1 Accounting entries for issue of redeemable debentures

The categorization of redeemable debentures encompasses the following scenarios:

1. Debentures issued at par and redeemable either at par or at a discount.
2. Debentures issued at a discount and redeemable either at par or at the same discount.
3. Debentures issued at a premium and redeemable either at par or at a discount.
4. Debentures issued at par and redeemable at a premium.
5. Debentures issued at a discount and redeemable at a premium.
6. Debentures issued at a premium and redeemable at the same premium.

Note: Redemption at a discount is an uncommon occurrence in practical situations.

Journal entries in each of the above cases are discussed below:

1. Debentures issued at par redeemable at par: When debenture are issued at par i.e the issue price is equal to par value, the following entries are recorded:

   (a) For receipt of application money:

   Bank A/c Dr.

   To Debenture Application A/c

   (b) For transfer of application money to debentures account :

   Debenture Application A/c Dr.

   To % Debenture A/c

2. Debentures issued at Discount and Redeemable at par or at discount : In the case of debentures issued at a discount, the issue price is lower than the par value. The variance between the two is recognized as a loss on debenture issuance and is amortized over the lifespan of the debentures. In this scenario , the following entries are given passed :

   (a) For receipt of application money

   Bank A/c Dr.

   To Debenture Application A/c

(b) At the time of making allotment

Debenture Application A/c Dr.

Discount on issue of debentures A/c Dr.

To ...% Debentures A/c

3. Debentures Issued at Premium and Redeemable at par or at discount

In instances where debentures are issued at a premium, the issue price exceeds the par value. The surplus amount is then transferred to the securities premium account. In this case , the journal entries are recorded as follows :

When premium amount is received at the time of application;

(a) For receipt of application money

Bank A/c Dr.

To Debenture Application A/c

(b) For transfer of application of money at the time of allotment

Debenture application A/c Dr.

To ...% Debentures A/c

To Securities Premium A/c

When debentures are issued at par or a premium but redeemed at a discount, it implies that the company will benefit by making a lesser payment.

This gain is not acknowledged in the books during the debenture issuance in adherence to the conservatism concept. The utilization of debenture premium is guided by the provisions outlined in Section 52 of the Companies Act, 2013.

4. Debentures issued at par and redeemable at a premium

When debentures are set to be redeemed at a premium, an additional entry is required during the debenture issue and allotment. This supplementary entry is made to account for the premium due upon redemption.

The Debenture Redemption Premium Account serves as a personal account, indicating a liability for the company concerning the premium payable upon redemption.

In such instances, where the issue price is equal to the par value but the redemption value exceeds the par value, the redemption premium is recorded as a loss during the allotment of debentures.

Following journal entries are passed in this regard:

(a) For application money received

Bank A/c Dr.

To Debenture application A/c

(b) For making allotment

(i) Application money transferred to debenture account

Debenture Application A/c Dr.

To ...% Debenture A/c

(ii) Call made on allotment

Debenture Allotment A/c Dr.

Loss on issue of debenture A/c Dr. [Equal to Debenture Redemption Premium]

To ...% Debenture A/c

To Debenture redemption premium A/c

Instead of passing the separate entries, a compound entry can also be passed:

Bank A/c Dr.

Loss on issue of debenture A/c Dr.

To ...% Debenture A/c

To Debenture redemption premium A/c

5. Debentures Issued at discount and redeemable at premium

In this scenario, the issue price is lower than the par value, while the redemption value exceeds the par value. The disparity between the redemption price and the issue price is considered as a discount or loss on the debenture issuance.

For example, if a 10% debenture with a face value of Rs.1,000 is issued at a discount of Rs. 100 and redeemable at a premium of Rs. 5 per debenture, the calculated loss would be Rs. 1,005 – Rs. 900 = Rs. 105. This amount is recognized as a loss on the issue. It is important to note that the premium on the redemption of debentures is also offset by Rs. 5.

(a) For application money received

Bank A/c Dr.

To Debenture Application A/c

(b) For making allotment

(i) Application money transferred to debenture account

Debenture Application A/c Dr.

To % Debentures A/c

(ii) Allotment money due of debentures at Discount and redeemable at premium

Debenture Allotment A/c Dr.

Discount/Loss on issue of debenture A/c Dr. [Amount equal to the discount on issue of debenture plus Premium on redemption]

To ...% Debenture A/c

(c) For allotment money received

Bank A/c Dr.

To Debenture Allotment A/c

Instead of passing the separate entries, a compound entry can also be passed:

Bank A/c	Dr.	
Discount/Loss on issue of debentures A/c	Dr.	
To ...% Debentures A/c		
To Debenture redemption premium A/c		

6. Debentures Issued at premium and redeemable at premium

In this scenario, both the issue price and redemption value surpass the par value. The premium received during the debenture issuance is acknowledged in the Securities Premium Account, and the premium paid upon redemption represents a loss to be accounted for during the debenture issue.

For instance, if a 10% debenture with a face value of Rs.1,000 is issued at a premium of Rs.100 and redeemable at a premium of Rs.50 per debenture, in this case, Rs.100 is credited to the Securities Premium Account, and Rs.50 is recognized as a loss to be provided for at the time of the debenture issue. It is important to note that the premium on the redemption of debentures is also credited by Rs.50.

(a) For application money received

Bank A/c	Dr.	
To Debenture Application A/c		

(b) For making allotment

(i) Application money transferred to debenture account

Debenture Application A/c	Dr.	
To % Debentures A/c		

(ii) Allotment money due of debenture at premium and Redeemable at premium

Debenture Allotment A/c	Dr.	
Loss on issue of debenture A/c	Dr.	[Amount equal to the Premium on redemption]
To ...% Debenture A/c		
To Securities Premium A/c		[Amount equal to premium on issue]
To Premium on Redemption of Debentures		[Amount equal to Debentures A/c premium on redemption]

Instead of passing the separate entries, a compound entry can also be passed:

Bank A/c	Dr.	
Loss on issue of Debentures A/c	Dr.	
To ...% Debentures A/c		
To Securities Premium A/c		
To Premium on redemption of debentures A/c		

3.6.2 Accounting for issue of debentures payable in instalments

Similar to shares, the payment for debentures can be made either in full with the application or in instalments. The accounting entries will vary to some extent in each scenario.

Debentures Payable in Full on Application

When the amount owed on debentures is payable in full upon application, it is customary to establish distinct Debentures Application Accounts for each debenture class, such as the 10% Debentures Application Account or 12% Debentures Application Account.

These accounts document the funds received from debenture applicants. In cases of oversubscription, these accounts can be utilized to record the repayment of funds to unsuccessful applicants.

During the debenture allotment process, the sum in the Debentures Application Account is transferred to the corresponding Debentures Account.

As previously discussed, debentures may be issued at par, at a premium, or at a discount.

Debentures Issued at Par

Debentures issued at par are priced at their nominal value, meaning that if a debenture with a face value of Rs.100 is issued at par, the company receives Rs.100.

The accounting entries would be recorded as follows:

(a) When Application money is received

Bank A/c Dr.

To Debentures Application A/c

(Being money received on.... debentures @` ....each)

(b) When excess Application money is refunded or adjusted for future calls

Debentures Application A/c Dr.

To Bank A/c (Amount refunded)

To Debenture Allotment A/c (Amount adjusted for allotment)

(Being excess money...debentures adjusted)

(c) When the debentures are allotted

Debentures Application A/c Dr.

To % Debentures A/c

(Being the allotment of...debentures of ` ....each.)

(d) When Allotment money becomes due

Debenture Allotment A/c Dr.

To % Debentures A/c

(Being Allotment Money due)

(e) When Allotment money is received

Bank A/c Dr.

To Debenture Allotment A/c (Being Allotment money received)

(f) On Debenture Call money being due

Debenture Calls A/c Dr.

To % Debentures A/c (Being Debentures Call money made due)

(g) On Debenture Call money being received

Bank A/c Dr.

To Debenture Calls A/c (Being Debentures Call money received)

Debentures Issued at a Premium

A company opts to issue debentures at a premium when the market interest rate is lower than the debenture's stated interest rate. Debentures issued at a premium are priced higher than their nominal value.

For instance, if a debenture with a face value of Rs.100 is issued at a 10% premium, the company receives Rs.110, and the investor receives slightly less interest than indicated in the debenture. Consider 12% Debentures with a face value of Rs.100 issued at a premium of 10%. The investor receives Rs.12 annually for the investment of Rs.110. Consequently, the effective rate of interest on the investment is calculated as (12/110x 100) = 10.91%.

The following accounting entries would be recorded:

(a) When Application money is received

Bank A/c Dr. [Nominal value plus premium]

To Debentures Application A/c

(Being Application money received on....debentures @ ` ..... each including premium of `)

(b) When Application money is refunded

Debentures Application A/c Dr.

To Bank A/c

(Being refund of money on....debentures @ ` .... Each)

(c) When the debentures are allotted

Debentures Application A/c Dr.

To % Debentures A/c

To Securities Premium A/c

(Being the allotment of....debentures, premium transferred to Securities Premium A/c)

Debentures Issued at a Discount

- The Companies Act does not impose any limitations on the price at which debentures can be issued, unlike shares.
- There is no specified limit for the discount on the issue of debentures, making it quite common for debentures to be issued at a discount. Debentures issued at a discount are priced below their nominal value.

- For instance, if a debenture with a nominal value of Rs.100 is issued at a 10% discount, the company receives only Rs.90. Issuing debentures at a discount slightly increases the effective rate of interest payable. Consider 12% Debentures with a face value of Rs.100 issued at a discount of 10%. The company has to pay Rs.12 for a loan of Rs.90. Therefore, the effective rate of interest is calculated as (12/90 x 100) = 13.33%.
- When the market rate of interest exceeds the debenture interest rate, the company issues debentures at a discount, similar to shares.
- The Debentures Account is credited with the nominal value, and the difference between the nominal value of debentures and the cash received is transferred to the "Discount on Issue of Debentures" Account.
- In the subsequent years, the Discount on Issue of Debentures is gradually written off proportionately by charging it to the Statement of Profit and Loss. It is customary to amortize the discount on the issue of debentures over the period of benefit, typically 3 to 5 years, but not exceeding the tenure of the debentures.

The Following accounting entries would be recorded:

(a) When Application money is received

Bank A/c	Dr.	[Actual cash received]
To Debentures Application A/c		
(Being Application money received on....debentures @` ......each)		

(b) When excess Application money is refunded

Debentures Application A/c	Dr.	
To Bank A/c		
(Being excess money on...debentures refunded as per Board's Resolution No.....dated....)		

(c) When the debentures are allotted

Debentures Application A/c	Dr.	[Actual cash received]
(d) Discount on Issue of Debentures A/c	Dr.	[Discount on debentures]
To% Debentures A/c		[Nominal value of debentures]
(Being the allotment of...debentures of ` ....each @ ` .....each)		

Indeed, the discount on the issue of debentures is viewed as an additional interest expense. The actual cost (net borrowing cost) for a specific accounting period is, consequently, the sum of the total interest payment and the amortized discount.

3.7 ISSUE OF DEBENTURES AS COLLATERAL

SECURITY

Collateral security refers to an additional or supportive security provided for a loan, which the lender can utilize if the original loan is not repaid by the due date. In this arrangement, the borrower agrees that a specific asset or a set of assets will be liquidated, and the proceeds will be used to settle the loan if the amount due cannot be paid.

In such instances, the holder of these debentures is eligible to receive interest solely on the loan amount, and not on the debentures themselves.

Occasionally, companies use their own debentures as collateral security for a loan or a revolving overdraft. When the loan is repaid as scheduled, these debentures are promptly released along with the primary security.

However, if the company is unable to repay the loan and the associated interest on time, the lender assumes the role of the debenture holder and can exercise all the rights associated with being a debenture holder.

Accounting Entries

There are two methods of recording these types of debentures in the accounts of a company.

Method 1

With this approach, there is no recording of entries in the company's accounting books during the issuance of these debentures. Instead, the acknowledgment of the debentures being issued and outstanding is disclosed in the 'Notes to Accounts' section of the Balance Sheet, specifically noted under the secured liabilities.

3.8 ISSUE OF DEBENTURES IN CONSIDERATION OTHER THAN FOR CASH

Similar to shares, debentures can be issued in exchange for considerations other than cash, such as for the acquisition of land, machinery, and so on. In this scenario, the subsequent entries are recorded :

(a) Sundry Assets Account	Dr.	[Assets taken over]
To Sundry Liabilities Account		[Liabilities assumed]
To Vendors Account		[Purchase consideration]
(Being the assets and liabilities taken over)		
(b) Vendors Account	Dr.	
To Debentures Account (Being the issue of debentures as purchase consideration)		

Additionally, it is important to observe that these debentures can be issued at par, premium, or at a discount. In each instance, the second entry for the issuance of debentures should be made accordingly. The calculation for the number of debentures to be issued is as follows :

1. When debentures are issued at par

$$\text{No. of Shares} = \frac{\text{Purchase Consideration}}{\text{Par Value}}$$

2. When debentures are issued at premium

$$\text{No. of Shares} = \frac{\text{Purchase Consideration}}{\text{Par Value} + \text{Premium}}$$

3. When debentures are issued at discount

$$\text{No. of Shares} = \frac{\text{Purchase Consideration}}{\text{Par Value} - \text{Discount}}$$

3.9 TREATMENT OF DISCOUNT/LOSS ON ISSUE OF DEBENTURES

The discount on the issuance of debentures is amortized over the period between the date of issuance and the date of redemption.

The write-off should be done in the following manner based on the terms of redemption:

(a) If the debentures are redeemable after a specific period (i.e. in One go), for example, at the end of 5 years, the entire discount amount should be evenly written off over the debentures' lifespan (employing the straight-line method).

This method offers the advantage of distributing the discount burden equally over the years.

(b) If the debentures are redeemable on different dates (i.e. In Installment), the total discount amount should be written off in proportion to the benefit derived from the debenture loan in any given year (utilizing the sum of the year's digit method).

This method is suitable when debentures are redeemed through uneven installments.

The Following accounting entries would be passed :

Profit and Loss Account Dr.

To Discount on Issue of Debentures Account

(Being the amount of discount on issue of debentures written-off)

The loss incurred on the issuance of debentures is also considered a capital loss and should be amortized in a manner similar to the discount on issued debentures. In the balance sheet, both items (Discount and Loss) are presented as non-current or current assets, depending on the period over which they are to be written off.

3.10 INTEREST ON DEBENTURES

Interest due on coupon debentures is recognized as an expense against the company's profits. The interest on debentures is paid regularly, calculated at the coupon rate on the nominal value of the debentures.

The company disburses interest to debenture holders after deducting taxes (i.e. TDS). The deducted tax is then deposited by the company with the income tax authorities.

In this case , following accounting entries are to be recorded:

1. For making interest due

Interest A/c Dr.

To Debenture holders' A/c

2. For interest paid and deduction of tax at source (TDS)

Debenture holders A/c Dr.

To TDS Payable A/c

To Bank A/c

3. For tax deducted at source (TDS) paid

   TDS payable A/c Dr.

   To Bank A/c

4. For interest transferred to profit and loss account

   Profit and Loss A/c Dr.

   To Interest A/c

TEST YOUR KNOWLEDGE

True and False

1. Debenture holders are the owners of the company. (ICAI Study Material)

Sol. False. Debenture holders are considered creditors of the company.

2. Perpetual debentures are payable at the time of liquidation of the company. (ICAI Study Material)

Sol. True. Perpetual debentures, also referred to as irredeemable debentures, are not repayable during the lifetime of the company.

3. Registered debentures are transferable by delivery. (ICAI Study Material)

Sol. False. Registered debentures are not easily transferable through delivery, while bearer debentures are transferable by delivery.

4. When companies issue their own debentures as collateral security for a loan, the holder of such debenture is entitled to interest only on the amount of loan and not on the debentures . (ICAI Study Material)

Sol. True. If the company fails to repay its loan and interest on the due date, the lender assumes the role of a debenture holder and is entitled to interest on the debentures.

5. Debentures suspense account appears on liability side of balance sheet. (ICAI Study Material)

Sol. False. Debentures Suspense Account is listed on the liabilities side of the balance sheet under non-current liabilities.

6. If a company incurs loss, then it does not pay interest to the debenture holders. (ICAI Study Material)

Sol. False, Regardless of whether the company incurs a loss or earns a profit, it is obligated to pay interest on debentures.

7. At the time of liquidation, debenture holders are paid off after the shareholders. (ICAI Study Material)

Sol. False, During liquidation, debenture holders are repaid before shareholders on a priority basis.

8. Convertible debentures can be converted into equity shares. (ICAI Study Material)

Sol. True. Convertible debentures can be converted into equity shares after a certain period from the date of issuance.

9. *Redeemable debentures are not payable during the life time of the company. (ICAI Study Material)*

Sol. **False.** *These debentures are repayable based on the terms of issue, for instance, after 8 years from the date of issue.*

10. *Debentures can be issued for a consideration other than for cash, such as for purchasing land, machinery etc. (ICAI Study Material)*

Sol. ***Correct.*** *Debentures can be issued in exchange for considerations other than cash, such as for purchasing land, machinery, etc.*

11. Debenture Redemption Premium Account and Discount on issue of debentures Account are Nominal Accounts.

Sol. **False:** The Debenture Redemption Premium Account is classified as a Personal Account, while the Discount on Issue of Debentures Account is categorized as a Nominal Account.

12. Now Debentures can be issued at Par/Premium but not at discount.

Sol. **False.** Debentures can be issued at par, premium, or discount, as there are no limitations on issuing debentures at a discount.

13. Like Shares a Company can issue debentures with voting rights.

Sol. **False.** A company is not permitted to issue debentures with voting rights.

14. A fixed charge generally covers all the assets of the company including future one.

Sol. False . A fixed charge is established on specific, identifiable assets (whether movable or immovable), while a floating charge encompasses the entire class of assets, including both existing and future assets.

MULTIPLE CHOICE QUESTIONS

1. *Premium on redemption of debentures account appearing in the balance sheet is.*

(ICAI Study Material)

(a) A nominal account – expenditure

(b) A nominal account - income

(c) A personal account_.

(d) None of the Above

Sol. *(c) A personal account.*

2. *Debenture interest-* **(ICAI Study Material)**

(a) Is payable before the payment of any dividend on shares

(b) Accumulates in case of losses or inadequate profits

(c) Is payable after the payment of preference dividend but before the payment of equity dividend _.

Sol. *(a) Is payable before the payment of any dividend on shares*

3. F Ltd. purchased Machinery from G Company for a book value of Rs.4,00,000. The consideration was paid by issue of 10% debentures of Rs.100 each at a premium of 25%. The debenture account was credited with _. **(ICAI Study Material)**
   (a) Rs. 4,00,000
   (b) Rs. 5,00,000
   (c) Rs. 3,20,000
   (d) Rs. 3,50,000

Sol. (c) Rs. 3,20,000

4. Which of the following is not a characteristic of Bearer Debentures? **(ICAI Study Material)**
   (a) They are treated as negotiable instruments
   (b) Their transfer requires a deed of transfer
   (c) They are transferable by mere delivery
   (d) None of the Above

Sol (b) Their transfer requires a deed of transfer

5. When debentures are issued as collateral security, the final entry for recording the collateral debentures in the books is. **(ICAI Study Material)**
   (a) Credit Debentures A/c and debit Cash A/c.
   (b) Debit Debenture suspense A/c and credit Cash A/c.
   (c) Debit Debenture suspense A/c and credit Debentures A/c.
   (d) None of the Above

Sol. (c) Debit Debenture suspense A/c and credit Debentures A/c.

6. When debentures are redeemable at different dates, the total amount of discount on issue of debentures should be written off. **(ICAI Study Material)**
   (a) Every year by applying the sum of the year's digit method
   (b) Every year by applying the straight line method
   (c) To profit and loss account in full in the year of final or last redemption
   (d) None of the Above

Sol. (a) Every year by applying the sum of the year's digit method

7. Debentures are issued at discount when – (ICAI Study Material)
   (a) Market interest rate is higher than debenture interest rate
   (b) Market interest rate is lower than debenture interest rate
   (c) Market interest rate is equal debenture interest rate
   (d) All of the Above

Sol. – (b) Market interest rate is lower than debenture interest rate

8. Interest payable on Debentures attract – (ICAI Study Material)
   (a) Tax deducted at source
   (b) Goods and Service tax
   (c) Fringe benefit tax
   (d) Entertainment tax

Sol. (a) Tax deducted at source

THEORETICAL QUESTIONS

1. Distinguish between debentures and shares.

Sol.

Debentures	Shares
1. Debenture holders function as the company's creditors.	**1.** Shareholders of the company are the proprietors of the business.
2. Debenture holders lack voting rights, thereby posing no threat to the existing control structure of the company.	**2.** Shareholders possess voting rights, thereby exercising control over the overall affairs of the company.
3. Debenture interest is typically paid at a predetermined fixed rate, regardless of the company's profitability. Debentures take precedence over all types of shares for the payment of due interest.	**3.** Dividends on equity shares fluctuate based on company profits (while dividends on preference shares are fixed).
4. Interest on debentures constitutes charges against profits and is deductible as an expense when determining the company's taxable profit.	**4.** Dividends represent a distribution of profits and are not deductible when calculating the taxable profit of the company.
5. On the Company's Balance Sheet, debentures are categorized under "Term Borrowings."	**5.** The company's Balance Sheet includes shares categorized under "Shareholder's Fund," detailed in the 'Share Capital' section of the Notes to Accounts.
6. Debentures have the option to be converted into other debentures or shares based on the terms specified during the debenture issuance.	**6.** Shares are not convertible into other shares under any circumstances.
7. Debentures cannot be forfeited due to non-payment of call moneys.	**7.** Shares may be forfeited if allotment and call moneys are not paid.
8. Upon maturity, debenture holders receive their invested capital in accordance with the stipulated terms and conditions of redemption.	**8.** Equity shareholders cannot reclaim their investment before the company undergoes liquidation (unlike preference shareholders who have that privilege).
9. In the event of liquidation, debenture holders are repaid before shareholders.	**9.** During liquidation, shareholders receive payment last, after settling obligations to debenture holders, trade payables, and other liabilities.

2. Explain the purpose for raising of debenture by the company. Also give the main features of debentures.

Sol. The debenture is a frequently utilized debt instrument issued by companies to secure funds for their business operations. The primary approach for enhancing a company's available capital is through the issuance of debentures, which can be either simple or naked, lacking any charge on assets, or mortgage debentures with either a fixed or floating charge on some or all of the company's assets.

1. It is a written record that signifies a loan extended to a company.
2. It is a secure, interest-bearing financial instrument with interest payments due on specific dates.
3. The interest is payable at a predetermined fixed rate, irrespective of the company's profit levels.
4. The initial amount is reimbursed at a designated future date, or it is converted into shares or alternative debentures.
5. It may or may not establish a claim on the company's assets as collateral.
6. Typically, it is tradable on the stock exchange, with the option to buy or sell at a price either above or below its nominal value.

UNIT-4

10 ACCOUNTING FOR BONUS ISSUE AND RIGHT ISSUE

UNIT – 4: ACCOUNTING FOR BONUS ISSUE AND RIGHT ISSUE

4.1 ISSUE OF BONUS SHARES

4.1.1 Introduction

A bonus share can be described as the **issuance of shares to existing shareholders** in a company **without any cost, determined by the number of shares already held by them**.

To clarify, a **bonus issue does not involve raising new funds.** While **it increases the total number of issued and owned shares, it does not impact the company's net worth. Despite the increase in the total number of shares**, the proportion (%) of shares held by each shareholder **remains constant.**

Example – to understand above mentioned para

A Ltd. issued and subscribed shares are 5000, out of which 10% (i.e.500 shares) is with Mr.X, A Ltd

gave an offer of 1 share as bonus for every 2 share held.

After giving the effect company share increase to 7500 (i.e.5000 + 2500 bonus issue) and Mr. X now

own 750 share (i.e.500 + 250 bonus)

However, % owned by Mr. X after bonus issue will remain same i.e 10%

The **term "bonus issue" is also referred to as 'capitalization of profits.' This process involves converting profits or reserves** ("which are otherwise available for distribution as dividends") **into paid-up capital by issuing fully paid bonus shares** to the members.

In the event that the subscribed and paid-up capital surpasses the authorized share capital due to a bonus issue, the company must in a general meeting pass a reSol. for the increase of the authorized capital.

Additionally, it is necessary to **submit a return of the bonus issue,** along with a copy of the reSol. authorizing the issuance of bonus shares, **to the Registrar of Companies.**

4.1.2 Provisions of the Companies Act, 2013

Section 63 of the Companies Act, 2013 addresses the issuance of bonus shares. As outlined in Sub-section (1) of Section 63, a **company is permitted to distribute fully paid-up bonus shares** to its members using any method,:

(i) its **free reserves;**

(ii) the **securities premium account;** or

(iii) the **capital redemption reserve account**

However, it is **important to note** that the capitalization of **reserves resulting from the revaluation of assets or reassessment of liability is not allowed for the purpose of issuing bonus shares.**

Sub-section (2) of Section 63 stipulates that a **company cannot capitalize** its **profits or reserves for the issuance of fully paid-up bonus** shares under sub-section (1) **unless** the following conditions are met:

(a) it is duly **authorized by** its **articles;**

(b) it has **received authorization in a general meeting** of the company on the recommendation of the Board;

(c) it has **not defaulted in the payment of interest or principal** related to **fixed deposits or debt securities issued** by the **company;**

(d) it has **not defaulted in meeting statutory obligations to employees,** such as contributions to provident fund, gratuity, and bonus;

(e) **any partly paid-up shares** outstanding on the date of allotment **are converted to fully paid-up shares; and**

Once a company has **publicly announced** the decision of its Board recommending a **bonus issue**, it is **not allowed to draw-back the decision.**

Also, Sub-section (3) of the section also explicitly states that **bonus shares cannot be issued as a substitute for dividend.**

According to Para 39 (i) of Table F under Schedule I to the Companies Act, 2013, during a general meeting, a **company** may, based on the Board's recommendation, **pass a reSol.**:

(i)

(a) expressing the desirability to capitalize a portion of the amount currently credited to any of the company's reserve accounts, the profit and loss account, or otherwise available for distribution; and

(b) specifying that the said amount should be released for distribution among the members in the designated manner, as if it were distributed as a dividend, and in the same proportions.

(ii) The aforementioned amount is not to be disbursed in cash but is to be utilized, subject to the conditions in clause (iii), either for:

(a) clearing any outstanding amounts on shares held by the respective members;

(b) fully paying up unissued company shares to be allotted and distributed, credited as fully paid-up, among the members in the specified proportions, either wholly as per (a) or partly as per (a) and partly as per (b) above.

It is important to note that a securities premium account and a capital redemption reserve account can exclusively be utilized for paying up unissued shares to be issued as fully paid bonus shares to members of the company. To clarify, these accounts cannot be used to settle unpaid amounts on shares held by current shareholders.

Question 1. Alpha Company announced bonus issue to its shareholders in the ratio of 2:3 ie. 2 shares for every 3 shares held. Shareholder X has 6.000 shares before announcement of bonus issue. How much shares would he have after bonus issue? **(ICAl Study Material)**

Sol. Company announced bonus issue in ratio of 2:3

Shareholder X will be entitled to have 4.000 bonus shares (6.000 shares / 3 x 2) Total number of shares X has after bonus issue 10.000 (6.000 + 4.000)

In accordance with Section 63(2) of the Companies Act. 2013. issuance of bonus shares is contingent upon the conversion of partly paid-up shares into fully paid-up status. Meanwhile. Para 39(ii) of Table F under Schedule I to the Companies Act. 2013 permits the utilization of free reserves to settle outstanding amounts on shares held by current shareholders.

By examining both provisions together, it can be concluded that free reserves are permissible for addressing unpaid amounts on shares held by existing shareholders, while it is important to note that the securities premium account and capital redemption reserve cannot be employed for this purpose.

4.1.3 Journal Entries

(A) (1) At the time of the sanction of an issue of bonus shares

Capital Redemption Reserve Account Dr.

Securities Premium Account1 Dr.

General Reserve Account Dr.

Profit & Loss Account Dr.

To Bonus to Shareholders Account.

(2) At the time of issue of bonus shares

Bonus to Shareholders Account Dr.

To Share Capital Account.

(B) (1) **At the time of the sanction of bonus by converting partly paid shares into fully paid shares**

General Reserve Account Dr.

Profit & Loss Account Dr.

To Bonus to Shareholders Account

(2) **For making the final call due**

Share Final Call Account Dr.

To Share Capital Account.

(3) **At the time of adjustment of final call**

Bonus to Shareholders Account Dr.

To Share Final Call Account

4.1.4 Effects of Bonus Issue

Bonus issue has following major effects:

- Increase In share capital
- Reduction In EPS and other per share values
- Favorable act considered by market
- Adjustment In market price.
- Reduction In accumulated profits

4.2 RIGHT ISSUE

4.2.1 Introduction

Section 62(1)(a) of the Companies Act. 2013 **applies to both public and private companies seeking to Increase their subscribed share capital through the Issuance of additional shares**

When a company plans to **Issue new shares, there Is a potential for dilution of voting and governance rights among existing shareholders** if they are not provided the means to safeguard these rights This scenario arises because new shareholders may subscribe to the issued share capital The Companies **Act, 2013 addresses this concern by granting existing shareholders the opportunity to maintain their position through the Initial offering of newly Issued shares, exclusive to them**

Existing shareholders have the right to subscribe to these shares if they so choose. Alternatively, **if they opt not to subscribe, they are also afforded the right to renounce these shares In favor of another party,** unless the company's articles prohibit such a right to renounce

In summary, **existing shareholders possess the right to subscribe** to any fresh Issuance of shares by the company in proportion to their existing holdings They **also have the Implicit right to renounce this subscription In favor of someone else or reject It altogether**

In other words, existing shareholders enjoy a right of first refusal, entitling them to either subscribe for these shares, sell their rights, or decline the offer

VALUE OF RIGHT = CUM-RIGHT VALUE OF SHARE - EX-RIGHT VALUE OF SHARE

Question 6. Let's consider a scenario where a company initiates a right issue of 10,000 shares while its existing issued and subscribed capital stands at 100.000 shares. This allows any shareholder holding 10 shares to subscribe to 1 new share. Consequently. X. an existing shareholder with 1.000 shares, has the option to subscribe to 100 shares as a matter of right. At the outset. X's existing share percentage is 1% (1,000 / 100,000). If X chooses to subscribe to these shares, his percentage ownership in the company will remain at 1% (1.100 / 110.000). However, if X is comfortable with a slight dilution to 0.91% (1.000 / 110.000), he has the option to renounce the right in favor of

[* These question are not complete *]

A company intending to issue new shares must, in accordance with Section 62(1)(a) of the Companies Act. 2013, extend an offer to existing equity shareholders through a letter of offer, subject to the following conditions:

- The **offer should be presented through a notice** specifying the number of shares offered, **setting a timeframe not less than** fifteen days **(15 Days) and not exceeding thirty days (30 Days)** from the date of the offer. **If the offer is not accepted** within this period, **it will be considered as declined.**
- Unless the company's articles state otherwise, the aforementioned offer is deemed to include a right that can be exercised by the concerned individual to renounce the shares offered to them in favor of another person. The notice, as mentioned above, must explicitly state this right.
- Following the expiration of the specified time in the **notice or upon earlier intimation from the recipient that they decline** the offered shares, the Board of Directors has the authority to dispose of the shares in a manner that is **not detrimental to the existing shareholders and the company.**

EXCEPTIONS TO THE RIGHTS OF EXISTING EQUITY SHAREHOLDERS

Section 62 recognizes four scenarios under which a company may issue further shares, and in these situations, there is no obligation to offer them to existing shareholders.

The shares can be offered, bypassing existing shareholders, if the company has passed a special reSol. and complies to the prescribed procedures.

Situation 1

Shares may be issued to employees under an employees' stock option scheme, subject to specific conditions.

Situation 2

Shares may be offered to any individuals, either for cash or for a consideration other than cash, provided that the share price is determined by the valuation report of a registered valuer and subject to certain specified conditions.

Situation 3

In some instances, companies raise funds through debentures or loans, granting creditors the option to purchase equity shares at a predetermined price on a future date.

Section 62(3) specifies that the increase in the subscribed capital due to the exercise of such options is exempted from the provisions of this section.

However, this exemption is dependent upon the terms of issuing such debentures or loans with options being approved by a special reSol. in a general meeting before their issuance.

Situation 4

In a **unique scenario** where a **loan is obtained from the government, and** the **government, in the public interest, directs the conversion of debentures or loans into equity shares.** Section 62(4) comes into play.

This section empowers the government to issue an order directing such conversion, **even if the terms of the debenture or loan do not inherently include a provision for this conversion,** provided the government deems it reasonable under the circumstances and the order is issued in the public interest.

FINANCIAL EFFECTS OF A FURTHER ISSUE

The balance sheet encapsulates the financial status of a business. Issuing additional shares enhances both the equity (net worth) and the liquid assets (Bank). The equity amount is determined by multiplying the number of additional shares issued by the issue price. It's noteworthy that the issue price can surpass the face value, a scenario known as issuing shares at a premium. However, it's essential to mention that the Companies Act prohibits the issuance of shares at a discount, with the exception of sweat equity shares under Section 53.

BOOK VALUE OF A SHARE

Book value of a share = Net worth (as per books)/ Number of shares

In a scenario where there are 10,000 shares with a net worth of ₹ 1.25.000. the book value per share is calculated as ₹ 12.50 (₹ 125,000 divided by 10,000 shares). It's important to note that the market value of shares may deviate from their book value.

The market value reflects the current worth of a company's shares, considering anticipated future cash flows in the form of dividends and expected capital gains from future share price appreciation.

The market price existing before a rights issue is referred to as the Cum-right Market Price of the share. The decision to issue additional shares can impact the market value of the share. In theory, the post-rights issue value of a company's shares should be the sum of the market capitalization just before the rights issue and the cash inflows generated from the rights issue.

Typically, further public issues to existing shareholders are offered at a discounted price from the market value to encourage a positive response and reward existing shareholders.

For instance, consider a company with a net worth of ₹ 250,000. If 1,000 shares are issued in a rights issue at a price of ₹ 14 per share (in a ratio of 1:10, i.e., 1 new share for every 10 existing shares held), the total worth of tangible assets held by the business after the issue would be ₹ 264,000 (Existing net worth ₹ 250,000 + Fresh Issue ₹ 14,000). The equity shares would consequently be valued at ₹ 264,000.

The market price of shares after the further issue of shares (rights issue) is termed as the Ex-right Market Price of the shares. The Theoretical Ex-Rights Price is a hypothetical value assigned to a company's share immediately after a rights issue transaction. This price is expected to prevail after the completion of the further share issuance.

E.g.:-Right value of the shares = [Cum-right value of existing shares + (Right shares X Issue Price)] / (Existing Number of Shares + Number of Right shares)

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According to Section 2(57) of the Companies Act. 2013. the term 'net worth' refers to the total value of the paid-up share capital, along with all reserves generated from profits and the securities premium account This calculation involves subtracting the combined value of accumulated losses, deferred expenditure, and miscellaneous expenditure not written off. as indicated in the audited balance sheet However, the definition excludes reserves resulting from the revaluation of assets, the write-back of depreciation, and amalgamation.

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RIGHT OF RENUNCIATION

The right of renunciation pertains to a **shareholder's ability to relinquish their entitlement to purchase securities and transfer this right to another individual.**

Shareholders who have **received right** shares **have three options** regarding their rights -

(a) They can exercise the rights by acquiring additional shares in accordance with the details of the rights issue or

(b) Sell the rights in the market, or

(c) choose not to capitalize on their rights, essentially declining the right offer.

In well-functioning capital markets, the renunciation of rights holds value and can be converted into monetary gain by existing shareholders.

The monetary value accessible to existing shareholders as a result of a rights issue is termed the 'value of right.'

If a shareholder opts to renounce some or all of the right shares in favor of a nominee, the value of right is confined to the sale price of renouncing the right in favor of the nominee.

If an existing shareholder chooses to avail the right issue offer, the value of right is determined as outlined below:

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Value of right = Cum-right value of share - Ex-right value of share

EX- right value of the shares = [Cum-right value of the existing shares + (Rights shares × Issue Price)] / (Existing Number of shares + Number of right shares)

In our previous example. Ex-right value of share = [₹ 250,000 + (₹ 14 × 1,000 shares)] / 10,000

+ 1,000 shares = ₹ 24

Value of right = ₹ 25 - ₹ 24 = ₹ 1 per share.

Question 7. Continuing the previous case, consider an individual shareholder Mr. Narain holding 100 shares of Prosperous Company before rights issue.

Current worth of holding = No. of shares × Cum-right Market Price = 100 × 25 = ₹ 2,500

(a) If Narain exercises his right, he will pay ₹ 14 × 10 shares = ₹ 140.

His total investment in the company including right is ₹ 2.640 (₹ 2.500 + ₹ 140).

On a per share basis, it is ₹ 2.640 /110 shares = ₹ 24. Which is the Ex-right Market value of the share.

(b) If Narain does not exercise his right to further issue, his holding's worth will decline to ₹ 24 × 100 shares ■ ₹ 2400. The law allows him to compensate for this dilution of shareholding by renouncing this right in favour of, say. Mr. Murthy.

Narain can charge Murthy, in well-functioning capital markets, this dilution of ₹ 100 by renouncing his right to acquire 10 shares. Hence Murthy will be charged ₹ 10 per share (₹ 100 / 10 shares), in return for a confirmed allotment of 10 shares at ₹ 14 each.

For every share to be offered to Murthy. Narain must have ten shares at the back. Hence his holding of 10 shares fetches him right money of ₹ 10 or ₹ 1 per share held. This is exactly equal to the difference between Cum-right and Ex-right value of the share. It is termed as the Value of Right. (ICAI Study Material)

In a well-functioning capital market, this mechanism works in a fair manner to all the participants.

- Murthy's total investment will be ₹ 140 (payable to Company) + ₹ 100 (payable to Narain, by way of value of right), or ₹ 240. He will end up holding ten shares at an average cost of ₹ 24, which is the Ex-right Market Price of the share.
- Narain will have a final holding of ten shares worth ₹ 2400 + ₹ 100 by way of value of right received from Murthy. It matches with his cum-right holding valuation.

4.2.2 Accounting for Right issue

The accounting treatment of rights share is the same as that of issue of ordinary shares and the journal entry will be made as follows :

Bank A/c Dr.

To Equity shares capital A/c

If rights shares are being offered at a premium, the premium amount is credited to the securities premium account.

The accounting entry is as follows -

Bank A/c Dr.

To Equity Share Capital A/c

To Securities Premium A/c

Question 9 A Company having 70,000 shares of ₹10 each as its issued share capital and having market value of ₹21 issues rights shares in the ratio of 1:10 at an issue price of ₹ 10. Pass journal entry for issue of right shares. **(ICAI Study Material)**

Sol. The entry at the time of subscription of right shares by the existing shareholders will be:

Bank A/c Dr. 70.000

To Equity Share Capital A/c

70,000 (Being issue of 7,000 right shares at price of .₹ .10)

Working Note- Number of rights shares to be issued- 70,000/10 X 1 = 7000 shares.

Question 10 A company having 1,00,000 shares of ₹10 each as its issued share capital, and having a market value of ₹ 46, issues rights shares in the ratio of 1:10 at an issue price of ₹ 31. Pass journal entry for issue of right shares. **(ICAI Study Material)**

Sol. The entry at the time of subscription of right shares by the existing shareholders will be: Bank

A/c Dr. 3.10,000

To Equity Share Capital A/c 1,00,000

To Securities Premium A/c

2,10,000 (Being issue of 10,000 right shares @ ₹31 offered)

4.2.3 Advantages and Disadvantages of Right Issue

Advantages of Right Issue

1. A rights issue allows **existing shareholders to preserve their proportionate ownership** in the company, safeguarding their financial and governance rights. It discourages management **issuing shares to known individuals to exercise greater control** over the company's affairs.
2. In well-operating capital markets, a right issue inevitably results in the dilution of share value. However, existing shareholders are insulated from this impact by acquiring new shares at a discounted value compared to their cum-right value, effectively compensating for the decrease in share value. The cum-right value is maintained even if existing shareholders renounce their rights in favor of a third party.
3. A rights issue serves as a **natural hedge against the issuance expenses typically** associated with a public offering (**IPO or FPO**)
4. **A right issue positively enhances the company's image,** garnering approval from the public and shareholders.
5. The **probability of success** for a rights issue surpasses that of a general public offering and is considerably more logistically manageable.

DISADVANTAGES OF RIGHT ISSUE

1.A right issue inevitably results in a **reduction of the market value of the company's shares.**

2.The **appealing price** of the rights issue must be **objectively evaluated in comparison to its actual value to guarantee a favorable deal.**

EFFECTS OF RIGHT ISSUE

- Maintenance of existing shareholders' proportional holding in company and retain their financial and governance rights
- Dilution in the value of share.
- Image enhancement
- Convenience in handling issue

TEST YOUR KNOWLEDGE

True and false

1. Earning per share gets increased after bonus issue **(ICAI Study Material)**

Sol. False Earnings per share decrease following a bonus issue.

2. Issued share capital including issue of rights shares and bonus shares may be more than the Authorised capital **(ICAI Study Material)**

Sol False The issued share capital, which includes rights shares and bonus shares, is always less than or equal to the authorized capital

3. Rights issue of shares results in decrease of market value of per share in comparison to market price before rights issue. **(ICAI Study Material)**

Sol True A rights issue of shares leads to a decrease in the market value per share compared to the market price before the rights issue.

4. Right shares are normally offered at a price more than the cum-right value of the share, causing dilution in its value post-right issue **(ICAI Study Material)**

Sol. False Right shares are typically offered at a price lower than the cum-right value of the share, resulting in a dilution in its value after the rights issue

MULTIPLE CHOICE QUESTIONS

1. Which of the following cannot be used for issue of bonus shares as per the Companies Act? (ICAI Study Material)
   (a) Securities premium account
   (b) Revaluation reserve
   (c) Capital redemption reserve
   (d) All of the above

Sol. (b) Revaluation reserve

2. Which of the following statements is true with regard to declaring and issuing of Bonus Shares? (ICAI Study Material)
   (a) Assets are transferred from the company to the shareholders
   (b) A Bonus issue results in decrease in reserves and surplus
   (c) A Bonus issue is same as declaration of dividends
   (d) None of the Above

Sol. (b) A Bonus issue results in decrease in reserves and surplus

3. Which of the following statement is true in case of bonus issue? (ICAI Study Material)
   (a) Convertible debenture holders will get bonus shares in same proportion as to the existing shareholders
   (b) Bonus shares may be issued to convertible debenture holders at the time of conversion of such debentures into shares
   (c) Both (a) and (b).
   (d) None of the Above

Sol

Sol. (c) Both (a) and (b)

4. Bonus issue is also known as **(ICAI Study Material)**
   (a) Scrip issue
   (b) Capitalisation issue
   (c) Both (a) and (b)
   (d) None of the Above

Sol (c) Both (a) and (b)

5. The bonus issue is not made unless **(ICAI Study Material)**
   (a) Partly paid shares are made fully paid up.
   (b) It is provided in its articles of association
   (c) Both (a) and (b).
   (d) None of the Above

Sol – (c) Both (a) and (b)

6. Bonus issue has the following effect **(ICAI Study Material)**
   (a) Market price gets adjusted on issue of bonus shares
   (b) Effective Earnings per share. Book Value and other per share values stand increased
   (c) Markets generally take the action as an unfavourable act
   (d) All of the above

Sol. (a) Market price gets adjusted on issue of bonus shares

7. ABC Co Ltd resolved to issue bonus shares Which of the following is not a pre-requisite for issuance of bonus shares? **(ICAI Study Material)**
   (a) Authorization in Articles of Association
   (b) Timely Payment of statutory dues of employees such as PF. Gratuity etc
   (c) Sufficient balance in bank account of company
   (d) None of the Above

Sol. (c) Sufficient balance in bank account of company

8. In case of further issue of shares, the right to renounce the shares in favour of a third party **(ICAI Study Material)**
   (a) Must include a right exercisable by the person concerned to renounce the shares;
   (b) Should include a right exercisable by the person concerned to renounce the shares;
   (c) Is deemed to include a right exercisable by the person concerned to renounce the shares (subject to the provisions under the articles of the company).
   (d) All of the above

Sol. (c) Is deemed to include a right exercisable by the person concerned to renounce the shares (subject to the provisions under the articles of the company)

9. A company 's share 's face value is ₹10. book value is ₹ 20. Right issue price is ₹ 30 and Market price is ₹ 40. while recording the issue of right share, the securities premium will be credited with **(ICAI Study Material)**
   (a) ₹ 10
   (b) ₹ 20

(c) ₹ 30

(d) ₹40

Sol. (b) ₹ 20

10. A. Right shares enable existing shareholders to maintain their proportional holding in the company (ICAI Study Material)

B. Right share issue does not cause dilution in the market value of the share

Which of the option is correct? (ICAI Study Material)

(a) A-Correct; B Correct

(b) A - Incorrect; B Correct

(c) A - Correct. B - Incorrect

(d) None of the above

Sol. (c) A - Correct; B - Incorrect

11. Ex-Rights price can be calculated by which of these formulas ? (ICAI Study Material)

(a) (Cum rights value of the existing shares + Rights share issue proceeds)/ (existing number of shares + No of right shares)

(b) (Cum rights value of the existing shares + Rights share issue proceeds) × (existing number of shares + No of right shares)

(c) (Cum rights value of the existing shares - Rights share issue proceeds)/ (existing number of shares - No of right shares)

(d) None of the Above

Sol - (a) (Cum rights value of the existing shares + Rights share issue proceeds)/ (existing number of shares + No of right shares).

THEORETICAL QUESTIONS

1. What is meant by Bonus issue? Explain its related provisions as per the Companies Act. 2013 **(ICAI Study Material)**

Sol. A Bonus Issue refers to the provision of complimentary additional shares to current shareholders A company might opt to allocate additional shares as an alternative method to enhance dividend distribution For details, refer para 41.1 & 41.2

2. Explain the financial effects of a further issue of equity shares on the market value of the share. **(ICAI Study Material)**

Sol. The financial status of a business is outlined in its balance sheet The issuance of additional shares augments both the share capital and the liquid resources (Bank) The total share capital issued results from multiplying the additional number of shares by the issue price, which can surpass the face value, indicating an issuance at a premium

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3. What are the advantages and disadvantages of a rights issue? **(ICAI Study Material)**

Sol. A rights issue entails the granting of privileges to a company's current shareholders, allowing them to purchase additional shares directly from the company in proportion to their existing holdings within a specified timeframe For advantages and disadvantages of right issue, refer para 4.2 3

4. What is meant by renunciation of rights shares by existing shareholder?.

(ICAI Study Material)

Sol. In a scenario where a current shareholder does not plan to participate in a company's rights issue, they have the option to relinquish their entitlement in favor of another individual in exchange for consideration This act of surrendering rights is referred to as the renunciation of rights

CHAPTER

10

Redemption of debentures

6.1 INTRODUCTION

A **debenture is a financial instrument issued by a company under its official seal, acknowledging a financial obligation** and outlining terms for the repayment of both principal and interest.

In accordance with Section 71(1) of the Companies Act, 2013, a **company has the authority to issue debentures with** an **option to convert them** into shares, either in full or in part, during the redemption process.

However, this issuance, specifically debentures **with a conversion option, must receive approval through a special resolution** passed at a properly convened general meeting.

As specified in **Section 71(2)**, **it is prohibited for any company to issue debentures with voting rights.**

Basic provisions

In the **event when charge** has been **established** on a specific asset or the entirety of a company's assets, the **document should describe:**

The **characteristics of** the charge (i.e Fixed or Floating)
A **description of the asset(s)** subject to the charge. (in case of fixed charge) are described therein.

As **registration with** the Registrar is a prerequisite for the validity **of the charge**, the bond includes a certificate from the Registrar confirming the registration of the charge.

In the case of **mortgage debentures**, it is a **common practice to establish** a **trusteeship in favor of one or more individuals**. The **trustees** holding the debentures possess the **authority equivalent to that of a property mortgage, enabling them to take any necessary actions to protect the interests of debenture** holders.

6.2 REDEMPTION OF DEBENTURES

Debentures typically possess a redeemable nature, indicating that they are **either repaid in cash or can be converted into equity shares** after a specified duration.

The **redemption** of these debentures **may occur through various methods**, including:

Completion of a fixed number of years **(i.e. One Shot Repayment)**

Any time subsequent to a specific duration from their issuance
Providing a designated notice period
Annual drawing **(i.e In Instalments)**

Moreover, a company retains the option to acquire its debentures at its convenience in the open market. In situations where the debentures are traded at a discount on the Stock Exchange, it can be advantageous for the company to **purchase and subsequently cancel them.**

6.3 DEBENTURE REDEMPTION RESERVE

When a **company issues debentures,** it **may be obligated** (required) **to establish a debenture redemption reserve account using profits available for dividend distribution.**

The **funds credited to this account** must be exclusively **designated for** the **redemption of debentures** and cannot be employed by the company for any purpose other than the debenture redemption. **This structure ensures** that the **company maintains adequate liquid funds to meet debenture redemption obligations** when they become due.

Annually, a **suitable portion of profits** is **allocated to** the Debenture **Redemption Reserve, and** the **corresponding investment** is **referred to** as **Debenture Redemption Reserve Investment or Debenture Redemption Fund.**

In the final year or **at the time of debenture redemption**, the **investments** in the Debenture Redemption Reserve **are liquidated, and** the proceeds are **utilized for** the **redemption** of debentures.

63.1 Requirement to create Debenture Redemption Reserve

The Companies Act 2013, specifically outlined in Section 71, addresses the necessity of establishing a debenture redemption reserve account. The provisions of Section 71 are detailed as follows:

(1) In instances where a **company issues debentures** under this section, it is **mandated to establish** a debenture redemption reserve **(DRR) A/c using its profits available for dividend** distribution **each year until** the said debentures are duly **redeemed**.

(2) The **sums credited to the debenture redemption reserve are strictly reserved** for the stipulated purpose and may not be utilized by the company for any other objective beyond the aforementioned purpose.

(3) The **company is required to comply** with the **T & C of** the **debentures' issuance, including** the **payment of interest** and the **redemption of debentures**.

(4) In instances **where a company neglects** to **redeem debentures upon maturity or defaults in paying** the **interest** when due, the **Tribunal** (Type of Court) has the authority, **upon the application of debenture holders or the debenture trustee**, and subsequent to a hearing involving all concerned parties, to **issue an order compelling** the company to promptly **redeem the debentures** by settling the principal and the accrued interest.

6.3.2 Balance in Debenture Redemption Reserve (DRR)

When the **company establishes** the Debenture Redemption Reserve **(DRR) A/c** the **designated amount** from the **credit to** the Debenture Redemption Reserve **(DRR) A/c** and a **debit to** the

Statement of P & L. This signifies the company's intent to allocate funds for the creation of a reserve intended for debenture redemption.

Concurrently, the **company** should **acquire investments**. The **corresponding entry** for this purpose would naturally involve **Dr. DRR Investment A/c** and **Cr.** the **Bank A/c.**

6.3.3 Adequacy of Debenture Redemption Reserve (DRR)

In accordance with Rule 18 (7) of the Companies (Share Capital and Debentures) Amendment Rules, 2019, the company is required to adhere to the stipulations concerning the Debenture Redemption Reserve (DRR) and the investment or deposit of funds related to debentures maturing in the year ending on the 31st day of March of the subsequent year (refer to paragraph 6.4 below), based on the conditions outlined below —

The **creation of the Debenture Redemption Reserve must be sourced from the company's profits available for dividend payment**; the **prescribed limits pertaining to the sufficiency of DRR and investment or deposits,** as **applicable, are as follows:**

S. No	Debentures issued by	Adequacy of Debenture Redemption Reserve (DRR)
1	All India Financial Institutions **(AIFIs), under the supervision of the Reserve Bank of India and Banking Companies,** are overseen in their issuance of debentures, whether publicly or privately placed.	The creation of a Debenture Redemption Reserve (DRR) is **not obligatory (i.e. optional to create**)
2	Other financial institutions (FIs) as defined in clause (72) of section 2 of the Companies Act, 2013.	(DRR) will be applicable to Non-Banking Financial Companies (NBFCs) registered with the RBI , as per the provision outlined in (3) below.
3	**Regarding listed companies** (other than AIFIs and Banking Companies as indicated in Sr. No. 1 above):	
	a. All **listed NBFCs** (registered with RBI under (Housing Finance Companies registered with National Housing Bank) **for both public as well as privately placed debentures**	**No DRR** is required section 45-IA of the RBI Act,) and **listed HFCs**
	b. **Other listed companies for both public** as **privately placed debentures**	**No DRR** is required well
4	**Regarding unlisted companies** (other than AIFIs and Banking Companies as indicated in Sr. No. 1 above	
	a. All **unlisted NBFCs** (registered with RBI under section 45-IA of the RBI (Amendment) Act, 1997) and **unlisted HFCs** (Housing Finance Companies registered with National Housing Bank) **for privately placed debentures**	**No DRR** is required
	b. **Other unlisted companies**	**DRR** shall be **10% of** the **value of** the **outstanding debentures** issued

6.3.4Investment of Debenture Redemption Reserve (DRR) Amount

Moreover, in accordance with Rule 18 (7) of the Companies (Share Capital and Debentures) Amendment Rules, 2019, the **subsequent categories of entities are subject to the following regulations:**

(a) All publicly **listed NBFCs**

(b) All publicly **listed HFCs**

(c) All other publicly **listed companies (excluding AIFIs, Banking Companies, and other Financial Institutions)**; and

(d) All **unlisted companies** that are **neither NBFCs nor HFCs**

Shall, by the 30th day of April each year, concerning the issued debentures, **deposit or invest**, as applicable, an amount not less than 15% of the total debentures maturing in the year ending on the 31st day of March of the subsequent year, utilizing one or more of the following methods:

(a) In deposits with any scheduled bank, clear of any charge or lien;

(b) In unencumbered securities of the Central Government or any State Government;

(c) In unencumbered securities listed in clauses (a) to (d) and (ee) of Section 20 of the Indian Trusts Act, 1882;

(d) In unencumbered bonds issued by any other company specified under clause (f) of Section 20 of the Indian Trusts Act, 1882.

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The deposited or invested amount, as applicable, must be exclusively utilized for the redemption of debentures maturing in the specified year.

However, it is imperative that the remaining deposited or invested amount never falls below 15% of the total debentures maturing by the 31st day of March of that particular year.

In the case of partly convertible debentures, the creation of the Debenture Redemption Reserve (DRR) is required for the non-convertible portion of the debenture issue.

The funds credited to the DRR are reserved solely for the purpose of debenture redemption and cannot be employed for any other use by the company.

Note: While it is permissible to allocate to the DRR at any time before redemption and to invest in specified securities mentioned above before the 30th of April for debentures maturing in that year, for the sake of simplicity, it is advisable to perform the allocation and investment promptly after the debentures are allotted, assuming the company has adequate profits (if the allotment date is not provided in the question). Additionally, in cases where the date of allotment is missing, the appropriation and investments should be executed on the first day of the year for which ledger accounts are to be prepared.

6.3.5Journal Entries

The required journal entries recorded in a company's accounts are as follows::

1. After allotment of debentures
   (a) For setting aside the fixed amount of profit for redemption
       Profit and Loss A/c Dr.
       To Debenture Redemption Reserve A/c
   (b) For investing the amount set aside for redemption
       Debenture Redemption Reserve Investment A/c Dr.
       To Bank A/c
   (c) For receiving interest on Debenture Redemption Reserve Investments Bank A/c Dr.
       To Interest on Debenture Redemption Reserve Investment A/c
   (d) For transfer of interest on Debenture Redemption Reserve Investments (DRRI)
       Interest on Debenture Redemption Reserve Investment A/c Dr.
       To Profit and loss A/c*

* Taking into account the circumstance where interest is annually received through the cash/bank account and is not reinvested, this aspect has been acknowledged in the examples provided in the chapter. Consequently, the interest on DRR investment is not credited to the DRR Account but is instead accounted for in the Profit and Loss Account.

2. At the time of redemption of debentures
   (a) For encashment of Debenture Redemption Reserve Investments
       Bank A/c Dr.
       To Debenture Redemption Reserve Investment A/c
   (b) For amount due to debentureholders on redemption
       Debentures A/c Dr.
       To Debentureholders A/c
   (c) For payment to debentureholders
       Debentureholders A/c Dr.
       To Bank A/c
   (d) After redemption of debentures, DRR should be transferred to general reserve
       DRR A/c Dr.
       To General Reserve

6.4 METHODS OF REDEMPTION OF DEBENTURES

The redemption of debentures should adhere to the terms outlined in the debenture issuance, and any deviation from these terms will be regarded as a default by the company.

The settlement of the debt associated with the issued debentures can be accomplished through one of the three methods, namely:

6.4.1 By payment in lumpsum

In the lump-sum payment method, the complete redemption of the debenture occurs either at its maturity or before the designated period's expiration, with the entire amount settled in a single payment.

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8.1.1 By payment in Instalments

In the installment payment method, specified portions of the debenture are paid in installments at designated intervals.

8.1.2 Purchase of Debentures in Open Market

The acquisition of debentures in the open market is occasionally practiced. However, it's important to note that this topic is not addressed in the chapter as it has been deliberately excluded from the Foundation level syllabus.

TEST YOUR KNOWLEDGE

TRUE AND FALSE

1. Amounts credited to the debenture redemption reserve may be utilised by the company for any purpose. .(ICAI Study Material)

Sol. False: The funds credited to the debenture redemption reserve should only be utilized for the specific purpose of debenture redemption and not for any other purpose.

2. All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures need not create any Debenture Redemption Reserve (DRR). **.(ICAI Study Material)**

Sol. True: All India Financial Institutions (AIFIs) regulated by the Reserve Bank of India and Banking Companies for both publicly and privately placed debentures are not obligated to create any Debenture Redemption Reserve (DRR).

3. Under payment in instalments method, the payment of entire debenture is made in one lot. **(ICAI Study Material)**

Sol. False: In the installment payment method, specified portions of debentures are paid in installments at specified intervals.

4. At redemption of debentures, DRR should be transferred to general reserve. . **(ICAI Study Material)**

Sol. True: The Debenture Redemption Reserve (DRR) is transferred to the general reserve at the time of debenture redemption.

MULTIPLE CHOICE QUESTIONS

1. Which of the following statements is true? .(ICAI Study Material)

(a) A debenture holder is an owner of the company.

(b) A debenture holder can get his money back only on the liquidation of the company.

(c) A debenture issued at a discount can be redeemed at a premium.

(d) All of the Above

Sol. (c) A debenture issued at a discount can be redeemed at a premium.

2. Which of the following statements is false? **(ICAI Study Material)**

(a) Debentures can be redeemed by payment in lump sum at the end of a specified period.

(b) Debentures cannot be redeemed during the life time of the company.

(c) Debentures can be redeemed by payments in annual instalments.

(d) None of the Above

Sol. (b) Debentures cannot be redeemed during the life time of the company.

3. For debentures issued by unlisted companies (other than AIFIs, Banking companies, NBFCs and HFCs), Debentures Redemption reserve will be considered adequate if it is:. **(ICAI Study Material)**

(a) 25% of the value of debentures issued through public issue.

(b) 10% of the value of debentures issued through public issue.

(c) 5% of the value of debentures issued through public issue.

(d) 15% of the value of debentures issued through public issue

Sol. (b) 10% of the value of debentures issued through public issue

5. A company has issued 6% debentures for ₹ 10,00,000, interest being payable on 31st March and 30th September. The company redeems ₹ 10,000 debentures at ₹ 96 (ex-interest) on 1st August 2021. The amount of Profit/loss on cancellation of debentures will be - **(ICAI Study Material)**

(a) Profit of ₹ 600.

(b) Profit of ₹ 400.

(c) Loss of ₹ 400

(d) Loss of ₹ 500

Sol. (b) Profit of ₹ 400

THEORETICAL QUESTIONS

1. What is meant by redemption of debentures? Explain. **(ICAI Study Material)**

Sol. Debentures are typically redeemable, meaning they are either repaid in cash or convertible after a specific period. The redemption of these debentures can occur through various methods:

- After a fixed number of years
- Any time after a certain number of years has passed since their issuance

- Upon providing a specified notice
- Through an annual drawing.

For details, refer para 6.2 of this chapter .

2. Write short note on Debenture Redemption Reserve. **(ICAI Study Material)**

Sol. A company issuing debentures might need to establish a debenture redemption reserve account using profits allocated for dividend distribution. The amounts credited to this account should solely be earmarked for debenture redemption and cannot be utilized by the company for any purpose other than the redemption of debentures. This structure ensures that the company maintains adequate liquid funds for the timely redemption of debentures when they become due for payment.For details , refer para 6.3 of the chapter .

CHAPTER

00

Redemption of Preference Shares

INTRODUCTION

Redemption involves the **systematic repayment of an obligation** in predetermined amounts and schedules. It constitutes a **contractual agreement stipulating** the **redemption of preference shares within or at the end of** a **specified period at** a **predetermined price**.

These shares are issued with the understanding **that shareholders will, at a later date, receive a repayment equivalent to their initial investment** in the company, **in addition** to **periodic payments of specified dividends** as a return on investment during the tenure of the preference shares.

The **redemption date**, denoting the scheduled repayment, is typically **indicated on the preference share certificate**. The redemption process also allows a company to adjust its financial structure, such as eliminating preference shares and substituting them with other securities if the company's future growth makes such a change advantageous.

PURPOSE OF ISSUING REDEEMABLE PREFERENCE SHARES

A company might opt to release redeemable preference shares for the following reasons:

- It serves as an **appropriate means of raising funds** in a sluggish primary market.
- A **company facing challenges in raising share capital**, particularly **if** its **shares are not actively traded** on the stock exchange, **might find redeemable preference shares tempting to potential investors**. The redeemable feature can offer assurance to investors who may be hesitant to invest in shares that lack liquidity.
- **Redemption** of preference shares **becomes viable when** there is a surplus of capital, and the **excess funds cannot be effectively utilized for profitable business purposes**.
- **In situations of loss or no profit**, **redeemable preference shares** offer the **advantage of not requiring dividend payments, unlike debentures or loans where interest is payable even in the absence of profits**.
- Essentially, the **declared/paid preference dividend** remains classified as an **appropriation of profits**, similar to the treatment for equity shares, **in contrast** to the treatment of **debenture interest**, which is considered a **charge against profits**.

In India, the issuance and redemption of preference shares are regulated by Section 55 of the Companies Act, 2013.

PROVISIONS OF THE COMPANIES ACT (SECTION 55)

A company limited by shares, if authorized by its Articles, has the discretion to release preference shares that are subject to redemption, typically within a period not exceeding 20 years from the date of their issuance. It is important to observe that:

(a) The **redemption** of shares is **permissible solely from divisible or distributable profit**, i.e., the company's profit available for dividends, **or from** the **proceeds of a fresh issue of shares** specifically **generated for the purpose of redemption**.

(b) **Redemption** of such shares is only **allowed if they are fully paid**.

(c) (i) For c**ompanies falling** within the prescribed class and whose financial statements comply with the accounting standards specified for that class **under Section 133, any premium payable on redemption must be accounted for; from the profits of the company before the redemption of shares**:

Provided also that any **premium payable on** the **redemption of preference shares issued on or before the commencement Companies Act, 2013** by any such company **shall be accounted for; from** the profits **of the company** or from the company's **securities premium** account **before such shares are redeemed.**

(ii) For **other companies not included** by the provisions **in (**i) ab**ove**, any **premium payable on redemption shall** be **accounted for from** the **profits** of the company **or from** the company's **securities premium account before** the **redemption** of such shares.

(d) **In the event** that **such shares are intended to be redeemed** from the **company's profits**, a **sum equivalent to the** nominal amount **(face value) of** the **redeemed shares Less proceeds from a fresh issue for** redemption **purpose** shall be **transferred from** the **divisible profits**, i.e., the profits otherwise available for dividends, **to a reserve account named** the **Capital Redemption Reserve Account**.

The provisions of the Act concerning the reduction of the share capital of a company shall apply, with the exception as provided in the Section, as if the Capital Redemption Reserve (CRR) Account were the paid-up share capital of the company. **The utilization of the CRR Account is further constrained to the issuance of fully paid-up bonus shares exclusively.**

The **objective behind transfer to CRR A/c** is to **ensure** that the **security for creditors/bankers, etc.**, is not diminished with the repayment of redeemable preference shares.

METHODS OF REDEMPTION OF FULLY PAID-UP SHARES

The redemption of preference shares involves the company repaying its obligation related to the issued shares. As per the Companies Act, 2013, **preference shares must be redeemed within the maximum period allowed under the Act, usually not exceeding 20 years**. Consequently, the **issuance of irredeemable preference** shares by a company **is prohibited**.

In the case of **redeeming preference shares from** the **proceeds of a fresh** share **issue, the replacement of capital and tangible assets is evident.**

If redemption is carried **out from distributable profits**, the **replacement of capital occurs indirectly through the retention of profit** transferred **to the Capital Redemption Reserve. In this scenario**, the **amount that would have been distributed** to shareholders **as dividends** is

retained in the business and utilized to settle the claims of preference shareholders.

Consequently, there is **no additional depletion from** the **net assets** of the company. **The transfer** of divisible profits **to** the Capital Redemption Reserve **(CRR) renders them non-divisible profits**. As the Capital Redemption Reserve **can only be used for issuing fully paid bonus shares**, profits retained in the business **ultimately convert into share capital**.

The protection afforded to external stakeholders relies on both the called-up capital and the uncalled capital that the company can demand as per its requirements. In order to safeguard the interests of outsiders, **Section 55 stipulates the redemption of solely fully paid-up shares.**

From the preceding paragraphs, it can be inferred that the **'impact' resulting from the redemption of redeemable preference shares in the company's capital needs to be addressed by**:

(a) the proceeds from a **fresh issuance of shares**; **or**

(b) the **capitalization of undistributed profits** (accomplished by establishing a Capital Redemption Reserve); or

(c) a combination of **both** (a) **and** (b) as mentioned above.

Redemption of Preference Shares by Fresh Issue of Shares

Utilizing the funds generated from a new share issuance is one of the approaches for redeeming preference shares. The company has the option to issue fresh shares, whether they are equity shares or preference shares, and the funds derived from this new issuance can be employed for the redemption of preference shares.

However, **funds derived from the issuance of debentures cannot be allocated for this redemption of Preference Share**.

An **issue arises when** a new share offering is conducted with the intention of **redeeming preference shares at a premium. The crucial consideration is whether the fresh share issuance shall be a premium or not for the amount needed for the redemption of preference shares**.

Because as per Section 52 of the Companies Act, 2013 the securities premium account, permissible uses include –

(a) Utilization for the issuance of unissued shares of the company, provided to members as fully paid bonus securities.

(b) Writing off preliminary expenses of the company. **(Use Not Allowed for Companies covered Under Sec 133)**

(c) Writing off expenses or commissions paid, or discounts allowed on the company's securities or debentures.

(d) Provision for premium on the redemption of redeemable preference shares or debentures. **(Use Not Allowed for Companies covered Under Sec 133)**

(e) Purchasing its own shares or other securities.

Note: It is important to highlight that certain **categories of companies whose financial statements comply with the Accounting Standards specified under Section 133 of the Companies Act, 2013**, are **restricted from applying** the **securities premium account for the purposes mentioned in (b) and (d) above.**

Reasons for issue of New Equity Shares

A company may opt to release new equity shares for the following reasons:

(a) When the company acknowledges the **need for permanent capital, and it is more beneficial to issue Equity Shares instead of Redeemable Preference Shares**, as **Preference Shares entail** a **fixed rate of dividend.**

(b) When the **remaining profit**, typically available **for dividends, is inadequate.**

(c) In situations where the **company's liquidity position is not sufficiently robust**.

Advantages of redemption of preference shares by issue of fresh equity shares

The **benefits of redeeming preference** shares **through** the **issuance of fresh equity shares** are as follows:

(1) There is **no immediate or future cash outflow**.

(2) The **new equity shares can be issued a premium** value.

(3) Shareholders maintain their equity stake.

Disadvantages of redemption of preference shares by issue of fresh equity shares

The drawbacks include:

(1) **Future earnings** may face **dilution**.

(2) If the fresh issue is extended to external parties, there is a **shift in shareholding. However, if the fresh issue is offered to existing shareholders** proportionally (as **in a rights issue**), the **alteration in the shareholding structure** can be **avoided**.

ACCOUNTING ENTRIES

- When new shares are issued at par

  Bank Account Dr.

  To Share Capital Account

  (Being the issue of ....shares of `......each for the purpose of redemption of preference shares)

- When new shares are issued at a premium

  Bank Account Dr.

  To Share Capital Account

  To Securities Premium Account

  (Being the issue of shares of `......each at a premium of `......each for the purpose of redemption of preference shares)

- When preference shares are redeemed at par

  Redeemable Preference Share Capital Account Dr.

  To Preference Shareholders Account

- When preference shares are redeemed at a premium

  Redeemable Preference Share Capital Account Dr. Premium on Redemption of Preference Shares Account Dr.

  To Preference Shareholders Account

- When payment is made to preference shareholders

  Preference Shareholders Account Dr.

  To Bank Account

- For adjustment of premium on redemption

  Profit and Loss Account Dr.

  To Premium on Redemption of Preference Shares Account

CALCULATION OF MINIMUM FRESH ISSUE OF SHARES

Occasionally, exam questions omit the quantity of shares to be issued for redeeming preference shares, mandating the issuance of the minimum shares to comply with Section 55 of the Companies Act, 2013. This process involves four steps outlined below:

- In such scenarios, the utmost amount of reserves and surplus available for redemption is determined, considering the balances presented in the balance sheet pre-redemption and any supplementary details provided in the problem. For instance, if the general reserve balance in the balance sheet is Rs.1,00,000 and additional information states that the Board of Directors has decided it should not fall below Rs.40,000 under any circumstances, then the maximum amount of general reserve available for redemption is Rs.60,000.
- Following the determination of the maximum amount of reserves and surplus available for redemption, adjustments for the premium on redemption payable from profits are applied. This adjusted figure is then juxtaposed with the nominal value of the shares slated for redemption. This comparison yields the minimum proceeds from a fresh share issue, as Section 55 allows redemption from either the proceeds of a fresh issue or divisible profits.

Therefore, Minimum Proceeds from Fresh Share Issue:

Nominal value of preference shares to be redeemed – Maximum amount of reserve and surplus available for redemption.

- After the calculation of the minimum proceeds, the minimum number of shares to be issued is established by dividing the minimum proceeds by the value of one share. The procedure is as follows:

Minimum Number of Shares = Minimum proceeds to comply with Section 55 / Face value of one share

The term "proceeds of one share" refers to the par value of a share issued, whether at par or at a premium. However, in the case of shares issued at a discount, it pertains to the discounted value.

- The minimum number of shares computed as per (3) above requires adjustment for various reasons. Primarily, shares cannot be issued in fractions. Therefore, if the minimum number of shares as per (3) includes a fraction, it must be rounded up to the next higher whole number to ensure compliance with the provisions of Section 55. Additionally, if the exam question stipulates that the proceeds/number of shares should be a multiple of, for example, 10, 50, or 100, then the next higher multiple should be considered.

FRESH ISSUE AT A PREMIUM AND MINIMUM FRESH ISSUE

The calculation of the minimum number of shares, especially when a fresh issue is at a premium, requires careful consideration. It cannot be determined without knowledge of the profits available for replacing preference shares, and the available profit for replacement cannot be established without knowing the portion of profit allocated for the redemption, including the premium.

To address this, one may assume that the profits available for redemption are not needed for paying the premium on the redemption of preference shares. Essentially, this assumption implies that the securities premium, including the premium on the fresh issue, exceeds the premium on redemption.

If this assumption holds true, the minimum number of shares can be computed straightforwardly without resorting to the use of equations. However, if the stated condition does not hold true, an equation is employed to ascertain the minimum number of shares.

MINIMUM FRESH ISSUE TO PROVIDE FUNDS FOR REDEMPTION

Moreover, in addition to ensuring adherence to Section 55, the issuance of fresh shares is undertaken to generate funds for satisfying payment obligations to preference shareholders. To determine the minimum number of fresh shares required for fund provision, the amount payable to preference shareholders is juxtaposed with the available redemption funds, and the remaining funds to be raised through the issuance of fresh shares are computed. This amount to be raised is then divided by the issue price of a share (comprising the amount payable by the shareholder, including any premium on the fresh issue) to calculate the minimum number of shares to be issued.

REDEMPTION OF PREFERENCE SHARES BY CAPITALISATION OF UNDISTRIBUTED DIVISIBLE PROFITS

Another approach for redeeming preference shares, in accordance with the Companies Act, involves utilizing distributable profits instead of issuing new shares. When shares are redeemed using distributable profit, an amount equivalent to the face value of the redeemed shares is moved to the Capital Redemption Reserve Account by debiting the distributable profit. Essentially, a portion of the distributable profits is set aside to ensure it cannot be distributed to shareholders as dividends.

Profit, or a segment of profit, that is legally available for distribution to shareholders as dividends is referred to as Divisible or Distributable Profit.

The Companies Act specifies that "When any such shares are redeemed otherwise than out of the proceeds of a fresh issue, there shall, out of profits which would otherwise have been available for dividend (i.e., out of divisible profits), be transferred to a reserve called the Capital Redemption Reserve Account a sum equal to the nominal amount of the shares redeemed."

Note: Only Divisible Profits can be utilized to establish the Capital Redemption Reserve; Non-Divisible Profits cannot be employed for this purpose.

Advantages of redemption of preference shares by capitalisation of undistributed divisible profits

The benefits of redeeming preference shares through the capitalization of undistributed divisible profits include:

- **Maintaining the existing percentage of equity** shareholding in the company.
- **Utilizing surplus funds** effectively.

Disadvantages of redemption of preference shares by capitalisation of undistributed divisible profits

The drawback of redeeming preference shares through the **capitalization of undistributed profits is that it may result in decreased liquidity, requiring potential asset sales, such as divesting investments..**

Accounting Entries

- **For transferring nominal amount of shares redeemed to Capital Redemption Reserve Account**

  General Reserve Account Dr.

  Profit and Loss Account Dr.

  any other Divisible Profits Dr.

  To Capital Redemption Reserve Account

  (Being the transfer of amount to Capital Redemption Reserve Account as per the requirement of the Act).

- **When shares are redeemed at par**

  Redeemable Preference Share Capital Account Dr.

  To Preference Shareholders Account

  (Being the amount payable on redemption of preference shares transferred to Preference Shareholders Account)

- **When shares are redeemed at a premium**

  Redeemable Preference Share Capital Account Dr. Premium on Redemption of Preference Shares AccountDr.

  To Preference Shareholders Account

  (Being the amount payable on redemption transferred to Preference Shareholders Account)

- **When payment is made to preference shareholders**

  Preference Shareholders Account Dr.

  To Bank Account

  (Being the payment to preference shareholders as per terms)

- **For adjustment of premium of redemption**

  Divisible Profit Account Dr.

  To Premium on Redemption of Preference Shares Account (Being the premium on redemption adjusted against Profit and Loss Account)

Redemption of Preference Shares by combination of Fresh Issue and Capitalisation of Undistributed divisible Profits

A corporation has the option to partially redeem preference shares using funds from a fresh issue and partly from profits. To bridge the difference between the face value of the redeemed shares and the proceeds from the new issue, a transfer must be executed from distributable profits (Profit & Loss Account, General Reserve, and other Free Reserves) to the Capital Redemption Reserve Account..

Formula:

- Amount to be Transferred to Capital Redemption Reserve `

  Face value of shares redeemed ***

  Less: Proceeds from new issue ***

  ***

- Proceeds to be collected from New Issue ` Face value of shares redeemed *** Less: Profits available for distribution as dividend ***

  ***

The term "proceeds from a fresh/new issue" shall be construed as:

(a) The sum credited to Share Capital in the case of an issue at par.

(b) The sum credited to Share Capital in the case of an issue at a premium. Although the premium is received and credited to the Securities Premium A/c, it shall not be considered as 'proceeds.' Treating it as such would result in a lower transfer of distributable profits to the Capital Redemption Reserve by the premium amount received.

(c) The amount received (i.e., debited to Cash/Bank) in the case of an issue at a discount.

Note: Section 53 of the Companies Act, 2013 prohibits the issuance of shares at a discount, except for the issuance of Sweat Equity Shares as outlined in Section 54.

Sale of Investments to Provide Sufficient Funds for Redemption

Companies might possess ample investments that can be liquidated in the market to generate funds for the redemption of preference shares..

REDEMPTION OF PARTLY CALLED-UP PREFERENCE SHARES

One of the requirements for redemption is that a company can only redeem fully paid-up preference shares. Therefore:

- If the scenario indicates the redemption of partly called-up preference shares, it is assumed that the final call on these shares has been demanded and received before initiating the redemption process.

- When information about both fully paid and partly paid preference shares is provided, it is presumed that only fully paid shares are intended for redemption, while partly paid shares remain outstanding.
- In the event of non-receipt of call money despite reminders, the company has the option to forfeit the shares.

REDEMPTION OF FULLY CALLED BUT PARTLY PAID-UP PREFERENCE SHARES

The issue of unpaid calls on fully called-up shares can be examined within the following classifications:

Upon the receipt of Calls-in-Arrears

If the Company receives the unpaid calls amount before redemption, the corresponding entry is as follows:

Bank A/c Dr.

To Calls-in-Arrears A/c

Upon receiving the arrears of calls, the shares attain full payment status, enabling the company to proceed with the redemption process as usual..

In case of Forfeited Shares

If shareholders neglect to fulfill their unpaid calls obligations, even after receiving a formal notice from the company, the Board of Directors holds the authority to opt for forfeiture. Rather than reissuing the forfeited shares, which is impractical due to the impending redemption, the company cancels these shares. The corresponding journal entry for forfeiture is made in the customary manner, as outlined below:

Preference Share Capital A/c # Dr (#Called up share capital only relating to the shares to be forfeited)

To Calls In Arrears A/c To Shares Forfeited A/c *

(*Amount actually collected on shares forfeited. This will be equal to the balancing amount)

NOTE: However, it is crucial to recognize that, in this scenario, the quantity of shares slated for redemption will be diminished by the count of shares subject to forfeiture. Additionally, as the preference shares are slated for redemption, the forfeited shares will not undergo reissuance. Consequently, the remaining balance in the Shares Forfeited Account needs to be transferred to Capital Reserve, which is executed through the subsequent journal entry:

Shares Forfeited A/c Dr.

To Capital Reserve A/c

TEST YOUR KNOWLEDGE

True and False

1. When shares are redeemed by utilising distributable profit, an amount equal to the face value of shares redeemed is transferred to Capital Reserve account by debiting the

distributable profit. (ICAI Study Material)

Sol. False . Transferring an amount equivalent to the face value of redeemed shares to the Capital Redemption Reserve account by debiting distributable profit occurs when shares are redeemed.

2. A company who prepares financial statements in compliance with Accounting Standards under Section 133 of the Companies Act, 2013, it cannot utilize securities premium for the purpose of providing for premium on the redemption of Redeemable Preference shares of the Company. . (ICAI Study Material)

Sol. True . If a company, in accordance with Accounting Standards under Section 133 of the Companies Act, 2013, prepares financial statements, it is not permitted to utilize securities premium for redeemable preference shares' premium on redemption.

3. The balance in forfeited shares account can be used for transfer to capital redemption reserve account. . (ICAI Study Material)

Sol. False . Utilizing the balance in the Forfeited shares account for transferring to the capital redemption reserve account is not allowed.

4. Capital redemption reserve cannot be used for writing off miscellaneous expenses and losses . . (ICAI Study Material)

Sol. True . The utilization of capital redemption reserve for the write-off of miscellaneous expenses and losses is not permissible.

Multiple Choice Questions

1. Securities premium cannot be used to . . (ICAI Study Material)

(a) Issue bonus shares

(b) Redeem preference shares

(c) Write-off preliminary expenses

(d) All of the Above

Sol. (b) Redeem preference shares

2. S Ltd. issued 2,000, 10% Preference shares of ₹ 100 each at par on 1.4.2021, which are redeemable at a premium of 10%. For the purpose of redemption, the company issued 1,500 Equity Shares of ₹ 100 each at a premium of 20% per share. At the time of redemption of Preference Shares, the amount to be transferred by the company to the Capital Redemption Reserve Account = ? . (ICAI Study Material)

(a) ₹ 50,000

(b) ₹ 40,000

(c) ₹ 2,00,000

(d) ₹ 1,00,000

Sol. (a) ₹ 50,000

HINT = 2,00,000 – 1,50,000

3. Which of the following cannot be used for the purpose of creation of capital redemption reserve account? . (ICAI Study Material)
   (a) Profit and loss account (credit balance)
   (b) General reserve account
   (c) Unclaimed dividend account
   (d) None of the Above

Sol. (c) Unclaimed dividend account

4. According to Section 52 of the Companies Act, 2013, the amount in the Securities Premium A/c cannot be used for the purpose of – . (ICAI Study Material)
   (a) Issue of fully paid bonus shares
   (b) Writing off losses of the company
   (c) For purchase of own securities
   (d) All of the Above

Sol. (b) Writing off losses of the company

5. Which of the following can be utilized for redemption of preference shares? . (ICAI Study Material)
   (a) The proceeds of fresh issue of equity shares
   (b) The proceeds of issue of debentures
   (c) The proceeds of issue of fixed deposit
   (d) All of the above

Sol. (a) The proceeds of fresh issue of equity shares

6. Preference shares amounting to ₹ 2,00,000 (already issued on 1.4.2021) are redeemed at a premium of 5%, by issue of shares amounting to ₹ 1,00,000 at a premium of 10%. The amount to be transferred to capital redemption reserve = ? . (ICAI Study Material)
   (a) ₹ 1,05,000
   (b) ₹ 1,00,000
   (c) ₹ 2,00,000
   (d) ₹ 2,50,000

Sol. (b) ₹ 1,00,000

HINT = 2,00,000 – 1,00,000

Theoretical Questions

1. What is the purpose of issuing redeemable preference shares?

Sol. To secure funds in a lackluster primary market, a company has the option to issue redeemable preference shares. These shares can be repurchased when there is an excess of capital, and the surplus funds cannot be effectively employed for profitable business purposes. For details , refer para 5.2 of this chapter .

2. What are the provisions of the Companies Act, 2013 related with redemption of preference shares? Explain in brief.

Sol. Provisions regarding the redemption of preference shares are addressed in Section 55 of the Companies Act, 2013. This section safeguards against any reduction in shareholders' funds resulting from redemption, thereby preserving the interests of external stakeholders. For details , refer para 5.3 of this chapter .