

Corporate Accounting Part 1

Issue of shares

By Pro. Poshan Sahu
(Commerce Department)

Corporate Accounting: Issue of shares

Corporate Accounting is a special branch of accounting which deals with the accounting for companies, preparation of their final accounts and cash flow statements, analysis and interpretation of companies' financial results and accounting for specific events like amalgamation, absorption, preparation of consolidated balance sheets.

CLASSES OF CAPITAL: In view of the stages involved in collecting the money on shares, the shares capital of a company may be classified as follow:



- 1) **Authorised Capital:** It is the capital which is stated in company's memorandum of association with which the company intends to be registered. It is called the nominal or registered capital. It is the maximum amount of shares capital which a company is authorised to raise by issuing the shares.
- 2) **Issue Capital:** It is that part of the authorised capital which is actually offered (issued) to the public for subscription. Therefore, the issued capital can never be more than the authorised capital. It can at the most be equal to the nominal capital. The balance of nominal capital remaining to be issued is called 'unissued

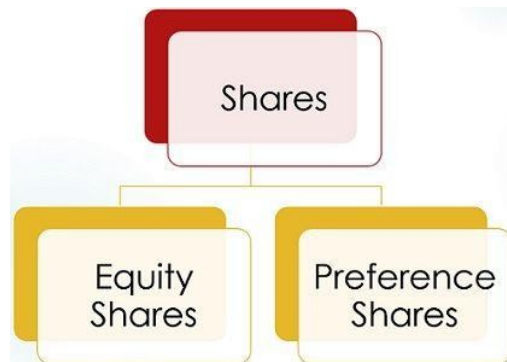
subscribed by the public. In other words, it is that part of issued capital for which the applications have been received from the public and shares allotted to them.

- 4) **Called-up Capital:** It is that part of nominal value of issued capital which has been called-up or demanded on the shares by the company. Normally, a company does not collect the full amount of shares it has allotted.
- 5) **Paid-up Capital:** It is that part of the called-up capital which has actually been received from the shareholders.
- 6) **Reserve Capital:** It is that part of the uncalled capital which cannot be called by the company except in the event of its winding up.

Meaning of Shares

Section 2(84) of the Companies Act, 2013 defines share as a share in the share capital of a company and it includes stock. The share capital of a company is divided into units of smaller denominations. Each such unit is called a Share. It entitles the holder to ownership in the company.

Types of shares:



1. EQUITY SHARES

Equity shares are also known as ordinary shares. The majority of shares issued by the company are equity shares. This type of share is traded actively in the secondary or stock market. These shareholders have voting rights in the company meetings. They are also entitled to get dividends declared by the board of directors. However, the dividend on these shares is not fixed and it may vary year to year depending on the company's profit. Equity shareholders receive dividends after preference shareholders.

2. PREFERENCE SHARES

As the name suggests, this type of share gives certain preferential rights as compared to other types of share. The main benefits that preference shareholders have are:

- i. They get first preference when it comes to the payout of dividend, they get paid a fixed amount of dividend or the amount of dividend, calculated at a fixed rate, e.g., 10% nominal value of shares
- ii. When the company winds up, preference shareholders have the first right in terms of getting repaid

DIFFERENTIAL VOTING RIGHT (DVR) SHARES

The DVR shareholders have less voting rights compared to equity shareholders. To dilute the voting privileges, companies provide extra dividend to DVR shareholders. As DVR shares have less voting rights, their prices are also low. The price gap between equity shares and DVR shares is almost 30-40%.

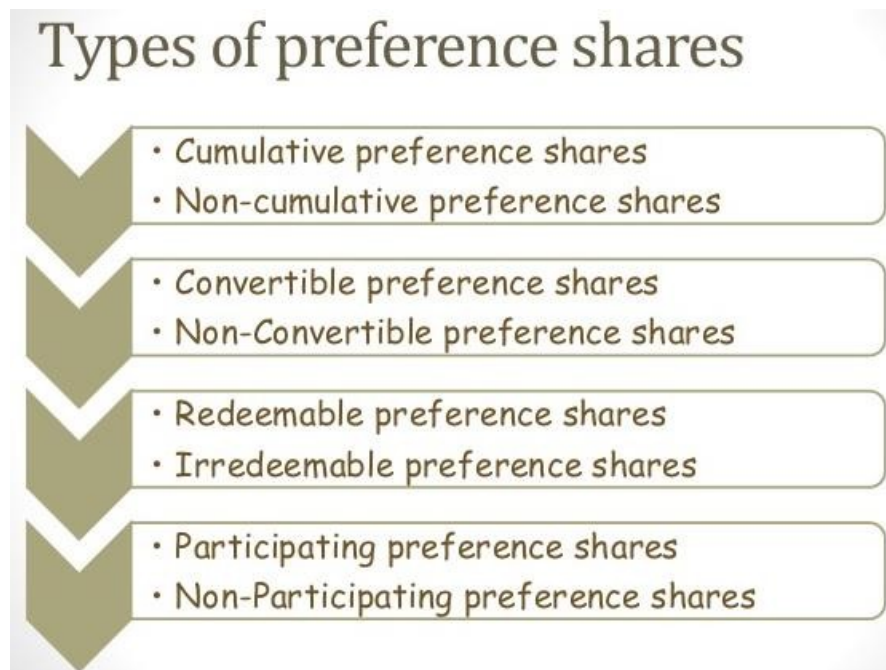
Right Shares

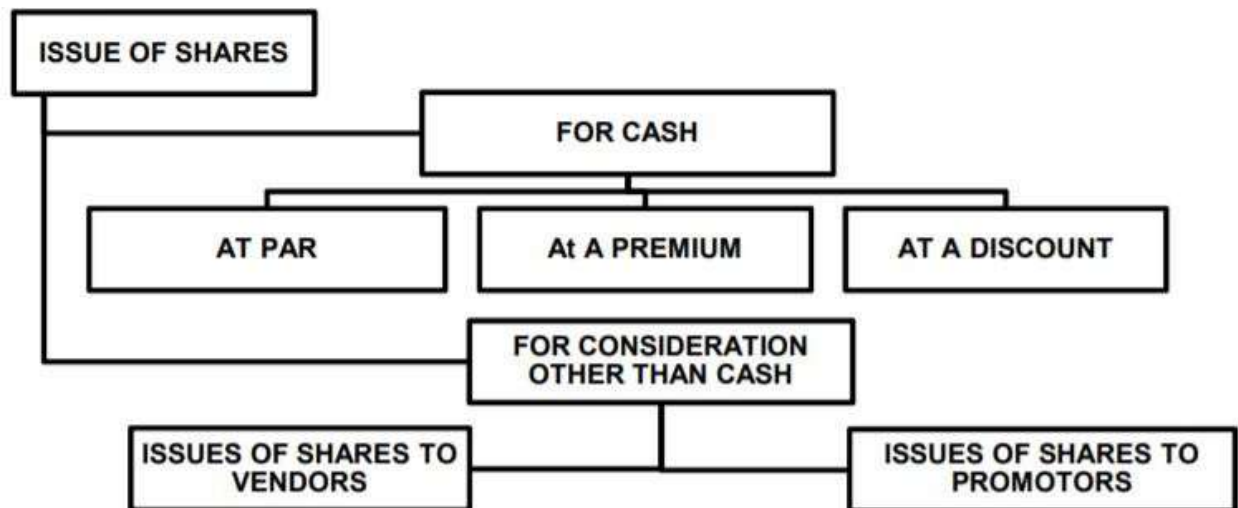
The Right Shares refers to those issues of shares which a company offers to their existing shareholders at a discounted price. The company's shareholders have rights to accept or reject the proposal and also there are minimum criteria for subscriptions of the share if the shareholder accepts the proposal.

Types of preference shares:

- 1) **Cumulative Preference Shares:** These shares are entitled to dividend at a fixed rate whether there are profits or not. The company pays dividend if it has sufficient profits.
- 2) In case the company does not have sufficient profits, dividend on cumulative preference shares will go on accumulating till it is fully paid off, such arrears are carried forward to the next year and are actually paid out of the subsequent years' profits. In the case of winding up of the company, the arrears of dividend on these shares are payable only if the article of association contains express provision in this respect. It may be noted, that all preference shares are presumed to be cumulative unless expressly stated in the articles to be non-cumulative.
- 3) **Non-cumulative Preference Shares:** Non-cumulative preference shares are those shares on which the arrears of dividend do not accumulate. If in a particular year there are no profits or profits are inadequate, the shareholders shall not get anything or receive a partial dividend and they cannot claim the arrears of dividends in the subsequent year. In simple words, on such shares the unpaid dividends do not accumulate but lapse, i.e., the shareholders lose them forever.
- 4) **Participating Preference Shares:** The holders of such shares are entitled to receive dividend at a fixed rate and, in addition, **they have a right to participate in the surplus profits along with equity shareholders after dividend at a certain rate has been paid to equity shareholders**, there are surplus assets, then the holders of such shares shall be entitled to share in the surplus assets as well. Such shares can be issued only if there is a clear provision in the memorandum or articles of association or the terms of issue.
- 5) **Non-participating Preference Shares:** The holders of such shares are entitled to **only a fixed rate of dividend and do not participate further in the surplus profits**. If the articles are silent, all preference shares are deemed to be non-participating.
- 6) **Convertible Preferences Shares:** The holders of such shares have a right to convert these shares into equity shares within a certain period.

- 7) **Non-convertible Preference Shares:** The preference shares, where the holders have no right to convert their shares into equity shares are known as non-convertible preference shares. Unless otherwise stated preference shares are assumed to be non-convertible.
- 8) **Redeemable Preference Shares:** ordinarily, the amounts received by the company on shares are not returned except on the winding up of the company. A company limited by shares, if authorised by its articles, may issue preference shares which are to be redeemed or repaid after a certain fixed period. Thus, the amounts received on such shares can be returned during the life-time of the company. Such shares are termed as redeemable preference shares.
- 9) **Irredeemable preference shares:** are those preference shares which can only be redeemed at the time of liquidation of the company. These shares do not have any incorporated clause with respect to their redemption and thus cannot be bought back at the choice of the issuing company. Section 55 of the Companies Act, 2013 (the Act) prescribes that a company shall not issue an irredeemable preference shares. Further, it also imposes restriction on companies limited by shares to issue preference shares liable to be redeemed at the end of the end of 20 years.





The accounting entries pertaining to the issue of shares are as follows:

1. On receipt of applications money:

Bank a/c Dr.

To share application a/c

(Being share application money received)

2. On allotment of shares:

(a) Share application a/c Dr.

To share capital a/c

(Being appropriation of application money towards share capital)

(b) Share Allotment a/c Dr.

To share capital a/c

(Being allotment money due on shares @ Rs. per share)

Bank a/c Dr.

To share allotment a/c (Being allotment money received)

4. (a) If any call is made on the shares, the following entries are passed:

Share call a/c Dr.

To share capital a/c

(b) On receipt of call money:

Bank a/c Dr.

To share call a/c

Issue of Share at Premium (Accounting Entries):

Section 78 of the companies Act, as amended by the Companies Amendment Act 1999 provides that the amount of premium on the securities issued by the company shall be transferred to Securities Premium Account. Generally, premium money is received along-with allotment money.

In such a case, the following entries are passed:

(a) Bank a/c Dr.

To share application a/c

(Being application money received)

(b) Share application a/c Dr.

To share capital a/c

(Being application appropriated towards capital a/c)

(c) Share Allotment a/c Dr.

To share capital a/c

To securities premium a/c

(Being allotment money and premium money due on share)

Bank a/c Dr.

To share allotment a/c

(Being allotment money received)

- The Company's Act **does not impose any restriction on the issue of shares at a premium.** However, it is only prosperous companies because of their financial strength and high earning capacity which are in a position to offer shares at a premium.
- As per provisions of Companies Act, **the premium money must be credited to a separate account called securities premium account.**

Under Section 78 of the Act, the amount of securities premium can be used wholly or in part for:

- 1) Paying up unissued shares of the company to be issued to members of the company as **bonus shares**
- 2) **Writing off the preliminary expenses** of the company
- 3) Writing off the expenses of or the **commission paid or discount allowed on shares or debentures of the company**
- 4) Providing for the **premium payable on the redemption of redeemable preference shares or debentures of the company.**

Q: On an equity share of Rs.20, the company has called up Rs,18 but actually received Rs.16 only. The share capital would be credited by ____.

a. Rs.18

- b. Rs.16
- c. Rs.20
- d. None of the above

Ans: The correct option is A. Share Capital will be credited with the entire amount called up, i.e. Rs 18/-. The Rs 2/- not received may be in Calls-in-Arrears A/c.

PROHIBITION ON ISSUE OF SHARES AT DISCOUNT:

Often Shares are issued at Premium. Sometime the situation arises where we decide to issue shares at discount. Discounted prices may be offered when company is not able to pay its debts and offering it share to its creditors.

- **Company Act 2013 strictly prohibited the companies to issue shares at discounted price.**
- It invites penalty and imprisonment for directors. Recently the changes were made in the penalty provisions.
- Section 53 levies penalty equal to the amount raised by the issue of shares at a discount or Rs. 5 lakh, whichever is lower.
- Company shall also be liable to refund the money received with interest at 12% per annum from the date of issue of the shares

According to the Companies Act 2013, a company raises money through three ways which are

- A. Public offer
- B. Private placement
- C. Right or bonus issue

The method of private placement refers to the issue of shares to select group of investors rather than inviting the public.

Oversubscription and Undersubscription

Situation in which the application money received by the company is in excess of the number of shares offered to the public for the purpose of subscription. In such a situation, the company cannot allot shares to all the persons who have applied for it. This is because the total number of shares to be allotted will not exceed the number of shares offered by the company.

When the shares of the company are traded in the recognized stock exchange, then the excess money received in connection to the application cannot be used towards allotments or calls. **And the amount in excess needs to be refunded, or else the directors would require to return the sum with interest @ 12% per annum.** However, when the company has obtained approval from the stock exchange then it can utilize the excess amount towards allotment or calls.

Alternatives for Over Subscription

Over subscription, there are three alternatives available to the company with respect to the allotment:

1. Full Allotment and Rejection of Excess Application: Rejection of some excess applications and allotment is made in full to other applicants. Those applicants whose applications are rejected are sent a letter of regret along with the refund of the money paid by them. Also, the applicants whose applications are accepted are sent a letter of allotment.

2. Pro-rata Allotment: Proportionate distribution of available shares can be made by the Board of Directors for allotment among applicants. The applicants get a lesser number of shares than the shares they have applied for, proportionately, which is called a pro-rata allotment. The allotment is based on the ratio between the number of shares to be allotted and the number of shares applied for.

$$\frac{\text{Number of Shares applied by an applicant} \times \text{Total number of shares to be allotted}}{\text{Total number of shares applied for}}$$

Letter of allotment is delivered to all the applicants and excess application money received in the application is not refunded rather it is retained and adjusted towards allotment and calls.

3. Combination of the above two alternatives:

- a) **Reject some applications and make pro-rata allotment of the remaining applicants:** In this case letter of regret is sent to the rejected applicants and a letter of allotment is sent to the ones accepted over.
- b) **Full allotment to some applicants and making pro-rata allotment of the left ones:** In this case letter of allotment is sent to all the applicants.
- c) **Rejection of some applications, full allotment to some applicants, and making pro-rata allotment to the remaining ones:** Letter of regret is sent to the rejected ones. And the letter of allotment is sent to the applicants whose applications have been accepted.

Under subscription

Under subscription, as the name signifies, is a situation in which the application received by the company from the public is less than the shares offered. In this case, the company will keep a record of the actual number of shares purchased by public

Here, it is to be noted that the condition for a minimum subscription must be fulfilled by the company i.e. **90% of the issued shares must be subscribed for by the public**, so as to allot shares to the public.

Accounting Treatment for Under subscription

Accounting is done in the basic manner as no special treatment is given. Further, journal entries are made as per the actual number of shares applied for and allotted to the public. By

doing so the company can satisfy all the applicants.

SEBI Guidelines for Under Subscription

When the company has not received 90% of the amount issued from public subscription and accepted devolvement of shares from underwriters and other sources, in case of under subscription, within a period of 60 days, counting from the date of closure of share issue, the company is required to refund the full amount of subscription to the applicants within 78 days without interest and with interest for the delayed period past 78 days, @ 15% per annum.

Issue of shares other than cash

When an asset is acquired by a company, the payment of asset price can be made by the issue of shares or in cash to the vendor. Moreover, when shares are given against the purchase price, it is known as 'Issue of shares for consideration other than cash'.

Such shares may be issued to the vendor either:

(i) At par or

(ii) At a discount or

(iii) At a premium.

Accounting Entries		
(a) For Assets Acquired :		
S. Assets A/c	... Dr.	(With purchase price)
To Vendors		
<hr/>		
(b) For Shares Issued at Par :		
Vendor	...Dr.	
To Share Capital A/c		
<hr/>		
(c) For Shares Issued at Discount :		
Vendor	... Dr.	(With purchase price)
Discount on Issue of Shares A/c	... Dr.	(With discount)
To Share Capital A/c		(With nominal value)
<hr/>		
(d) For Shares Issued at Premium :		
Vendor	... Dr.	(With purchase price)
To Share Capital A/c		(With nominal value)
To Securities Premium Reserve A/c		(With premium)
<hr/>		
Note. No. of shares to be issued = $\frac{\text{Amount Payable}}{\text{Issue Price}}$		

Q. (Issue of share against purchase of Assets). R.K. Ltd. purchased a building from Ravi for Rs 90,000 payable in fully paid shares of Rs 10 each.

Pass Journal Entries when:

- 1) Shares are issued at par.
- 2) Shares are issued at 10% discount.
- 3) Shares are issued at 20% premium.

Ans.

Date	Particulars	L.F.	Debit ₹	Credit ₹
(i)	Building A/c Dr. To Ravi A/c (Being building purchased)		90,000	90,000
	Ravi Dr. To Share Capital A/c (Being 9,000 shares issued at par)		90,000	90,000
(ii)	Ravi Dr. Discount on issue of Shares A/c Dr. To Share capital A/c (Being 10,000 shares of ₹ 10 each issued at 10% discount)		90,000 10,000	1,00,000
	Ravi (7,500 × 12) Dr. To Share Capital A/c (7,500 × 10) To Securities premium Reserve A/c (7,500 × 2) (Being 7,500 shares of ₹ 10 each issued at a premium of ₹ 2)		90,000	75,000 15,000

$$\frac{90,000}{9} = 10,000 \text{ shares}$$

$$\frac{90,000}{12} = 7,500 \text{ shares}$$

