

COMPANY ACCOUNTS



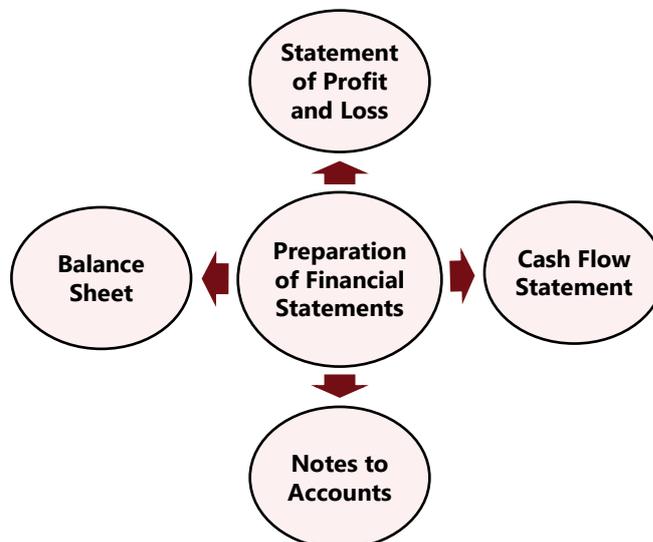
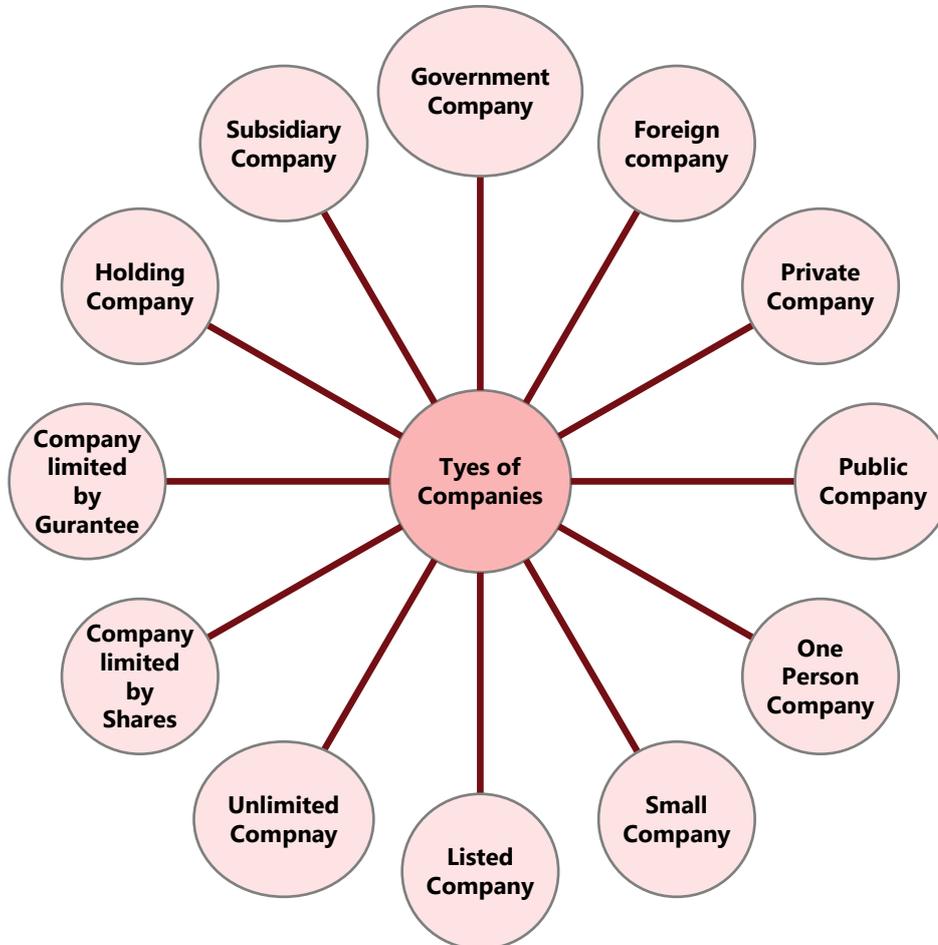
UNIT – 1 INTRODUCTION TO COMPANY ACCOUNTS

LEARNING OUTCOMES

After studying this unit, you would be able to:

- ◆ Understand the reason for the existence and survival of a company.
- ◆ Learn the nature and types of companies.
- ◆ Explain the salient features of a company.
- ◆ Understand the purpose of preparing the financial statements of the company.

UNIT OVERVIEW





1.1 INTRODUCTION

The never-ending human desire to grow and grow further has given rise to the expansion of business activities, which in turn has necessitated the need to increase the scale of operations so as to provide goods and services to the ever-increasing needs of the growing population of consumers. Large amount of money, modern technology, large human contribution etc. is required for it, which is not possible to arrange under partnership or proprietorship. To overcome this difficulty, the concept of 'Company' or 'Corporation' came into existence.

While the invention of steam power ignited the human imagination to build big machines for the mass production of goods, the need to separate the management from ownership gave birth to a form of organisation today known as 'company'.

Company form of organisation is one of the ingenious creations of human mind, which has enabled the business to carry on its wealth creation activities through optimum utilisation of resources. In course of time, a company structure has become an important institutional form for business enterprise, which has carved out a key place for itself in the field of business operations as well as in the wealth-generating functions of society.



1.2 MEANING OF COMPANY

The word 'Company', in everyday usage, implies an assemblage of persons for social purpose, companionship or fellowship. As a form of organisation, the word 'company' implies a group of people who voluntarily agree to form a company.

The word 'company' is derived from the Latin word 'com' i.e. with or together and 'panis' i.e. bread. Originally the word referred to an association of persons or merchant men discussing matters and taking food together. However, in law 'company' is termed as company which is formed and incorporated under the Companies Act, 2013 or an existing company formed and registered under any of the previous company laws. As per this definition of law, there must be group of persons who agree to form a company under the law and once so formed; it becomes a separate legal entity having perpetual succession with a distinct name of its own and a common seal. Its existence is not affected by the change of members.

Company begs its origin in law. It is an organisation consisting of individuals, called shareholders by virtue of holding the shares of a company, who are authorised by law to elect a board of directors and, through it, to act as a separate legal entity as regards its activities. Generally, the capital of the company consists of transferable shares, and members have limited liabilities.

To get to the heart of the nature of the company, let us examine the concept of company propounded under corporate jurisprudence.

According to Justice Marshal, "A corporation is an artificial being, invisible, intangible and existing only in the contemplation of law".

In the same manner, Lord Justice Hanay has defined a company as "an artificial person created by law with a perpetual succession and a common seal".

A common thread running through the various definitions of 'company' is that it is an association of persons created by law as a separate body for a special purpose. At the same time, definitions have laid down certain characteristics of a corporate organisation, which make it out as a separate and unique organisation which enables the people to contribute their wealth to the capital of the company by subscribing to its shares and appointing elected representatives to carry out the business.



1.3 SALIENT FEATURES OF A COMPANY

Following are the salient features of a company:

1. *Incorporated Association:* A company comes into existence through the operation of law. Therefore, incorporation of company under the Companies Act is must. Without such registration, no company can come into existence. Being created by law, it is regarded as an artificial legal person.
2. *Separate Legal Entity:* A company has a separate legal entity and is not affected by changes in its membership. Therefore, being a separate business entity, a company can contract, sue and be sued in its incorporated name and capacity.
3. *Perpetual Existence:* Since company has existence independent of its members, it continues to be in existence despite the death, insolvency or change of members.
4. *Common Seal:* Company is not a natural person; therefore, it cannot sign the documents in the manner as a natural person would do. In order to enable the company to sign its documents, it is provided with a legal tool called 'Common Seal'. The common seal is affixed on all documents by the person authorised to do so who in turn puts his signature for and on behalf of the company. Companies Act, 2013 required common seal to be affixed on certain documents (such as bill of exchange, share certificates, etc.) Now, the use of common seal has been made optional. All such documents which required affixing the common seal may now instead be signed by two directors or one director and a company secretary of the company. Further, every company registered in India are required to obtain unique Corporate Identification Number (CIN) that is assigned by Registrar of Companies.

5. *Limited Liability:* The liability of every shareholder of a company is limited to the amount he has agreed to pay to the company on the shares allotted to him. If such shares are fully paid-up, he is subject to no further liability.
6. *Distinction between Ownership and Management:* Since the number of shareholders is very large and may be distributed at different geographical locations, it becomes difficult for them to carry on the operational management of the company on a day-to-day basis. This gives rise to the need of separation of the management and ownership.
7. *Not a citizen:* A company is not a citizen in the same sense as a natural person is, though it is created by the process of law. It has a legal existence but does not enjoy the citizenship rights and duties as are enjoyed by the natural citizens.
8. *Transferability of Shares:* The capital is contributed by the shareholders through the subscription of shares. Such shares are transferable by its members except in case of a private limited company, which may have certain restrictions on such transferability.
9. *Maintenance of Books:* A limited company is required by law to keep a prescribed set of account books and any failure in this regard attracts penalties.
10. *Periodic Audit:* A company has to get its accounts periodically audited through the chartered accountants appointed for the purpose by the shareholders on the recommendation of board of directors.
11. *Right of Access to Information:* The right of the shareholders of a company to inspect its books of account, with the exception of books open for inspection under the Statute, is governed by the Articles of Association. The shareholders have a right to seek information from the directors by participating in the meetings of the company and through the periodic reports.



1.4 TYPES OF COMPANIES

1. Government Company

According to Section 2(45) of the Companies Act, 2013, "Government company" means any company in which not less than fifty-one per cent of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.

2. Foreign Company

According to Section 2 (42) of the Companies Act, 2013, "Foreign company" means any company or body corporate incorporated outside India which –

- (a) Has a place of business in India whether by itself or through an agent physically or through electronic mode; and
- (b) Conducts any business activity in India in any other manner.

3. Private Company

Section 2(68) of the Companies Act, 2013 defines 'Private company' as a company which by its articles,

- i. Restrict the right to transfer its shares;
- ii. Except in case of One Person Company limits the number of its members to two hundred:

Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this sub-clause, be treated as a single member:

Provided further that—

- (A) Persons who are in the employment of the company; and
 - (B) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased,
shall not be included in the number of members; and
- (iii) Prohibits any invitation to the public to subscribe for any securities of the company. Shares of a Private Company are not listed on Stock Exchange.

4. Public Company

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

- (a) is not a private company; and
- (b) has a minimum paid-up share capital as may be prescribed:

Provided that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles;

A company which is a listed public company if it gets unlisted continues to be a public company.

No Minimum Paid-up Share Capital: The minimum paid-up share capital requirement of INR 1,00,000 (in case of a private company) and INR 5,00,000 (in case of a public company) has been done away with under Companies Act, 2013. Accordingly, no minimum paid-up

capital requirements will now apply for incorporating private as well as public companies in India.

5. One Person Company

Section 2 (62) of the Companies Act, 2013 defines "One Person Company" as a company which has only one person as a member.

6. Small Company

Section 2(85) of the Companies Act, 2013 defines "Small company" means a company, other than a public company

- (i) paid-up share capital of which does not exceed four crores rupees or such higher amount as may be prescribed which shall not be more than ten crore rupees; and
- (ii) turnover of which as per its last profit and loss account for the immediately preceding financial year does not exceed forty crore rupees or such higher amount as may be prescribed which shall not be more than hundred crore rupees:

Provided that nothing in this clause should 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

7. Listed Company

As per Section 2 (52) of the Companies Act, 2013,"listed company" means a company which has any of its securities listed on any recognised stock exchange.

The company, whose shares are not listed on any recognised stock exchange, is called "Unlisted Company".

An unlisted company can be a public company or a private company.

8. Unlimited Company

Section 2 (92) of the Companies Act, 2013 defines "Unlimited company" means a company not having any limit on the liability of its members.

9. Company limited by Shares

As per Section 2(22) of the Companies Act, 2013, "Company limited by shares" means a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them.

10. Company limited by Guarantee

As per Section 2(21) of the Companies Act, 2013, "company limited by guarantee" means a company having the liability of its members limited by the memorandum to such amount as

the members may respectively undertake to contribute to the assets of the company in the event of its being wound up.

11. Holding Company

According to Section 2 (46) of the Companies Act, 2013, "Holding company", in relation to one or more other companies, means a company of which such companies are subsidiary companies.

12. Subsidiary Company

Section 2(87) of the Companies Act, 2013 defines "subsidiary company" as a company in which the holding company:

- (i) Controls the composition of the Board of Directors; or
- (ii) Exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies.

A company shall be deemed to be a subsidiary company of the holding company even if there is indirect control through the subsidiary company (ies). The control over the composition of a subsidiary company's Board of Directors means exercise of some power to appoint or remove all or a majority of the directors of the subsidiary company.



1.5 MAINTENANCE OF BOOKS OF ACCOUNT

As per Section 128 of the Companies Act, 2013, every company shall prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any, and explain the transactions effected both at the registered office and its branches and such books shall be kept on accrual basis and according to the double entry system of accounting:

Provided further that the company may keep such books of account or other relevant papers in electronic mode in such manner as may be prescribed.



1.6 PREPARATION OF FINANCIAL STATEMENTS

Under Section 129 of the Companies Act, 2013, the financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the notified accounting standards and shall be in the form or forms as may be provided for different class or classes of companies, as prescribed in Schedule III. The Board of Directors of the company shall lay financial statements at every annual general meeting of a company.

Financial Statements as per Section 2(40) of the Companies Act, 2013, inter-alia include -

- i. A balance sheet as at the end of the financial year;
- ii. A profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;
- iii. cash flow statement for the financial year;
- iv. A statement of changes in equity, if applicable; and
- v. any explanatory note annexed to, or forming part of, any document referred to in sub-clause (i) to sub-clause (iv):

Provided that the financial statement, with respect to One Person Company, small company and dormant company, may not include the cash flow statement.

Requisites of Financial Statements

It shall give a true and fair view of the state of affairs of the company as at the end of the financial year.

Provisions Applicable

- (1) Specific Act is Applicable

For instance, any

- (a) Insurance company
- (b) Banking company or
- (c) Any company engaged in generation or supply of electricity* or
- (d) Any other class of company for which a Form of balance sheet or Profit and loss account has been prescribed under the Act governing such class of company.

- (2) In case of all corporate entities:

Schedule III to the Companies Act, 2013 deals with the format of the financial statements. However, Schedule III contains three divisions either based on the applicability of the standards or on the nature of the entity. Each division of Schedule III contains parts dealing with formats of financial statements. Part I prescribes the format of Balance Sheet while Part II prescribes the format of Statement of Profit and Loss.

Applicability of Divisions as given under Schedule III has been explained below:

Division	Applicable to:
Division I	Companies that are required to apply Accounting Standards notified under the Companies Act, 2013.
Division II	Companies that are required to apply Indian Accounting Standards notified under the Companies Act, 2013.
Division III	Non-Banking Finance Companies (NBFCs) that are required to apply Indian Accounting Standards notified under the Companies Act, 2013.

The paper of accounting at Foundation level incorporates fundamentals of accounting and accounting of non-corporate entities and corporate entities. At foundation level, students are expected to understand the format of financial statements of corporate entities prepared as per Accounting Standards. Therefore, the format of financial statements as per Division I of Schedule III to the Companies Act, 2013 has been given below:

PART I – FORM OF BALANCE SHEET

Name of the Company.....

Balance Sheet as at.....

(₹ in.....)

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 (A) total outstanding dues of micro enterprises and small enterprises; and (B) total outstanding dues of creditors other than micro enterprises and small enterprises.]		xxx	xxx
	c.	Other current liabilities (F)		xxx	xxx
	d.	Short-term provisions		xxx	xxx
	Total			xxx	xxx
	ASSETS				
	Non-current assets				
1.	a.	Property, Plant & Equipment and Intangible Assets		xxx	xxx
	i.	Property, Plant and Equipment (G)			
	i.	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

Certain items are to be explained as follows (list not exhaustive):

A. SHARE CAPITAL

For each class of share capital following points is to be kept in mind:

- i. The number and amount of shares authorised.
- ii. The number of shares which are issued, subscribed and fully paid and which are issued, subscribed but not fully paid.
- iii. The par value per share.
- iv. Shares outstanding at the beginning and at the end of the reporting period should be reconciled.
- v. Calls unpaid.
- vi. Forfeited shares.

B. RESERVES AND SURPLUS

Reserves and surplus can be distributed among the following sub-heads:

- 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 classified under the following sub-heads:

- 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 classified as follows:

- i. Employee benefits provision like gratuity, provident fund etc.
- ii. Other provisions (specify the nature)

E. SHORT TERM BORROWINGS

Short term borrowings can be classified among the following sub-heads:

- i. Loans repayable on demand
- ii. Loans and advances from related parties
- iii. Deposits
- iv. Other loans and advances (specify the nature)
- v. Current maturities of long term borrowings shall be disclosed separately.

F. OTHER CURRENT LIABILITIES

Some of the other current liabilities can be grouped as under:

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

G. PROPERTY, PLANT AND EQUIPMENT

Property, Plant and Equipment can be classified as follows:

- i. Land
- ii. Buildings
- iii. Plant and Equipment
- iv. Furniture and Fixtures
- v. Vehicles
- vi. Office equipment
- vii. Others (specify the nature)

A detailed report showing additions, disposals, acquisitions through business combinations and other adjustments and amount related to depreciation, impairment losses, revaluation etc. should be provided for each class of asset.

H. INTANGIBLE ASSETS

Intangible assets can be classified as follows:

- i. Goodwill
- ii. Brands/trademarks
- iii. Computer software
- iv. Mining rights
- v. Mastheads and 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)

A detailed report showing additions, disposals, acquisitions through business combinations and other adjustments and amount related to depreciation, impairment losses, revaluation etc. should be provided for each class of asset.

I. NON-CURRENT INVESTMENTS

Investments can be classified 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 can be classified under the following sub-groups:

- i. Capital advances
- ii. Loans and advances to related parties
- iii. Other loans and advances (specify nature)

The above shall also be sub-classified as follows:

- i. Secured, considered good
- ii. Unsecured, considered good
- iii. Doubtful

K. CURRENT INVESTMENTS

It can be classified 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 can be classified as:

- 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)

M. CASH AND CASH EQUIVALENTS

The following head can be classified as follows:

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

PART II – FORM 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 Income (I + II)			xxx		xxx
IV.	Expenses:			xxx		xxx
	Cost of materials consumed			xxx		xxx
	Purchases of Stock-in-Trade			xxx		xxx
	Changes in inventories of finished goods, Work-in-Progress and Stock-in-Trade			xxx		xxx
	Employee benefits expense			xxx		xxx
	Finance costs			xxx		xxx
	Depreciation and amortization expense			xxx		xxx
	Other expenses					
	Total expenses			xxx		xxx
V.	Profit before exceptional and extraordinary items and tax (III-IV)			xxx		xxx
VI.	Exceptional items			xxx		xxx
VII.	Profit before extraordinary items and tax (V-VI)			xxx		xxx
VIII.	Extraordinary Items			xxx		xxx
IX.	Profit before tax (VII-VIII)			xxx		xxx

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

SUMMARY

1. 'Company' is termed as an entity which is formed and incorporated under the Companies Act, 2013 or an existing company formed and registered under any of the previous company laws.
2. Salient features of a company include: Incorporated Association; Separate Legal Entity; Perpetual Existence; Common Seal; Limited Liability; Distinction between Ownership and Management; Not a citizen; Transferability of Shares; Maintenance of Books; Periodic Audit; Right of Access to Information.
3. Types of companies: Government Company; Foreign Company; Private Company; Public Company; One Person Company; Small Company; Listed Company; Unlimited Company; Company limited by Shares; Company limited by Guarantee; Holding Company; Subsidiary Company.
4. The financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the notified accounting standards and shall be in the form or forms as may be provided for different class or classes of companies, as prescribed in Schedule III to the Companies Act, 2013. Financial Statements as per Section 2(40) of the Companies Act, 2013, include balance sheet as at the end of the financial year; profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year; cash flow statement for the financial year; statement of changes in equity, if applicable; and any explanatory note annexed to.

TEST YOUR KNOWLEDGE

True and False

1. Every public company is a listed company.
2. Shares of a private company are not listed on stock exchange.
3. It is not mandatory to incorporate a company under the companies act.
4. Company is an artificial, legal person created by law.
5. Death, insolvency or change of members affects the existence of a company.
6. If the shares are fully paid-up by the shareholder, he is subject to no further liability.
7. Public limited company has restrictions on transferability of shares.
8. Financial statements of company show the financial position of the business.
9. Schedule I gives proforma of Balance Sheet.
10. Schedule III prescribes the format of Directors' Report
11. Financial statements need to be true and correct as per Companies Act.

Multiple Choice Questions

1. Which of the following statement is not a feature of a Company?
 - (a) Separate legal entity
 - (b) Perpetual Existence
 - (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
 - (a) 25%
 - (b) 50 %
 - (c) 51%
3. Which of the following statement is true in case of a Foreign Company?
 - (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.

4. Which of the following statements is not a feature of a private company?
- (a) Restricts the rights of members to transfer its shares.
 - (b) Does not restrict on the number of its members to any limit.
 - (c) Does not involve participation of public in general.
5. Under Schedule III of the Companies Act, assets and liabilities are to be disclosed based on:
- (a) Current/ non-current.
 - (b) Financial /non-financial.
 - (c) Owned /not-owned.
6. Schedule III of the Companies Act prescribes the format and content of
- (a) Balance sheet and statement of profit and loss
 - (b) Auditors' report.
 - (c) Directors' report.
7. A company is required to maintain its books of accounts at
- (a) its registered office.
 - (b) its largest branch office.
 - (c) Managing Director's residence.
8. Cash flow statements are not required for
- (a) Private company.
 - (b) One person company.
 - (c) Public company.
9. The presentation and disclosure requirements of a company are prescribed by
- (a) Schedule III.
 - (b) Schedule II.
 - (c) Schedule I.
10. Following is an example of current assets
- (a) Inventories.
 - (b) Property, Plant & Equipment.

- (c) *Intangible Assets.*
11. *Earnings per share (EPS) is to be disclosed in which of the following section of the financial statements*
- (a) *Balance Sheet.*
- (b) *Statement of Profit and Loss.*
- (c) *Cash Flow Statements.*
12. *Following is NOT an example of a company under Companies Act, 2013*
- (a) *Small company.*
- (b) *Private company.*
- (c) *Large company.*

Theory Questions

1. *Explain salient features of a company in brief.*
2. *Write short note on:*
- (i) *Foreign company.*
- (ii) *Small company.*
- (iii) *Company limited by guarantee.*

ANSWER/HINTS

True and False

1. False: Listed companies are those which are listed on the stock exchange. Shares of listed companies are open to general public. Every listed company is a public company but every public company is not a listed company.
2. True: Only the shares of public company are listed on stock exchange. Every listed company is a public company.
3. False: It is mandatory to incorporate a company under the Companies Act. Without such incorporation, a company cannot come into existence.
4. True: Company comes into existence through the operation of law. It is a separate entity distinct from its members.

5. False: Company is a separate legal entity created by law. Death, insolvency or change of member does not affect it's existence.
6. True: Liability of shareholders is limited to the extent of the unpaid share capital. So, if shares are fully paid-up, he is subject to no further liability.
7. False: Shares of public company are freely transferable. Transferability of shares is restricted in a private limited company.
8. True: Financial statements give a true & fair view of the state of affairs of the company. Financial statements include profit and loss account, balance sheet, etc.
9. False: Schedule III Part I explains proforma of Balance Sheet.
10. False: Schedule III Part I explains proforma of Balance Sheet and Profit and Loss.
11. False: As per Section 128, every company shall prepare financial statement for every financial year which give a true and fair view of the state of the affairs of the company.

Multiple Choice Questions

1.	(c)	2.	(c)	3.	(b)	4.	(b)	5.	(a)	6.	(a)
7.	(a)	8.	(b)	9.	(a)	10.	(a)	11.	(b)	12.	(c)

Theoretical Question

1. Refer para 1.3 of this unit for salient features of a company.
2. **(i) Foreign Company**

According to Section 2 (42) of the Companies Act, 2013, "Foreign company" means any company or body corporate incorporated outside India which –

- (a) Has a place of business in India whether by itself or through an agent physically or through electronic mode; and
- (b) Conducts any business activity in India in any other manner.

(ii) Small Company

Section 2(85) of the Companies Act, 2013 defines "Small company" means a company, other than a public company.

- (i) paid-up share capital of which does not exceed four crores rupees or such higher amount as may be prescribed which shall not be more than ten crore rupees; or

- (ii) turnover of which as per its last profit and loss account for the immediately preceding financial year does not exceed forty crores rupees or such higher amount as may be prescribed which shall not be more than hundred crore rupees.

Provided that nothing in this clause should 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 per Section 2(21) of the Companies Act, 2013, "company limited by guarantee" means a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up.

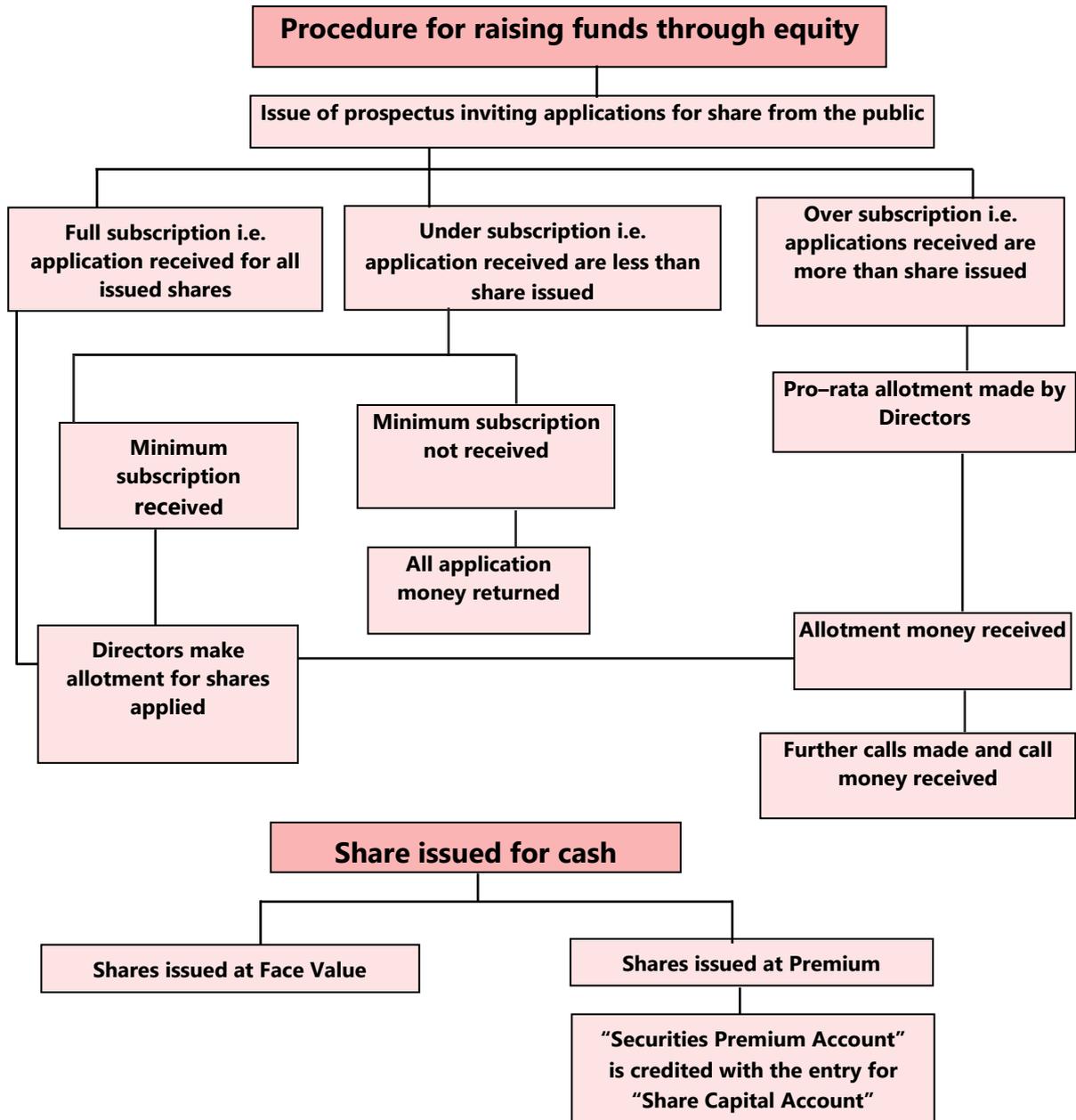
UNIT – 2 ISSUE, FORFEITURE AND RE-ISSUE OF SHARES

LEARNING OUTCOMES

After studying this unit, you would be able to:

- ◆ Appreciate various types of shares and share capital.
- ◆ Learn the accounting treatment if shares issued under different circumstances.
- ◆ Differentiate the accounting treatment for under-subscription and over-subscription of shares.
- ◆ Understand the concept and accounting treatment of call-in-arrears and call-in-advance.
- ◆ Deal with the forfeiture of shares issued with different conditions.
- ◆ Journalize the entry for re-issue of shares.
- ◆ Know the treatment of shares issued for consideration other than cash.

UNIT OVERVIEW



Note: As per Section 53 of Companies Act, 2013 a company cannot issue shares at discount except for in case of sweat equity shares and therefore any issue on discount by the company will be void with company being punishable with fine. Sweat equity shares means such equity shares as are issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

2.1 INTRODUCTION

Funds provided by the owner(s) into a business are recorded as capital. Capital of the business depends upon the form of business organisation. Proprietor provides capital in a sole-proprietorship business. In case of a partnership, there is more than one proprietor, called partners. Partners introduce capital in a partnership firm. As the maximum number of members in a partnership firm is restricted, therefore only limited capital can be provided in such form of businesses. Moreover, the liability of the proprietor(s) is unlimited in case of non-corporate business, namely, sole-proprietorship and partnership.

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

With the onset of industrial revolution, requirement of capital investment soared to a new height and the attached risk of failure increased due to pace of technological developments. Non-corporate entities could not cope with the pressure of increased capital and degree of risk involved. This led to the emergence of corporate form of organisation.

2.2 SHARE CAPITAL

Total capital of the company is divided into a number of small indivisible units of a fixed amount and each such unit is called a share. The fixed value of a share, printed on the share certificate, is called nominal/par/face value of a share. However, a company can issue shares at a price different from the face value of a share. The liability of holder of shares (called shareholders) is limited to the **issue price of shares** acquired by them.

Note: The issue price need not be equal to market price of the share. These days the shares are generally priced on the basis of book building process. (Book building is a process through which company determines its share prices. Under this method company determines a price band of its shares and on the basis of bids received from potential investors at various prices within the price band finally fixes its issue price.)

The total capital of the company is divided into shares, the capital of the company is called 'Share Capital'. At the time of issue of shares, every Company is required to follow SEBI Regulations.

Share capital of a company is divided into following categories:

- (i) *Authorised Share Capital or Nominal Capital:* A company estimates its maximum capital requirements. This amount of capital is mentioned in 'Capital Clause' of the 'Memorandum of Association' registered with the Registrar of Companies. It puts a limit on the amount of capital, which a company is authorised to raise during its lifetime and is called 'Authorised Capital'. It is shown in the Share Capital schedule in the financial statements as per the prescribed format at face value.
- (ii) *Issued Share Capital:* A company need not issue total authorised capital. Whatever portion of the share capital is issued by the company, it is called 'Issued Capital'. Issued capital means and includes the nominal value of shares issued by the company for:
 - 1. Cash, and
 - 2. Consideration other than cash to:
 - (i) Promoters of a company; and
 - (ii) Others.

It is also presented in the balance sheet at nominal value.

The remaining portion of the authorised capital which is not issued either in cash or consideration may be termed as '**Un-issued Capital**'. It is not shown in the balance sheet.

- (iii) *Subscribed Share Capital:* It is that part of the issued share capital, which is 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 generally receive the issue price of shares in instalments. The portion of the issue price of shares which 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 future may be referred to as **Uncalled Capital**.
- (v) *Paid-up Share Capital:* It is the portion of called up capital which is paid by the shareholders. Whenever a particular amount is called by the company and the shareholder(s) fails to pay the amount fully or partially, it is known as '**unpaid calls**' or '**instalments (or Calls) in Arrears**'. Thus, instalments in arrears mean 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 instalments in arrears is deducted from called up capital.

Call-in-advance is that portion of capital which is yet to be called by the company but has already been paid by shareholder.

In the financial statements, called-up and paid-up capital are shown together.

- (vi) *Reserve Share Capital:* As per Section 65 of the Companies Act, 2013, a Company may decide by passing a resolution that a certain portion of its subscribed uncalled capital shall not be called up except in the event of winding up of the company. Portion of the uncalled capital which a company has decided to call only in case of liquidation of the company is called Reserve Capital.

Reserve Capital is different from Capital reserve, Capital reserves are part of 'Reserves and Surplus' and refer to those reserves which are not available for declaration of dividend. Thus, reserve capital which is portion of the uncalled capital to be called up in the event of winding up of the company is entirely different in nature from capital reserve which is created out of capital profits only.

1. Authorised Capital = Issued Capital + Unissued Capital.
2. Subscribed Capital can be equal to or greater than or less than Issued Capital resulting in 3 situations respectively: Fully Subscribed; Over Subscribed and Under Subscribed.
3. Called up Capital = Paid up Capital + Calls in arrears if any – Calls in advance if any.

ILLUSTRATION 1

A company had an authorised capital of ₹ 10,00,000 divided into 1,00,000 equity shares of ₹ 10 each. It decided to issue 60,000 shares for subscription and received applications for 70,000 shares. It allotted 60,000 shares and rejected remaining applications. Upto 31-3 -2022, it has demanded or called ₹ 9 per share. All shareholders have duly paid the amount called, except one shareholder, holding 5,000 shares who has paid only ₹ 7 per share.

Prepare a balance sheet assuming there are no other details.

SOLUTION

Balance Sheet as at 31st March, 2022

Particulars	Notes No.	₹
EQUITY AND LIABILITIES		
Shareholders' funds		
Share capital	1	5,30,000
Total		5,30,000

ASSETS		
Current assets		
Cash and cash equivalents	2	5,30,000
Total		5,30,000

Notes to accounts

		₹	₹
1.	Share Capital		
	Equity share capital		
	Authorised share capital		
	1,00,000 Equity shares of ₹ 10 each	10,00,000	
	Issued share capital		
	60,000 Equity shares of ₹ 10 each	6,00,000	
	Subscribed share capital		
	60,000 Equity shares of ₹ 10 each	6,00,000	
	Called up and Paid up share capital		
	60,000 Equity shares of ₹ 10 each ₹ 9 called up	5,40,000	
	Less: Calls unpaid on 5,000 shares @ ₹ 2 per share	(10,000)	5,30,000
2.	Cash and cash equivalents		
	Balances with banks		5,30,000

It is clear from above, that details of authorised, issued and subscribed capital are given in the Notes to Accounts but are not counted. It is only the paid-up capital i.e., the portion of the issued capital subscribed by shareholders which is taken into account while totalling the liabilities side of the balance sheet.



2.3 TYPES OF SHARES

Share issued by a company can be divided into following categories :

- (i) **Preference Shares:** According to Section 43 of the Companies Act, 2013 persons holding preference shares, called preference shareholders, are assured of a preferential dividend at a fixed rate during the life of the company. They also carry a preferential right over other shareholders to be paid first in case of winding up of the company. Thus, they enjoy preferential rights in the matter of:
- (a) Payment of dividend, and

(b) Repayment of capital

Generally, holders of these shares do not get voting rights. Companies use this mode of financing as it is cheaper than raising debt. Dividend is generally cumulative in nature and need not be paid every year in case of deficiency of profits. The Companies Act, 2013 prohibits the issue of any preference share which is irredeemable. Preference shares are cumulative and non-participating unless expressly stated otherwise.

Types of Preference Shares

Preference shares can be of various types, which are as follows :

- (a) **Cumulative Preference Shares:** A cumulative preference share is one that carries the right to a fixed amount of dividend or dividend at a fixed rate. Such a dividend is payable even out of future profit if current year's profits are insufficient for the purpose. This means that dividend on these shares accumulates unless it is paid in full and, therefore, the shares are called Cumulative Preference Shares. The companies are required to disclose the arrears of fixed cumulative dividends on preference shares separately in the financial statement. In case, the dividend remains in arrears for a period of not less than two years, holders of such shares will be entitled to take part and vote on every resolution on every matter in the general body meeting of the shareholders.
- (b) **Non-cumulative Preference Shares:** A non-cumulative preference share carries with it the right to a fixed amount of dividend. In case no dividend is declared in a year due to any reason, the right to receive such dividend for that year expires. It implies that holder of such a share is not entitled to arrears of dividend in future.
- (c) **Participating Preference Shares:** Notwithstanding the right to a fixed dividend, this category of preference share confers on the holder the right to participate in the surplus profits, if any, after the equity shareholders have been paid dividend at a stipulated rate. Similarly, in the event of winding up of the company, this type of share carries the right to receive a pre-determined proportion of surplus as well once the equity shareholders have been paid off.
- (d) **Non-participating Preference Shares:** A share on which only a fixed rate of dividend is paid every year, without any accompanying additional rights in profits and in the surplus on winding-up, is called 'Non-participating Preference Shares.' Unless otherwise specified, the preference shares are generally non-participating.

- (e) **Redeemable Preference Shares:** These are shares that a company may issue on the condition that the company will repay after the fixed period or even earlier at company's discretion. The repayment on these shares is called redemption and is governed by Section 55 of the Companies Act, 2013.
 - (f) **Non-redeemable Preference Shares:** The preference shares, which do not carry with them the arrangement regarding redemption, are called Non-redeemable Preference Shares. According to Section 55, no company limited by shares shall issue irredeemable preference shares or preference shares redeemable after the expiry of 20 years from the date of issue. However, a Company may issue preference shares redeemable after 20 years for such infrastructure projects as may be specified, under the Companies Act, 2013.
 - (g) **Convertible Preference Shares:** These shares give the right to the holder to get them converted into equity shares at their option according to the terms and conditions of their issue.
 - (h) **Non-convertible Preference Shares:** When the holder of a preference share has not been conferred the right to get his holding converted into equity share, it is called Non-convertible Preference Shares. Preference shares are non-convertible unless otherwise stated.
- (ii) **Equity Shares:** Equity shares are those shares, which are not preference shares. It means that they do not enjoy any preferential rights in the matter of payment of dividend or repayment of capital. The rate of dividend on equity shares is recommended by the Board of Directors and may vary from year to year. Rate of dividend depends upon the dividend policy and the availability of profits after satisfying the rights of preference shareholders. These shares carry voting rights. Companies Act, 2013 permits issue of equity share capital with differential rights as to dividend, voting or otherwise in accordance with prescribed rules.

The shares can be issued by a company either

- (1) for cash or
- (2) for consideration other than cash.



2.4 ISSUE OF SHARES FOR CASH

To issue shares, private companies depend upon 'Private Placement' of shares. Public companies issue a 'Prospectus' and invite general public to subscribe for shares. To discuss accounting treatment, we shall concentrate on public companies who invite general public to subscribe for equity shares. Similar accounting treatment is applicable in other cases. However, for journal entries in case of issue of preference shares, the word 'Equity' is replaced with the word 'Preference'.

A public company issues a prospectus inviting general public to subscribe for its shares. On the basis of prospectus, applications are deposited in a scheduled bank by the interested parties along with the amount payable at the time of application, in cash. First instalment paid along with application is called 'Application Money'. **As per Section 39 of the Companies Act, 2013. Application money must be at least 5% of the nominal value of shares.** After the closing date of the issue (the last date for filing applications), company decides about allotment of shares in consultation with the SEBI and stock exchange concerned. According to the Companies Act, 2013, a company cannot proceed to allot shares unless minimum subscription is received by the company.

Minimum Subscription: A public limited company cannot make any allotment of shares unless the amount of minimum subscription stated in the prospectus has been subscribed and the sum payable as application money for such shares has been paid to and received by the company. The amount of minimum subscription to be disclosed in prospectus by the Board of Directors taking into account the following:

- (a) Preliminary expenses of the company,
- (b) Commission payable on issue of shares,
- (c) Cost of fixed assets purchased or to be purchased,
- (d) Working capital requirements of the company, and
- (e) Any other expenditure for the day to day operation of the business.

As per guidelines of the Securities Exchange Board of India (SEBI), the minimum subscription to be received in an issue shall not be less than ninety per cent of the offer through offer document [Provided that in the case of an initial public offer, the minimum subscription to be received shall be subject to allotment of minimum number of specified securities, as prescribed by Securities Contracts (Regulation) Rules, 1957]. If the Company does not receive the minimum subscription of 90% of the issue, all application moneys received shall be refunded to the applicants forthwith, but not later than:

- (a) fifteen days of the closure of the issue, in case of a non-underwritten issue; and

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

(Being the sum due on allotment and application money transferred to capital account)

(3) On receipt of allotment money

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

To Share Allotment A/c

(Being money received on allotment)

Sometimes separate Application and Allotment Accounts are not prepared and entries relating to application and allotment monies are passed through a combined Application and Allotment Account.

On receipt of Application Money:

Bank A/c Dr
To Share Application and Allotment A/c

On allotment of shares:

Share Application & Allotment A/c Dr (With total application and allotment amount)

To Share Capital A/c

On Allotment money being received:

Bank A/c Dr
To Share Application & Allotment A/c

(4) 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 ₹...)

(5) 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)



2.5 SUBSCRIPTION OF SHARES

Accounting for issue of shares depends upon the type of subscription. Whenever a company decides to issue shares to public, it invites applications for subscription by issuing a prospectus. It is not necessary that company receives applications for the number of shares to be issued by it. There are three possibilities:

2.5.1 Full Subscription

Issue is fully subscribed if the number of shares offered for subscription and the number of shares actually subscribed by the public are same. To start discussion on accounting treatment for issue of shares, let us assume that the issue is fully subscribed.

ILLUSTRATION 2

A company invited applications for 10,000 equity shares of ₹ 50 each payable on application ₹ 15, on Allotment ₹ 20, on first and final call ₹15. Applications are received for 10,000 shares and all the applicants are allotted the number of shares they have applied for and instalment money was duly received by the company. Show Journal entries in the books of the company.

SOLUTION

Journal entries in the books of a company

For application money received: Amount received along with application is accounted as follows:

Bank A/c	Dr.	(Application money on allotted share i.e., $10,000 \times ₹ 15 = ₹ 1,50,000$)
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To Equity Share Application A/c

At the time of allotment: Application money received from successful applicants become part of share capital and is transferred to share capital as under:

Equity Share Application A/c	Dr.	(Application money on allotted share i.e., $10,000 \times ₹ 15 = ₹ 1,50,000$)
------------------------------	-----	--------------------------------------------------------------------------------

To Equity Share Capital A/c

To record amount due on allotment: When the decision is taken to allot shares, allotment money on allotted shares falls due and is recorded as follows:

Equity Share Allotment A/c	Dr.	(Allotment money due at the allotted share i.e., $10,000 \times ₹ 20 = ₹ 2,00,000$)
----------------------------	-----	-----------------------------------------------------------------------------------------

To Equity Share Capital A/c

SOLUTION

A Ltd.

Journal

2021			₹	₹
May 20	Bank Account To Share Application A/c (Application money on 40,000 shares at ₹ 20 per share received.)	Dr.	8,00,000	8,00,000
June 1	Share Application A/c To Share Capital A/c (The amount transferred to Capital Account on 40,000 shares at - ₹ 20 on application. Directors' resolution no..... dated))	Dr.	8,00,000	8,00,000
	Share Allotment A/c To Share Capital A/c (Being share allotment made due at ₹ 30 per share. Directors' resolution no..... dated))	Dr.	12,00,000	12,00,000
July 15	Bank Account To Share Allotment A/c (The sums due on allotment received.)	Dr.	12,00,000	12,00,000
Oct. 1	Share First Call Account To Share Capital Account (Amount due from members in respect of first call-on 40,000 shares at ₹ 25 as per Directors, resolution no... dated...)	Dr.	10,00,000	10,00,000
Oct. 20	Bank Account To Share First Call Account (Receipt of the amounts due on first call.)	Dr.	10,00,000	10,00,000
2022				
Feb. 1	Share Second and Final Call A/c To Share Capital A/c (Amount due on 40,000 share at ₹ 25 per share on second and final call, as per Directors resolution no... dated...)	Dr.	10,00,000	10,00,000

Mar. 31	Bank Account	Dr.	10,00,000	
	To Share Second & Final Call A/c			10,00,000
	(Amount received against the final call on 40,000 shares at ₹ 25 per share.)			

2.5.3 Over Subscription

In actual practice, issue of shares is either under or over-subscribed. If an issue is over-subscribed, some applications may be rejected and application money refunded and in respect of others, only a part of the shares applied for may be allotted and the excess amount received can be utilised towards allotment or call money which has fallen due or will soon fall due for payment. The entries are:

- (1) 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)

- (2) 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 application money adjusted)

*Credited to Share Capital A/c subsequently.

(Note: This type of share allotment is termed as Pro-rata allotment and has been discussed in detail in para 2.8)

ILLUSTRATION 4

Pant Ltd. invited applications for 50,000 equity shares at ₹ 50 each, which are payable as on application ₹ 20, on allotment ₹ 10 and on first and final call ₹ 20. The company received applications for 60,000 shares. The directors accepted application for 50,000 shares and rejected the rest. Show Journal entries if company refunded the application money to rejected applicants and allotment money was received for 45,000 shares.

SOLUTION

Pant Ltd.

Journal

		₹	₹
Bank A/c	Dr.	12,00,000	
To Equity Share Application A/c			12,00,000
(Being the application money received for 60,000 shares at ₹ 20 per share)			
Equity Share Application A/c	Dr.	12,00,000	
To Equity Share Capital A/c			10,00,000
To Bank A/c			2,00,000
(Being share allotment made for 50,000 shares and excess refunded.)			
Equity Share Allotment A/c	Dr.	5,00,000	
To Equity Share Capital A/c			5,00,000
(Being allotment amount due on 50,000 equity shares at ₹ 10 per share as per Directors' resolution no... dated...)			
Bank A/c	Dr.	4,50,000	
Calls in Arrears A/c	Dr.	50,000	
To Equity Share Allotment A/c			5,00,000
(Being allotment money received for 45,000 shares at ₹ 10 per share.)			

ILLUSTRATION 5

The Delhi Artware Ltd. issued 50,000 equity shares of ₹ 100 each and 1,00,000 preference shares of ₹ 100 each. The Share Capital was to be collected as under:

	Equity Shares (₹)	Preference Shares (₹)
On Application	25	20
On Allotment	20	30
First Call	30	20
Final Call	25	30

All these shares were subscribed. Final call was received on 42,000 equity shares and 88,000 preference shares. Prepare the cash book and journalise the remaining transactions in the books of the company.

SOLUTION

Delhi Artware Ltd.

Cash Book

Dr.		₹		₹	Cr.
To	Equity Shares Applications Account (application money on 50,000 shares at ₹ 25)	12,50,000	By Balance c/d		14,440,000
To	Preference Share Application A/c (application money on 1,00,000 shares at ₹ 20)	20,00,000			
To	Equity Share Allotment A/c (allotment money on 50,000 shares at ₹ 20)	10,00,000			
To	Preference Share Allotment A/c (allotment money on 1,00,000 shares at ₹ 30)	30,00,000			
To	Equity Shares First Call A/c (₹ 30 on 50,000 shares)	15,00,000			
To	Preference Share First Call A/c (₹ 20 on 1,00,000 shares)	20,00,000			
To	Equity Shares Final Call A/c (₹ 25 on 42,000 shares)	10,50,000			
To	Preference Share Final A/c (₹ 30 on 88,000 shares)	26,40,000			
		1,44,40,000			1,44,40,000
To	Balance b/d	1,44,40,000			

Journal

		₹	₹
Equity Share Application A/c	Dr.	12,50,000	
Equity Share Allotment A/c	Dr.	10,00,000	
To Equity Share Capital A/c			22,50,000
[The Credit to share capital on allotment of 50,000 equity shares at ₹ 45 per share (₹ 25 on application and ₹ 20 on allotment) allotted as per Directors resolution no.... dated.....]			
Preference Share Application A/c	Dr.	20,00,000	
Preference Share Allotment A/c	Dr.	30,00,000	
To Preference Share Capital A/c			50,00,000
[The credit to Preference Share Capital on allotment of 1,00,000 preference shares at ₹ 50 per share (₹ 20 on application and ₹30 on allotment), allotted as per Directors' resolution no... dated...]			
Equity Share First Call A/c	Dr.	15,00,000	
To Equity Share Capital A/c			15,00,000
(Amount due on 50,000 equity shares at ₹ 30 per share as per Directors' resolution no... dated...)			
Preference Share First Call A/c	Dr.	20,00,000	
To Preference Share Capital A/c			20,00,000
(Amount due on 1,00,000 preference shares at ₹ 20 per share, as per Directors' resolution no...dated...)			
Equity Share Final Call A/c	Dr.	12,50,000	
To Equity Share Capital A/c			12,50,000
(Amount due on final call on 50,000 equity shares at ₹ 25 per share, as per Directors' resolution no... dated...)			
Preference Share Final Call A/c	Dr.	30,00,000	
To Preference Share Capital A/c			30,00,000
(Amount due on final call on 1,00,000 preference shares at ₹ 30 per share, as per Directors' resolution no... dated...)			

Note: Students may note that cash transactions have not been journalised as these have been entered in the Cash Book.



2.6 SHARES ISSUED AT DISCOUNT

Shares are regarded to be issued at a discount, if issue is at an amount less than the nominal or par value of shares. The excess of the nominal value over the issue price represents discount on the issue of shares. For example, when a share of the nominal value of ₹ 100 is issued at ₹ 98, it is said to have been issued at a discount of 2 per cent.

According to Section 53 of the Companies Act, 2013, a Company cannot issue shares at a discount except in the case of issue of sweat equity shares (issued to employees and directors). Thus, any issue of shares at discount shall be void.



2.7 SHARES ISSUED AT PREMIUM

When a company issues its securities at a price more than the face value, it is said to be an issue at a premium. Premium is the excess of issue price over face value of the security. It is quite common for the financially strong, and well-managed companies to issue their shares at a premium, i.e. at an amount more than the nominal or par value of shares. Thus, where a share of the nominal value of ₹ 100 is issued at ₹ 105, it is said to have been issued at a premium of 5 per cent.

When the issue is at a premium, the amount of premium may technically be called at any stage of share capital transactions. However, premium is generally called with the amount due on allotment, sometimes with the application of money and rarely with the call money.

2.7.1 Accounting Treatment

When shares are issued at a premium, the premium amount is credited to a separate account called "*Securities Premium Account*" because it is not a part of share capital. Rather, it represents a gain of a capital nature to the company.

Being a credit balance, Securities premium Account is shown under the heading, "Reserves and Surplus". However, 'Reserves and Surplus' is shown as 'shareholders' funds in the Balance Sheet as per Schedule III. According to Section 52 of the Companies Act, 2013, Securities Premium Account may be used by the company:

- (a) Towards issue of un-issued shares of the company to be issued to members of the company as fully paid bonus securities.
- (b) To write off preliminary expenses of the company.
- (c) To write off the expenses of, or commission paid, or discount allowed on any of the securities or debentures of the company.

- (d) To provide for premium on the redemption of redeemable preference shares or debentures of the company.
- (e) For the purchase of own shares or other securities.

Note : It may be noted that certain class of Companies as prescribed under Section 133 of the Companies Act, 2013, whose financial statements comply with the accounting standards prescribed for them (i.e. those companies to whom Indian Accounting Standards are applicable), can't apply the securities premium account for the purposes (b) and (d) mentioned above.

When shares are issued at a premium, the journal entries are as follows:

(a) Premium amount called with Application money

- | | | | |
|------|----------------------------------------------------------------------------------------|-----|----------------------------------------------------------------|
| (i) | Bank A/c | Dr. | [Total Application money + Premium Amount] |
| | To Share Application A/c | | [Amount received] |
| | (Money received on applications
For Shares @ ₹_____ per
share including premium) | | |
| (ii) | 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] |

(b) Premium Amount called with Allotment Money

- | | | | |
|-----|------------------------------------------------------------------------------|-----|------------------------------------------------------------------|
| (i) | 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] |
| | (Amount due on allotment of
shares @ ₹___ per share
including premium) | | |

- (ii) Bank A/c Dr.
 To Share Allotment A/c
 (Money received including premium consequent upon allotment).

ILLUSTRATION 6

On 1st October, 2022 Pioneer Equipment Limited received applications for 2,50,000 Equity Shares of ₹ 100 each to be issued at a premium of 25 per cent payable as :

- On Application ₹ 25
 On Allotment ₹ 75 (including premium)

Balance Amount on Shares As and when required

The shares were allotted by the Company on October 20, 2022 and the allotment money was duly received on October 31, 2022.

Record journal entries in the books of the company to record the transactions in connection with the issue of shares.

SOLUTION

Pioneer Equipment Limited

Journal

Date	Particulars	L.F.	Debit Amount	Credit Amount
2022			(₹000)	(₹000)
Oct. 1	Bank A/c Dr. To Equity Share Application A/c (Money received on applications for 2,50,000 shares @ ₹ 25 per share)		6,250	6,250
Oct. 20	Equity Share Application A/c Dr. To Equity Share Capital A/c (Transfer of application money on allotment to share capital)		6,250	6,250
Oct. 20	Equity Share Allotment A/c Dr. To Equity Share Capital A/c		18,750	12,500

	To Securities Premium A/c (Amount due on allotment of 2,50,000 shares @ ₹ 75 per share including premium)			6,250
Oct. 31	Bank A/c	Dr.	18,750	
	To Equity Share Allotment A/c (Money received including premium consequent upon allotment)			18,750

Note: Bifurcation of Allotment amount

$$\begin{aligned} \text{Security premium per share} &= 25\% \times ₹100 \\ &= ₹ 25 \end{aligned}$$

$$\text{Money received on allotment per share} = ₹ 75$$

	Premium	Capital
Per Share (75)	₹ 25	₹ 50
No. of Shares (in '000)	250	250
Total Amount (In '000)	₹ 6,250	₹12,500



2.8 OVER SUBSCRIPTION AND PRO-RATA ALLOTMENT

Over subscription is the application money received for more than the number of shares offered to the public by a company. It usually occurs in the case of good issues and depends on many other factors like investors' confidence in the company, general economic conditions, pricing of the issue etc. When the shares are oversubscribed, the company cannot satisfy all the applicants. It means that a decision is to be made on how the shares are going to be allotted. Shares can be allotted to the applicants by a company in any manner it thinks proper. The company may reject some applicants in full, i.e., no shares are allotted to some applicants and application money is refunded. Usually, multiple applications by the same persons are not considered. Allotment may be given to the rest of the applicants in full, i.e., for the number of shares they have applied for. A third alternative is that a company may allot shares to the applicants on **pro-rata** basis. 'Pro-rata allotment' means allotment in proportion of shares applied for.

For example, a company offers to the public 10,000 shares for subscription. The company receives applications for 12,000 shares. If the shares are to be allotted on pro-rata basis,

applicants for 12,000 shares are to be allotted 10,000 shares, i.e., on the 12,000: 10,000 or 6:5 ratio. Any applicant who has applied for 6 shares will be allotted 5 shares.

Under pro-rata allotment, the excess application money received is adjusted against the amount due on allotment or calls. Surplus money after making adjustment against future calls is returned to the applicants. The applicants are informed about the allotment procedure through an advertisement in leading newspapers.

When there is a pro-rata allotment, the total application money paid by an applicant is more than the exact amount due on application. The excess amount is treated as an advance against allotment or any other future calls. The net amount due on allotment or any other calls is the difference between the amount due on allotment or any other calls and the excess amount received in application.

Accounting Entries

(a) *For rejected applications:*

Share Application Account	Dr.
To Bank Account	

(Being application money refunded for rejected applications as per Board's Resolution No....dated....)

(b) *For pro-rata allotment:*

Share Application Account	Dr.
To Share Allotment Account	

(Being excess application money adjusted against allotment money as per Board's Resolution No....dated....)

Illustration 7

JHP Limited is a company with an authorised share capital of 10,00,000 in equity shares of ₹ 10 each, of which 6,00,000 shares had been issued and fully paid on 30th June, 2021. The company proposed to make a further issue of 1,00,000 of these ₹ 10 shares at a price of ₹ 14 each, the arrangements for payment being:

(a) *₹ 2 per share payable on application, to be received by 1st July, 2021;*

(b) *Allotment to be made on 10th July, 2021 and a further ₹ 5 per share (including the premium) to be payable;*

(c) *The final call for the balance to be made, and the money received by 30th April, 2022.*

Applications were received for 3,55,000 shares and were dealt with as follows:

- (i) Applicants for 5,000 shares received allotment in full;
- (ii) Applicants for 30,000 shares received an allotment of one share for every two applied for; no money was returned to these applicants, the surplus on application being used to reduce the amount due on allotment;
- (iii) Applicants for 3,20,000 shares received an allotment of one share for every four applied for; the money due on allotment was retained by the company, the excess being returned to the applicants; and
- (iv) the money due on final call was received on the due date.

You are required to record these transactions (including cash items) in the Journal of JHP Limited.

SOLUTION

Journal of JHP Limited

Date		₹	₹
2021	Particulars		
July 1	Bank A/c (Note 1 – Column 3) Dr. To Equity Share Application A/c (Being application money received on 3,55,000 shares @ ₹ 2 per share)	7,10,000	7,10,000
July 10	Equity Share Application A/c Dr. To Equity Share Capital A/c To Equity Share Allotment A/c (Note 1 Column 5) To Bank A/c (Note 1 – Column 6) (Being application money on 1,00,000 shares transferred to Equity Share Capital Account; on 2,15,000 shares adjusted with allotment and on 40,000 shares refunded as per Board's Resolution No.....dated...)	7,10,000	2,00,000 4,30,000 80,000
	Equity Share Allotment A/c Dr. To Equity Share Capital A/c	5,00,000	1,00,000

2022	To Securities Premium a/c (Being allotment money due on 1,00,000 shares @ ₹ 5 each including premium at ₹ 4 each as per Board's Resolution No....dated....)			4,00,000
	Bank A/c (Note 1 – Column 8)	Dr.	70,000	
	To Equity Share Allotment A/c (Being balance allotment money received)			70,000
2022	Equity Share Final Call A/c	Dr.	7,00,000	
	To Equity Share Capital A/c (Being final call money due on 1,00,000 shares @ ₹ 7 per share as per Board's Resolution No.....dated....)			7,00,000
April 30	Bank A/c	Dr.	7,00,000	
	To Equity Share Final Call A/c (Being final call money on 1,00,000 shares @ ₹ 7 each received)			7,00,000

Working Notes:**Calculation for Adjustment and Refund**

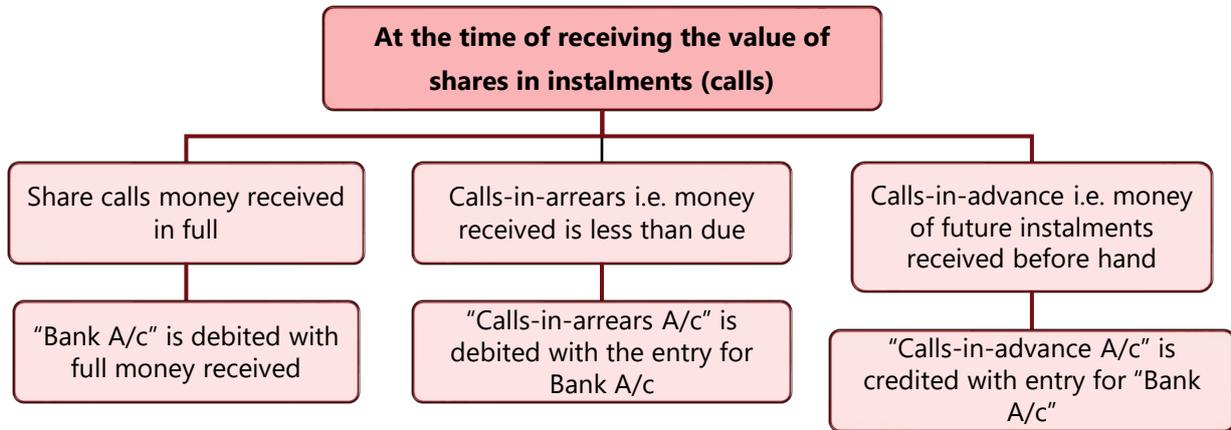
Category	No. of Shares Applied for	No. of Shares Allotted	Amount Received on Application	Amount Required on Application	Amount adjusted on Allotment	Refund [3 - 4 + 5]	Amount due on Allotment	Amount received on Allotment
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
(i)	5,000	5,000	10,000	10,000	Nil	Nil	25,000	25,000
(ii)	30,000	15,000	60,000	30,000	30,000	Nil	75,000	45,000
(iii)	3,20,000	80,000	6,40,000	1,60,000	4,00,000	80,000	4,00,000	Nil
TOTAL	3,55,000	1,00,000	7,10,000	2,00,000	4,30,000	80,000	5,00,000	70,000

Also,

- (i) Amount Received on Application (3) = No. of shares applied for (1) x ₹ 2
- (ii) Amount Required on Application (4) = No. of shares allotted (2) x ₹ 2



2.9 CALLS-IN-ARREARS AND CALLS-IN-ADVANCE



Calls-in-Arrears

Sometimes shareholders fail to pay the amount due on allotment or calls. The total unpaid amount on one or more instalments is known as *Calls-in-Arrears* or *Unpaid Calls*. Such amount represents the uncollected amount of capital from the shareholders; hence, it is shown by way of deduction from 'called-up capital' to arrive at paid-up value of the share capital.

For recording 'Calls-in-Arrears', the following journal entry is recorded :

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.)

Calls-in-Advance

Some shareholders may sometimes pay a part, or whole, of the amount not yet called up, such amount is known as Calls-in-advance. According to Table F, interest at a rate not exceeding 12 per cent p.a. is to be paid on such advance call money. This amount is credited in Calls-in-Advance Account. The following entry is recorded:

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

When calls become actually due, 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 due received)

ILLUSTRATION 8

Shreyas Ltd. did not receive the first call on 10,000 equity shares @ ₹ 3 per share which was due on 1.7.2021. This amount was received on 1.4.2022.

Open Calls in arrears account and journalise the entries in the books of the company on 1.7.2021 and 1.4.2022.

SOLUTION

Shreyas Ltd

Journal

Date	Particulars	L.F.	Amount	
			Dr.	Cr.
1.7.2021	Calls in Arrears A/c Dr. To Equity Share First Call A/c (Being amount due on first call on 10,000 shares at ₹ 3 per share transferred to calls in arrears account)		30,000	30,000
1.4.2022	Bank A/c Dr. To Calls in Arrears A/c (Being calls in arrears received)		30,000	30,000



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

Interest on calls in arrears is recoverable and that in respect of calls in advance is payable, according to provisions in this regard in the articles of the company, at the rates mentioned therein or those to be fixed by the directors, within the limits prescribed by the Articles. Table F prescribes 10% and 12% p.a. as the maximum rates respectively for calls in arrears and those in advance.

Interest on Calls in Arrears	Interest on Calls in Advance
It is payable by shareholders to company on the calls due but remaining unpaid.	It is payable by the Company to Shareholders on the call money received in advance but not yet due.

<p>As per Table F maximum prescribed rate is 10%.</p> <p>Period considered : From the date call money was due to the date money is finally received.</p> <p>Directors have a right to waive off such interest in individual cases at their own discretion.</p> <p>It is a nominal account in nature and is credited to statement of profit and loss as an income.</p>	<p>As per Table F maximum prescribed rate is 12%.</p> <p>Period considered: From the date money was received to the day call was finally made due.</p> <p>Shareholders are not entitled for any dividend on calls in advance.</p> <p>It is a nominal account in nature with interest being an expense for the company.</p>
-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------	----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------

The book entries to be passed for the adjustment of such interest are much the same as those in case of temporary borrowings or loans raised, the only difference being that debits are raised and credits are given to Sundry Members Account (and not the individual accounts of shareholders) in respect of interest recoverable on calls in arrear or that payable on call received in advance, the corresponding entries being made in the Interest Receivable on Calls in Arrears and Interest Payable on Calls in Advance, respectively.

The journal entries for calls-in-arrears are as follows :

- (i) 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 at the rate of ...% made due)
- (ii) For receipt of interest
- | | |
|----------------------|-----|
| Bank A/c | Dr. |
| To Shareholders' A/c | |
- (Being interest money received)

The accounting treatment of interest on Calls-in-Advance is as follows:

- (i) 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)

Equity Share First Call A/c	Dr.	2,00,000	
To Equity Share Capital A/c			2,00,000
(Being first call made due on 1,00,000 shares at ₹ 2 per share)			
Bank A/c	Dr.	2,25,000	
To Equity Share First Call A/c			2,00,000
To Calls in Advance A/c			25,000
(Being first call money received along with calls in advance on 10,000 shares at ₹ 2.50 per share)			
Equity Share Final Call A/c	Dr.	2,50,000	
To Equity Share Capital A/c			2,50,000
(Being final call made due on 1,00,000 shares at ₹ 2.50 each)			
Bank A/c	Dr.	2,22,500	
Calls in Advance A/c	Dr.	25,000	
Calls in Arrears A/c	Dr.	2,500	
To Equity Share Final Call A/c			2,50,000
(Being final call received for 89,000 shares and calls in advance for 10,000 shares adjusted)			
Interest on Calls in Advance A/c	Dr.	750	
To Shareholders A/c			750
(Being interest made due on calls in advance of ₹ 25,000 at the rate of 12% p.a.)			
Shareholders A/c	Dr.	750	
To Bank A/c			750
(Being payment of interest made to shareholder)			
Shareholders A/c	Dr.	41.67	
To Interest on Calls in Arrears A/c			41.67
(Being interest on calls in arrears made due at the rate of 10%)			

Bank A/c	Dr.	2,541.67	
To Calls in Arrears A/c			2,500
To Shareholders A/c			41.67
(Being money received from shareholder for calls in arrears and interest thereupon)			

2.11 FORFEITURE OF SHARES

The term 'forfeit' actually means taking away of property on breach of a condition. It is very common that one or more shareholders fail to pay their allotment and/or calls on the due dates. Failure to pay call money results in forfeiture of shares. Forfeiture of shares is the action taken by a company to cancel the shares. The directors are usually empowered by the Articles of Association to forfeit those shares by serving proper notice to the defaulting shareholder(s). When shares are forfeited, the title of such shareholder is extinguished but the amount paid to date is not refunded to him. The shareholder then has no further claim on the company. The power of forfeiture must be exercised strictly having regard to the rules and regulations provided in the Articles of Association and it should be bonafide in the interests of the company.

The Articles of a company usually authorise the Directors to forfeit shares of a member on account of non-payment of a call or interest thereon after serving him a prior notice as prescribed by the Articles. Directors also have the right to cancel such forfeiture before the forfeited shares are re-allotted.

Accounting Entries

At the time of passing entry for forfeiture of shares, students must be careful about the following matters:

- (i) Amount called-up (i.e., amount credited to capital) in respect of forfeited shares.
- (ii) Amount already received in respect of those shares.
- (iii) Amount due but has not been received in respect of those shares.

We know that shares can be issued at par or at a premium. Accounting entries for forfeiture will vary according to situations.

2.11.1 Forfeiture of Shares which were issued at Par

In this case, Share Capital Account will be debited with the called-up value of shares forfeited. Allotment or Calls Account will be credited with the amount due but not paid by the shareholder(s). (Alternatively, Calls-in-Arrears Account can be credited for all amount due, if

it was transferred to Calls-in-Arrears Account). Forfeited Shares Account or Shares Forfeiture Account will be credited with the amount already received in respect of those shares.

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]

Where all amounts due on allotment, first call and final call have been transferred to 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]

ILLUSTRATION 10

A Ltd forfeited 30,000 equity shares of ₹ 10 fully called-up, held by Mr. X for non-payment of final call @ ₹ 4 each. However, he paid application money @ ₹ 2 per share and allotment money @ ₹ 4 per share. These shares were originally issued at par. Give Journal Entry for the forfeiture.

SOLUTION

In the books of A Ltd.

Journal

Date	Particulars	₹	₹
	Equity Share Capital A/c (30,000 x ₹ 10) Dr.	3,00,000	
	To Equity Share Final Call A/c (30,000 x ₹ 4)		1,20,000
	To Forfeited Shares A/c (30,000 x ₹ 6)		1,80,000
	(Being the forfeiture of 30,000 equity shares of ₹ 10 each fully called-up for non-payment of final call money @ ₹ 4 each as per Board's Resolution No.... dated....)		

ILLUSTRATION 11

X Ltd forfeited 20,000 equity shares of ₹ 10 each, ₹ 8 called-up, for non-payment of first call money @ ₹ 2 each. Application money @ ₹ 2 per share and allotment money @ ₹ 4 per share have already been received by the company. Give Journal Entry for the forfeiture (assume that all money due is transferred to Calls-in-Arrears Account).

SOLUTION

In the books of X Ltd

Journal

Date	Particulars	₹	₹
	Equity Share Capital A/c (20,000 x ₹ 8) Dr.	1,60,000	
	To Calls-in-Arrears A/c (20,000 x ₹ 2)		40,000
	To Forfeited Shares A/c (20,000 x ₹ 6)		1,20,000
	(Being the forfeiture of 20,000 equity shares of ₹ 10 each, ₹ 8 called-up for non-payment of first call money @ ₹ 2 each as per Board's Resolution No.....dated.....)		

2.11.2 Forfeiture of Shares which were issued at a Premium

In this case, Share Capital Account will be debited with the called-up value of shares forfeited. If the premium on such shares has not been paid by the shareholder, the Securities Premium Account will be debited to cancel it (if it was credited earlier). Allotment, Calls and Forfeited Accounts will be credited in the usual manner.

If the premium has already received by the company, it cannot be cancelled even if the shares are forfeited in the future.

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]

ILLUSTRATION 12

X Ltd. forfeited 5,000 equity shares of ₹100 each fully called-up which were issued at a premium of 20%. Amount payable on shares were: on application ₹ 20; on allotment ₹ 50 (including premium); on First and Final call ₹ 50. Only application money was paid by the shareholders in respect of these shares. Pass Journal Entries for the forfeiture.

SOLUTION**In the books of X Ltd.****Journal**

Date	Particulars		₹	₹
	Equity Share Capital A/c (5,000 x ₹ 100)	Dr.	5,00,000	
	Securities Premium A/c (See Note)	Dr.	1,00,000	
	To Equity Share Allotment A/c (5,000 x ₹ 50)			2,50,000
	To Equity Share First and Final Call A/c (5000 x ₹ 50)			2,50,000
	To Forfeited Shares A/c (5000 x ₹ 20)			1,00,000
	(Being the forfeiture of 5,000 equity shares of ₹ 100 each fully called-up, issued at a premium of 20%, for non-payment of allotment and call money as per Board's Resolution No.....dated....)			

Tutorial Note: Share premium @ ₹ 20 on 5,000 shares has not been received by the company. Therefore, at the time of forfeiture, Securities Premium Account will be debited to cancel it (because Securities Premium Account was credited at the time of allotment).

Also, in case of pro-rata allotment where shares are issued at premium, the excess money received on application will be first adjusted to capital account and then for securities premium.

ILLUSTRATION 13

Mr. Shami has applied for 1,000 shares of Company XYZ Ltd. paying application money @ ₹ 2 per share but has been allotted only 600 shares. The shares have a face value of ₹ 10 and a premium of ₹ 2 per share, which are payable as: on Allotment- ₹ 5 (including premium) and on final call ₹ 5. Now in case Mr. Shami doesn't pay allotment money and final call and his shares are forfeited, then following entry will be passed on forfeiture:

SOLUTION

Share Capital A/c (600 x ₹ 10)	Dr.	6,000	
Securities Premium A/c (600 x ₹ 2)	Dr.	1,200	
To Share Forfeiture A/c			2,000
To Share Allotment A/c			2,200
To Share Final Call A/c (600 x 5)			3,000
(Being 600 shares forfeited due to non-payment of allotment money and call money as per Board Resolution no..... dated.....)			

Note:

Total Amount Received on application (1,000 x 2)	2,000
Less: Amount used for application money (600 x 2)	(1,200)
Excess money received on application	800
Amount due on Allotment (600 x 5)	3,000
For premium (600 x 2)	1,200
For Capital A/c (600 x 3)	1,800
Thus amount not received on allotment (3,000 - 800)	2,200

	For Premium A/c	For Capital A/c
Amount not received on allotment (2,200)	₹ 1,200	₹ 1,000

2.11.3 Forfeiture of Fully Paid-Up Shares

Forfeiture for non-payment of calls, premium, or the unpaid portion of the face value of the shares is one of the many causes for which a share may be forfeited. But fully paid-up shares may be forfeited for realization of debts of the shareholder if the Articles specifically provide it.

7. If the re-issued amount and forfeited amount (taken together) exceeds the face value of the shares re-issued, it is not necessary to transfer such amount to Securities Premium Account.

2.12.2 Calculation of Profit on Re-Issue of Forfeited Shares

Students will appreciate that the credit balance of forfeited shares account cannot be considered a surplus until the shares forfeited have been re-issued, because the company may, on re-issue, allow the discount to the new purchaser equivalent to the amount held in credit in this regard in the forfeited shares Account. Suppose 120 shares of a nominal value of ₹ 10 have been forfeited upon which ₹ 5 per share was paid up and transferred to Forfeited Share Account. Afterwards, 50 shares are re-issued, ₹ 6 per share being collected to make them fully paid up; ₹ 200 (50 shares x ₹ 10 - 50 shares x ₹ 6) out of shares forfeited will be credited to Share Capital Account to make up the deficiency on re-issued shares, and ₹ 50 (50 shares x ₹ 5 - ₹ 200) will be transferred to the Capital Reserve Account being the surplus on re-issue of the 50 shares. It would have in the Forfeited shares Account balance equivalent to the amount collected on the remaining 70 forfeited shares i.e. ₹ 350 which will be carried forward till these are re-issued.

In the above case, it has been assumed that the amount paid up on all the 120 forfeited shares was ₹ 5 per share. But in practice, shares may be forfeited on which varying amounts are outstanding. For instance, if in the above case 70 shares were forfeited with ₹ 5 paid up thereon and 50 shares with ₹ 7.50 was paid up thereon then:

$$\begin{aligned} \text{Share Forfeited Account Balance} &= (70 \times 5) + (50 \times 7.50) \\ &= ₹ 725 \end{aligned}$$

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

$$₹ (7.50 + 6 - 10) \times 50 \text{ shares} = ₹ 175$$

ILLUSTRATION 14

Mr. Long who was the holder of 2,000 preference shares of ₹ 100 each, on which ₹ 75 per share has been called up could not pay his dues on Allotment and First call each at ₹ 25 per share. The Directors forfeited the above shares and reissued 1500 of such shares to Mr. Short at ₹ 65 per share paid-up as ₹ 75 per share.

Give Journal Entries to record the above forfeiture and re-issue in the books of the company.

SOLUTION

Particulars		₹	₹
Preference Share Capital A/c (2,000 x ₹ 75)	Dr.	1,50,000	
To Preference Share Allotment A/c			50,000
To Preference Share First Call A/c			50,000
To Forfeited Share A/c			50,000
(Being the forfeiture of 2,000 preference shares ₹ 75 each being called up for non-payment of allotment and first call money as per Board's Resolution No.... dated....)			
Bank A/c (1,500 x ₹ 65)	Dr.	97,500	
Forfeited Shares A/c (1,500 x ₹ 10)	Dr.	15,000	
To Preference Share Capital A/c			1,12,500
(Being re-issue of 1500 shares at ₹ 65 per share paid-up as ₹ 75 as per Board's Resolution No.....dated....)			
Forfeited Shares A/c	Dr.	22,500	
To Capital Reserve A/c (Note 1)			22,500
(Being profit on re-issue transferred to Capital/Reserve)			

Working Note:**Calculation of amount to be transferred to Capital Reserve**

$$\text{Forfeited amount per share} = ₹ 50,000/2000 = ₹ 25$$

$$\text{Loss on re-issue} = ₹ 75 - ₹ 65 = ₹ 10$$

$$\text{Surplus per share re-issued} = ₹ 15$$

$$\text{Transferred to capital Reserve} ₹ 15 \times 1500 = ₹ 22,500$$

ILLUSTRATION 15

Beautiful Co. Ltd issued 30,000 equity shares of ₹ 10 each payable as ₹ 3 per share on application, ₹ 5 per share (including ₹ 2 as premium) on allotment and ₹ 4 per share on call. All the shares were subscribed. Money due on all shares was fully received except from Ram, holding 500 shares, who failed to pay the Allotment and Call money and Shyam, holding 1,000 shares, who failed to pay the Call Money. All those 1,500 shares were forfeited. Of the shares forfeited, 1,250 shares (including whole of Ram's shares) were subsequently re-issued to Jadu as fully paid up at a discount of ₹ 2 per share.

Pass the necessary entries in the Journal of the company to record the forfeiture and re-issue of the share. Also prepare the Balance Sheet of the company.

SOLUTION

In the books of Beautiful Co. Ltd.

Journal

Date	Particulars		₹	₹
	Equity Share Capital A/c (1,500 x ₹ 10)	Dr.	15,000	
	Securities Premium A/c (500 x ₹ 2)	Dr.	1,000	
	To Equity Share Allotment A/c (500 x ₹ 5)			2,500
	To Equity Share Call A/c (1,500 x ₹ 4)			6,000
	To Forfeited Shares A/c			7,500
	(Being forfeiture of 1,500 equity shares for non payment of allotment and call money on 500 shares and for non-payment of call money on 1,000 shares as per Board's Resolution No.....dated)			
	Bank A/c	Dr.	10,000	
	Forfeited Shares A/c	Dr.	2,500	
	To Equity Share Capital A/c			12,500
	(Being re-issue of 1250 shares @ ₹ 8 each as per Board's Resolution No.....dated....)			
	Forfeited Shares A/c	Dr.	3,500	
	To Capital Reserve A/c			3,500
	(Being profit on re-issue transferred to Capital Reserve)			

Balance Sheet of Beautiful Limited as at.....

Particulars	Notes No.	₹
EQUITY AND LIABILITIES		
Shareholders' funds		
Share capital	1	2,99,000
Reserves and Surplus	2	62,500
Total		3,61,500

ASSETS		
Current assets		
Cash and cash equivalents (bank)		3,61,500
Total		3,61,500

Notes to accounts

		₹	₹
1. Share Capital			
Equity share capital			
Issued share capital			
30,000 Equity shares of ₹ 10 each		3,00,000	
Subscribed, called up and paid up share capital			
29,750 Equity shares of ₹ 10 each		2,97,500	
Add: Forfeited shares		1,500	2,99,000
2. Reserves and Surplus			
Securities Premium		59,000	
Capital Reserve		3,500	62,500

Working Note :**(1) Calculation of Amount to be Transferred to Capital Reserve**

Amount forfeited per share of Ram	₹ 3	Amount forfeited per share of Shyam	₹ 6
Less: Loss on re-issue per share	(₹ 2)	Less: Loss on re-issue per share	(₹ 2)
Surplus	₹ 1	Surplus	₹ 4
Transferred to Capital Reserve:			₹ 500
Ram share (500 x ₹ 1)			
Shyam's Share (750 x ₹ 4)			₹ 3,000
Total			₹ 3,500

(2) Balance of Security Premium

Total Premium amount receivable on allotment	=	60,000
Less: Amount reversed on forfeiture	=	(1,000)
Balance remaining	=	<u>59,000</u>

ILLUSTRATION 16

A holds 2,000 shares of ₹ 10 each on which he has paid ₹ 2 as application money. B holds 4,000 shares of ₹ 10 each on which he has paid ₹ 2 per share as application money and ₹ 3 per share as allotment money. C holds 3,000 shares of ₹ 10 each and has paid ₹ 2 on application, ₹ 3 on allotment and ₹ 3 for the first call. They all fail to pay their arrears on the second and final call and the directors, therefore, forfeited their shares. The shares are re-issued subsequently for ₹ 12 per share fully paid-up. Journalise the transactions relating to the forfeiture and re-issue.

SOLUTION

Journal

Date	Particulars	₹	₹
	Share Capital A/c (9,000 x ₹ 10) Dr.	90,000	
	To Share Allotment A/c (2,000 x ₹ 3)		6,000
	To Share First Call A/c (6,000 x ₹ 3)		18,000
	To Share Final Call A/c (9,000 x ₹ 2)		18,000
	To Forfeited Shares A/c		48,000
	(Being forfeiture of 9,000 shares of ₹ 10 each for non-payment of allotment, first and final call money as per Board's Resolution No.....dated....)		
	Bank A/c (9,000 x ₹ 12) Dr.	1,08,000	
	To Share Capital A/c		90,000
	To Securities Premium A/c		18,000
	(Being the re-issue of 9,000 shares of ₹ 10 each @ ₹ 12 as per Board's Resolution No.....dated...)		
	Forfeited Shares A/c Dr.	48,000	
	To Capital Reserve A/c		48,000
	(Being profit on re-issue transferred to Capital Reserve).		

Working Note:

Shareholders	Money Received				Money Not Received On		
	Application	Allotment	First Call	Final Call	Allotment	First Call	Final Call
A	2,000	-	-	-	2,000	2,000	2,000
B	4,000	4,000	-	-	-	4,000	4,000
C	3,000	3,000	3,000	-	-	-	3,000

TOTAL	9,000	7,000	3,000	-	2,000	6,000	9,000
Money	₹ 2	₹ 3	₹ 3	₹ 2	₹ 3	₹ 3	₹ 2
Receivable	₹ 18,000	₹ 21,000	₹ 9,000	-	₹ 6,000	₹ 18,000	₹ 18,000

ILLUSTRATION 17

X Limited invited applications for issuing 75,000 equity shares of ₹ 10 each at a premium of ₹ 5 per share. The total amount was payable as follows:

- ₹ 9 per share (including premium) on application and allotment
- Balance on the First and Final Call

Applications for 3,00,000 equity shares were received. Applications for 2,00,000 equity shares were rejected and money refunded. Shares were allotted on pro-rata basis to the remaining applicants. The first and final call was made. The amount was duly received except on 1,500 shares applied by Mr. Raj. His shares were forfeited. The forfeited shares were re-issued at a discount of ₹ 4/- per share.

Pass necessary journal entries for the above transactions in the books of X Limited.

SOLUTION**Journal**

			Dr.	Cr.
1	Bank Account To Share Application & Allotment A/c (Being Application money on 3,00,000 shares at ₹ 9 per share received.)	Dr.	27,00,000	27,00,000
2	Share Application & Allotment A/c To Share Capital A/c (75,000 x ₹ 4) To Securities premium A/c (75,000 x ₹ 5) To Bank A/c (2,00,000 x ₹ 9) To Share First & Final Call A/c (Being application money transferred)	Dr.	27,00,000	3,00,000 3,75,000 18,00,000 2,25,000
3	Share First & Final Call A/c (75,000 x 6) To Share Capital Account (Amount First & Final Call A/c due from members as per Directors, resolution no..... dated.....)	Dr.	4,50,000	4,50,000

4	Bank Account A/c Calls in arrear A/c To Share First & Final Call Account (Being Receipt of the amounts due on first call.)	Dr.	2,21,625 3,375	2,25,000
5	Equity share capital A/c To Share forfeiture A/c To Calls in arrear A/c (Being 1,125 shares forfeited for non payment of final call.)	Dr.	11,250	7,875 3,375
6	Bank Account A/c (1,125 x ₹ 6) Share forfeiture A/c (1,125 x ₹ 4) To Share Capital Account (1,125 x ₹ 10) (Being forfeited shares reissued at ₹ 4 discount)	Dr.	6,750 4,500	11,250
7	Share forfeiture A/c To Capital reserve A/c (Being share forfeiture transferred to capital reserve*)		3,375	3,375

Working notes:

1.

Shares Applied	Shares Allotted	Money Received on Application @ ₹ 9/-	Money Transferred to Share Capital @ ₹ 4/-	Money Transferred to Security Premium @ ₹ 5/-	Excess Application Money	Share First and Final Call @ ₹ 6/-	Amount received from Share First and Final Call after adjusting excess appl. money	Money Refunded
2,00,000	-	18,00,000	-	-	-	-	-	18,00,000
1,00,000	75,000	9,00,000	3,00,000	3,75,000	2,25,000	4,50,000	2,25,000*	-
3,00,000	75,000	27,00,000	3,00,000	3,75,000	2,25,000	4,50,000	4,46,625*	18,00,000

*4,50,000 less 2,25,000

** ₹ 4,50,000 less ₹ 3,375.

2. Number of shares allotted to Mr. Raj = $1,500 \times 75,000 / 1,00,000 = 1,125$ shares

3. Calculation of calls in arrear

Application money received from Raj	(1,500 x9)	13,500
Less: actual application money	1,125 x9	<u>10,125</u>
Excess Application & Allotment Money Adjusted with first and final call		<u>3,375</u>
Final call due from Raj		6,750
Less: Adjusted with final call		<u>(3,375)</u>
Calls in arrear		<u>3,375</u>



2.13 ISSUE OF SHARES FOR CONSIDERATION OTHER THAN CASH

Public limited companies, generally, issue their shares for cash and use such cash to buy the various types of assets needed in the business. Sometimes, however, a company may issue shares in a direct exchange for land, buildings or other assets. Shares may also be issued in payment for services rendered by promoters, lawyers in the formation of the company. These shares should be shown separately under the heading 'Share Capital'.

Within specified time of allotment, the company must produce before the Registrar a written contract of sale of service in respect of which shares have been allotted.

Under accounting standards, if an asset is acquired, or partly acquired, by the issue of shares or other securities, the acquisition cost is the fair value of the securities issued (which, in appropriate cases, may be indicated by the issue price as determined by statutory authorities). The fair value may not necessarily be equal to 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

ILLUSTRATION 18

X Co. Ltd. was incorporated with an authorized share capital of 90,000 equity shares of ₹ 10 each. The company purchased land and buildings from Y Co. Ltd for ₹ 4,00,000 payable in fully paid-up shares of the company. The balance of the shares were issued to the public, which were fully subscribed and paid for.

You are required to pass Journal Entries and to prepare the Balance Sheet.

SOLUTION

Journal

Date	Particulars	₹	₹
	Land and Buildings A/c Dr. To Y Co. Ltd A/c (Being the land and buildings purchased from Y Co. Ltd as per agreement dated...).	4,00,000	4,00,000
	Y. Co. Ltd A/c Dr. To Equity Share Capital A/c (Being 40,000 shares of ₹ 10 each issued to Y Co. Ltd. on purchase of land and building)	4,00,000	4,00,000
	Bank A/c Dr. To Equity Share Application and Allotment A/c (Being the issue of 50,000 shares of ₹ 10 each as per Board's Resolution No.....dated...)	5,00,000	5,00,000
	Equity Share Application and Allotment A/c Dr To Equity Share Capital A/c (Being shares allotted for application money received.)	5,00,000	5,00,000

Balance Sheet of X Company Limited as at....

Particulars	Notes No.	₹
EQUITY AND LIABILITIES		
Shareholders' funds		
Share capital	1	9,00,000
Total		9,00,000
ASSETS		
1. Non-current assets		
a Fixed assets		
i. Plant Property and Equipment	2	4,00,000
2. Current assets		
Cash and cash equivalents	3	5,00,000
Total		9,00,000

Notes to accounts

	₹
1. Share Capital	
Equity share capital	
Authorised share capital	
90,000 Equity shares of ₹ 10 each	9,00,000
Issued share capital	
90,000 Equity shares of ₹ 10 each	9,00,000
Subscribed Share Capital	
90,000 Equity Shares of ₹ 10 each	9,00,000
Called up and Paid up Capital	
90,000 Equity Shares of ₹ 10 each	9,00,000
(Out of the above 40,000 shares have been allotted as fully paid up pursuant to contract(s) without payment being received in cash)	
2. Plant Property and Equipment	
Land and Building	4,00,000
3. Cash and cash equivalents	
Balances with banks	5,00,000

SUMMARY

- ◆ Total capital of the company is divided into a number of small indivisible units of a fixed amount and each such unit is called a share.
- ◆ The total capital of the company is divided into shares, the capital of the company is called 'Share Capital'.
- ◆ Share capital of a company is divided into following categories:
 - (i) Authorised Share Capital or Nominal Capital; (ii) Issued Share Capital; (iii) Subscribed Share Capital (iv) Called-up Share Capital; (v) Paid-up Share Capital; (vi) Reserve Share Capital

- ◆ Types of shares are:
 - (i) Preference Shares. Preference shares can be of various types, e.g.: (a) Cumulative Preference Shares (b) Non-cumulative Preference Shares (c) Participating Preference Shares (d) Non-participating Preference Shares (e) Redeemable Preference Shares (f) Non-redeemable Preference Shares (g) Convertible Preference Shares (h) Non-convertible Preference Shares.
 - (ii) Equity Shares
- ◆ A company can issue shares either
 - (1) for cash or
 - (2) for consideration other than cash.
- ◆ A public limited company cannot make any allotment of shares unless the amount of minimum subscription stated in the prospectus has been subscribed and the sum payable as application money for such shares has been paid to and received by the company.
- ◆ When a company issues its securities at a price more than the face value, it is said to be an issue at a premium. Premium is the excess of issue price over face value of the security.
- ◆ According to Section 52 of the Companies Act, 2013, Securities Premium Account may be used by the company:
 - (a) Towards issue of un-issued shares of the company to be issued to members of the company as fully paid bonus securities.
 - (b) To write off preliminary expenses of the company.
 - (c) To write off the expenses of, or commission paid, or discount allowed on any of the securities or debentures of the company.
 - (d) To provide for premium on the redemption of redeemable preference shares or debentures of the company.
 - (e) For the purchase of own shares or other securities.
- ◆ Sometimes shareholders fail to pay the amount due on allotment or calls. The total unpaid amount on one or more instalments is known as *Calls-in-Arrears or Unpaid Calls*.
- ◆ Some shareholders may sometimes pay a part, or whole, of the amount not yet called up, such amount is known as *Calls-in-advance*.

- ◆ Interest on calls in arrear is recoverable and that in respect of calls in advance is payable, according to provisions in this regard in the articles of the company, at the rates mentioned therein or those to be fixed by the directors, within the limits prescribed by the Articles. Table F prescribes 10% and 12% p.a. as the maximum rates respectively for calls in arrears and those in advance.
- ◆ The term 'forfeit' actually means taking away of property on breach of a condition. It is very common that one or more shareholders fail to pay their allotment and/or calls on the due dates. Failure to pay call money results in forfeiture of shares.
- ◆ 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.
- ◆ Public limited companies, generally, issue their shares for cash and use such cash to buy the various types of assets needed in the business. Sometimes, however, a company may issue shares in a direct exchange for land, buildings or other assets. These shares should be shown separately under the heading 'Share Capital'.

TEST YOUR KNOWLEDGE

True and False

1. *Liability of a holder of shares is limited to the face value of shares acquired by them.*
2. *Authorised capital appears in the balance sheet at face value.*
3. *The rate of dividend on preference shares may vary From year to year.*
4. *A company may issue shares at a discount to the public in general.*
5. *Sweat equity shares are those which are issued to employees & directors at a discount.*
6. *As per table F, rate of interest on calls in arrears is 12%.*
7. *As per Table F, rate of interest on calls in advance is 10%.*
8. *Non-participating preference shareholders enjoy voting rights.*
9. *Forfeited shares are available to the company for the purpose of resale.*
10. *Loss on reissue should exceed the forfeited amount.*

Multiple Choice Questions

1. The excess price received over the par value of shares, should be credited to _____.
 - (a) Calls-in-advance account
 - (b) Share capital account
 - (c) Securities premium account
2. The Securities Premium amount may be utilized by a company for _____.
 - (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
3. When shares are forfeited, the share capital account is debited with _____ and the share forfeiture account is credited with _____.
 - (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
4. T Ltd. proposed to issue 6,000 equity shares of ₹ 100 each at a premium of 40%. The minimum amount of application money to be collected per share as per the Companies Act, 2013
 - (a) ₹ 5.00
 - (b) ₹ 6.00
 - (c) ₹ 7.00
5. Dividends are usually paid as a percentage of _____.
 - (a) Authorized share capital
 - (b) Net profit
 - (c) Paid-up capital
6. As per the SEBI guidelines, on issue of shares, the application money should not be less than
 - (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

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 = ?
- (a) 6,000 shares
 - (b) 7,500 shares
 - (c) 9,375 shares
8. Securities Premium is presented as a part of
- (a) Reserves & Surplus
 - (b) Share Capital
 - (c) Liabilities
9. Schedule III of Companies Act 2013 prescribes the format for
- (a) Financial statements
 - (b) Directors' Report
 - (c) Auditors' Report
10. Dividend on _____ shares have to be paid before dividend on _____ shares.
- (a) Equity, Preference
 - (b) Preference, Equity
 - (c) Convertible, Non-Cumulative
11. Preference shares are _____ unless expressly stated otherwise.
- (a) Non-participating
 - (b) Convertible
 - (c) Interest-bearing

Theory Questions

1. Write short notes on:
- (i) Utilization of securities premium account
 - (ii) Re-issue of forfeited shares
2. Distinguish between:
- (i) Calls-in-Arrears and Calls-in-advance

(ii) Issue of shares for cash and Issue of Shares for Consideration other than Cash

3. Can a company issue shares at discount?

Practical Questions

1. X Ltd. invited applications for 10 lakhs shares of ₹ 100 each payable as follows :

	₹
On Application	20
On Allotment (on 1st May, 2022)	30
On First Call (on 1st Oct., 2022)	30
On Final Call (on 1st Feb., 2023)	20

All the shares were applied for and allotted. A shareholder holding 20,000 shares paid the whole of the amount due along with allotment. Journalise the transactions, assuming all sums due were received. Interest was paid to the shareholder concerned on 1st February, 2023.

2. A limited Company, with an authorized capital of ₹ 20,00,000 divided into shares of ₹ 100 each, issued for subscription 10,000 shares payable at ₹ 25 per share on application, ₹ 30 per share on allotment, ₹ 20 per share on first call three months after allotment and the balance as and when required.

The subscription list closed on January 31, 2022 when application money on 10,000 shares was duly received and allotment was made on March 1, 2022. All amounts due were received within one month of the date they were called.

The allotment amount was received in full but, when the first call was made, one shareholder failed to pay the amount on 1,000 shares held by him and another shareholder with 500 shares paid the entire amount on his shares.

Give journal entries in the books of the Company to record these share capital transactions.

3. A Ltd. forfeits 100 shares of Rs. 10 each fully called upon. The shareholder failed to pay the first call money of Rs. 4 per share and the second and final Call Money of Rs. 4 per share. Give journal entry to show the effect of this transaction.

4. B Ltd. issued 20,000 equity shares of ₹ 100 each at a premium of ₹ 20 per share payable as follows: on application ₹ 50; on allotment ₹ 50 (including premium); on final call ₹ 20. Applications were received for 24,000 shares. Letters of regret were issued to applicants for 4,000 shares and shares were allotted to all the other applicants. Mr. A, the holder of 150 shares, failed to pay the allotment and call money, the shares were forfeited. Show the Journal Entries and Cash Book in the books of B Ltd.

ANSWERS/ HINTS

True and False

1. False: Liability of the holder of shares is limited to the issue price of shares acquired by them.
2. True: Authorised capital is the amount of capital mentioned in 'capital clause' of the 'Memorandum of Association'. Authorised capital is considered only as presentation and not considered in total of balance sheet.
3. False: Rate of preference dividend is always fixed.
4. False: According to Section 53 of the Companies Act, 2013, a Company cannot issue shares at a discount except in the case of issue of sweat equity shares (issued to employees and directors). Thus any issue of shares at discount shall be void.
5. True: According to Section 53 of the Companies Act, 2013, a Company cannot issue shares at a discount except in the case of issue of sweat equity shares (issued to employees and directors).
6. False: As per table F, rate of interest on calls in arrears is 10%.
7. False: As per Table F, rate of interest on calls in advance is 12%.
8. False: A share on which only a fixed rate of dividend is paid every year, without any accompanying additional rights in profits and in the surplus on winding-up, is called 'Non-participating Preference Shares. Non-participating preference shareholders do not enjoy voting rights.
9. True: Reissue of forfeited shares is not allotment of shares but only a sale.
10. False: Loss on re-issue should not exceed the forfeited amount.

Multiple Choice Questions

1.	(c)	2.	(c)	3.	(c)	4.	(a)	5.	(c)	6.	(c)
7	(a)	8.	(a)	9.	(a)	10.	(b)	11.	(a)		

Theoretical Questions

1. (i) Refer para 2.7.1 for utilization of securities premium account.
(ii) 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. The share, after forfeiture, in the hands of the company is subject to an obligation to dispose it off. In practice, forfeited shares are disposed off by auction. These shares can be re-issued at any price so long as the total amount received (from the original allottee and the second purchaser) for those shares is not less than the amount in arrears on those shares.

2. (i) **Calls-in-Arrears:** Sometimes shareholders fail to pay the amount due on allotment or calls. The total unpaid amount on one or more instalments is known as Calls-in-Arrears or Unpaid Calls. Such amount represents the uncollected amount of capital from the shareholders; hence, it is shown by way of deduction from 'called-up capital' to arrive at paid-up value of the share capital.

Calls-in-advance: Some shareholders may sometimes pay a part, or whole, of the amount not yet called up, such amount is known as Calls-in-advance.

- (ii) The shares can be issued by a company either for cash or for consideration other than cash. Public limited companies, generally, issue their shares for cash and use such cash to buy the various types of assets needed in the business. Sometimes, however, a company may issue shares in a direct exchange for land, buildings or other assets.
3. According to Section 53 of the Companies Act, 2013, a Company cannot issue shares at a discount except in the case of issue of sweat equity shares (issued to employees and directors). Thus any issue of shares at discount shall be void.

Practical Question

1. **Journal of X Ltd.**

2022			₹ in lakhs	₹ in lakhs
May 1	Bank A/c	Dr.	200	
	To Share Application A/c			200
	(Receipt of applications for 10 lakh shares along with application money of ₹ 20 per share.)			
May 1	Share Application A/c	Dr.	200	
	Share Allotment A/c	Dr.	300	

	To Share Capital A/c (The allotment of 10 lakh shares: payable on application ₹ 20 share and ₹ 30 on allotment as per Directors' resolution no... dated...)		500
May 1	Bank A/c Dr. To Shares Allotment A/c To Calls in Advance A/c [Receipt of money due on allotment @ ₹ 30, also the two calls (₹ 30 and ₹ 20) on 20,000 shares.]	310	300 10
Oct. 1	Share First Call A/c Dr. To Share Capital A/c (The amount due on 10 lakh shares @ ₹ 30 on first call, as per Directors, resolution no... dated...)	300	300
	Bank A/c Dr. Calls in Advance A/c Dr. To Share First Call A/c (Receipt of the first call on 9.80 lakh shares, the balance having been previously received and now debited to call in advance account.)	294 6	300
2023			
Feb. 1	Share Final Call A/c Dr. To Share Capital A/c (The amount due on Final Call on 10 lakh shares @ ₹ 20 per share, as per Directors' resolution no... dated...)	200	200
Feb. 1	Bank A/c Dr. Calls in Advance A/c Dr. To Share Final Call A/c (Receipt of the moneys due on final call on 9.80 lakhs shares, the balance having been previously received.)	196 4	200

Feb. 1	Interest on calls in Advance A/c To Shareholder A/c (Being interest on call in advance made due)	Dr.	0.66	0.66
Feb 1	Shareholder A/c To Bank A/c (Being interest paid)	Dr.	0.66	0.66

Working Note:

The interest on calls in advance paid @ 12% on :	₹
₹ 6,00,000 (first call) from 1st May to 1st Oct., 2022–5 months	30,000
₹ 4,00,000 (final call) from 1st May to 1st Feb., 2023–9 months	36,000
Total Interest Amount Due	66,000

2.

Journal Entries in the Books of the Company

Date	Particulars	L.F.	Debit	Credit
2022			Amount	Amount
			(₹)	(₹)
Jan. 31	Bank A/c To Equity Share Application A/c (Money received on applications for 10,000 shares @ ₹ 25 per share)	Dr.	2,50,000	2,50,000
March 1	Equity Share Application A/c To Equity Share Capital A/c (Transfer of application money on 10,000 shares to share capital)	Dr.	2,50,000	2,50,000
March 1	Equity Share Allotment A/c To Equity Share Capital A/c (Amount due on the allotment of 10,000 shares @ ₹ 30 per share)	Dr.	3,00,000	3,00,000

April 1	Bank A/c To Equity Share Allotment A/c (Allotment money received)	Dr.		3,00,000	3,00,000
June 1	Equity Share First Call A/c To Equity Share Capital A/c (First call money due on 10,000 shares @ ₹ 20 per share)	Dr.		2,00,000	2,00,000
July 1	Bank A/c Calls-in-Arrears A/c To Equity Share First Call A/c To Calls-in-Advance A/c (First call money received on 9000 shares and calls-in-advance on 500 shares @ ₹ 25 per share)	Dr. Dr.		1,92,500 20,000	2,00,000 12,500

3.

**In the Books of A Ltd.
Journal Entries**

Date	Particulars		₹	₹
	Equity Share Capital A/c (100X10) To Share First Call A/c (100X4) To Second and Final Call A/c (100X4) To Share Forfeiture A/c (100X2) (Being share forfeiture of 100 shares as per Board's Resolution No.....dated...)	Dr.	1,000	400 400 200

4.

**In the Books of B Ltd.
Cash Book (Bank column only)**

Date	Particulars	₹	Date	Particulars	₹
	To Equity Share Application A/c (Being application money received on 24,000 shares @ ₹ 50 each)	12,00,000		By Equity Share Application A/c (Being excess money refunded on 4,000 shares @ ₹ 50 each as per Board's Resolution No...dated...)	2,00,000

To Equity Share Allotment A/c (Being allotment money received on 19,850 shares @ ₹ 50 each)	9,92,500		By Balance c/d	23,89,500
To Equity Share Final Call A/c (Being final call money received on 19,850 shares @ ₹ 20 each)	3,97,000			
	25,89,500			25,89,500

Journal Entries

Date	Particulars	₹	₹
	Equity Share Application A/c Dr. To Equity Share Capital A/c (Being application money on 20,000 shares @ ₹ 50 each transferred to Equity Share Capital Account as per Board's Resolution No.....dated...)	10,00,000	10,00,000
	Equity Share Allotment A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (Being allotment money @ ₹ 50 per share including premium of ₹ 20 per share being made due as per Board's Resolution No.....dated....)	10,00,000	6,00,000 4,00,000
	Equity Share Capital A/c (150 x ₹ 100) Dr. Securities Premium A/c (150 x ₹ 20) Dr. To Equity Share Allotment A/c To Equity Share Final Call A/c To Forfeited Shares A/c (Being forfeiture of 150 shares for non-payment of allotment money and final call money as per Board's Resolution No....dated...)	15,000 3,000	7,500 3,000 7,500

Equity Share Final Call A/c (19,850 x ₹ 20)	Dr.	3,97,000	
To Equity Share Capital A/c			3,97,000
(Being final call money received for ₹ 20 per share being made as per Board's resolution No.... dated)			

Note: Here, securities premium on forfeited shares has not been realised, so Securities Premium Account will be debited at the time of forfeiture of these shares.

Also, alternatively Calls in arrears A/c could have been used in which case following entries would have been passed in place of the entry (given above) for forfeiture:

On non- receipt of allotment money:			
Calls in Arrears A/c	Dr.	7,500	
To Equity Share Allotment A/c			7,500
(Being allotment money on 150 shares @ ₹ 50 not received transferred to calls in arrears.)			
On non - receipt of Call money:			
Calls in Arrears A/c	Dr.	3,000	
To Equity Share Final Call A/c			3,000
(Being final call on 150 shares @ ₹ 20 not received transferred to calls in arrears)			
On Forfeiture:			
Share Capital A/c (150 x ₹ 100)		15,000	
Securities Premium A/c (150 x ₹ 20)		3,000	
To Calls in Arrears A/c			10,500
To Share Forfeiture A/c			7,500
(Being forfeiture of 150 shares for non-payment of allotment money and final call money as per Board's Resolution No....dated...)			

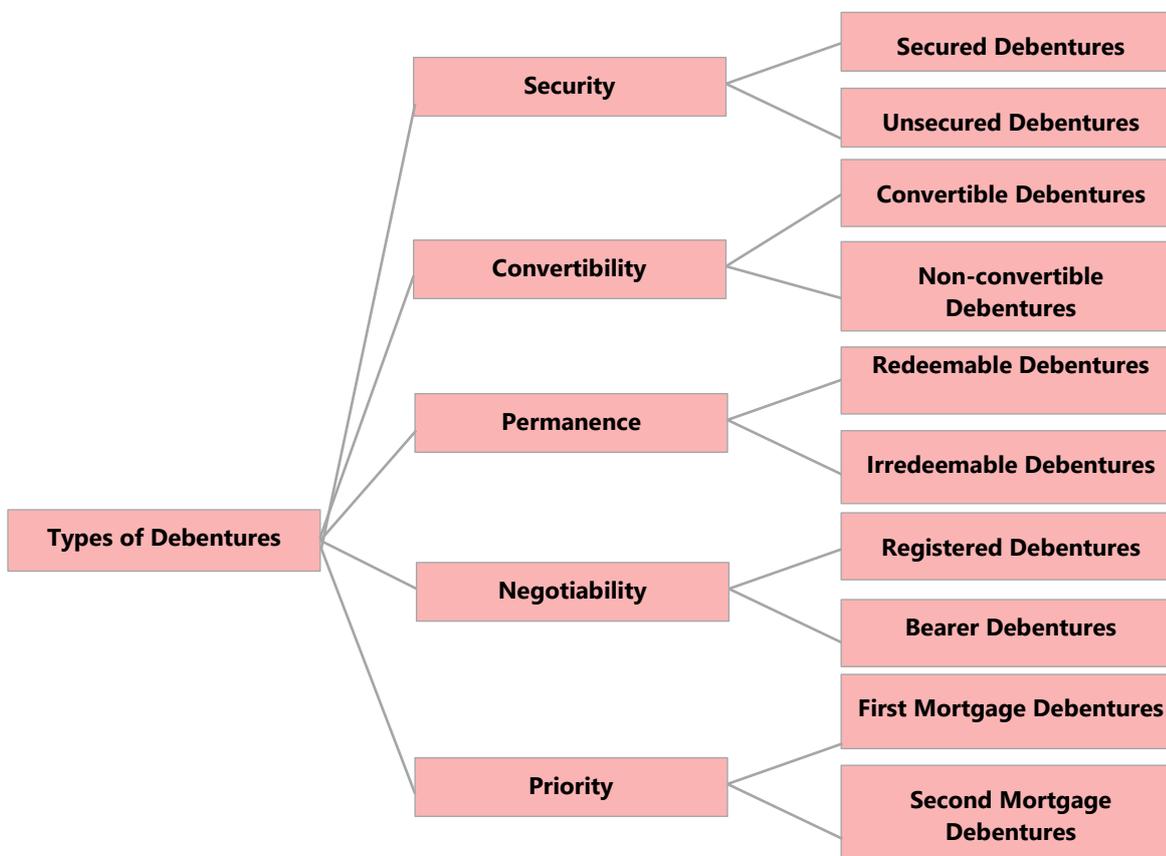
UNIT – 3 ISSUE OF DEBENTURES

LEARNING OUTCOMES

After studying this unit, you would be able to:

- ◆ Understand the meaning and basic purpose for raising debentures by the company
- ◆ Differentiate between shares and debentures of a company
- ◆ Understand various types of debentures
- ◆ Pass entries for issue of debentures payable in instalments
- ◆ Make entries for issue of debentures considering the conditions of redemption
- ◆ Pass entries for issue of debentures as collateral security
- ◆ Pass entries for debentures issued for consideration other than for cash
- ◆ Write off discount on issue of debentures
- ◆ Calculate interest on debentures.

UNIT OVERVIEW



3.1 INTRODUCTION

In the earlier units of this chapter, we have studied the issue of share capital as a means of raising funds for financing the business activities. But with increasing and evergrowing needs of the corporate expansion and growth, equity source of financing is not sufficient. Hence corporates turn to debt financing through various means. Issuing debt instruments by offering the same for public subscription is one of the sources of financing the business activities. Debt financing does not only helps in reducing the cost of the capital but also helps in designing appropriate capital structure of the company. Debenture is one of the most commonly used debt instrument issued by the company to raise funds for the business.



3.2 MEANING

The most common method of supplementing the capital available to a company is to issue debentures which may either be simple or naked carrying no charge on assets, or mortgage debentures carrying either a fixed or a floating charge on some or all of the assets of the company.

A debenture is a bond issued by a company under its seal, acknowledging a debt and containing provisions as regards repayment of the principal and interest. If a charge* has been created on any or on the entire assets of the company, the nature of the charge and the assets charged are described therein. Since the charge is not valid unless registered with the Registrar, and the certificate registering the charge is printed on the bond. It is also customary to create a trusteeship in favour of one or more persons in the case of mortgage debentures. The trustees of debenture holders have all powers of a mortgage of a property and can act in whatever way they think necessary to safeguard the interest of debenture holders.

Section 2 (30) of the Companies Act, 2013 defines debentures as "Debenture" includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not.

Thus, It is clear from definition that debenture may be Secured Debenture or Unsecured Debenture.

Note: No company shall issue any debentures carrying any voting rights.



3.3 FEATURES OF DEBENTURES

1. It is a document which evidences a loan made to a company.
2. It is a fixed interest-bearing security where interest falls due on specific dates.
3. Interest is payable at a predetermined fixed rate, regardless of the level of profit.
4. The original sum is repaid at a specified future date or it is converted into shares or other debentures.
5. It may or may not create a charge on the assets of a company as security.
6. It can generally be bought or sold through the stock exchange at a price above or below its face value.

*Charge is an incumbrance to meet the obligation under the Trust Deed, whereby the company agrees to mortgage specific portion either by way of a first or second charge. Such charge implies right of lenders to secure their payment from such asset(s) or from the liquidator in the event of winding up or from the company when the charge becomes void.



3.4 DISTINCTION BETWEEN DEBENTURES AND SHARES

Debentures	Shares
1. Debenture holders are the creditors of the company.	1. Shareholders are the owners of the company.
2. Debenture holders have no voting rights and consequently do not pose any threat to the existing control of the company.	2. Shareholders have voting rights and consequently control the total affairs of the company.
3. Debenture interest is generally paid at a pre-determined fixed rate. It is payable, whether there is any profit or not. Debentures rank ahead of all types of shares for payment of the interest due on them.	3. Dividend on equity shares is paid at a variable rate which is vastly affected by the profits of the company (however, dividend on preference shares is paid at a fixed rate).
4. Interest on debentures are the charges against profits and they are deductible as an expense in determining taxable profit of the company.	4. Dividends are appropriation of profit and these are not deductible in determining taxable profit of the company.
5. There are different kinds of debentures, such as Secured/ Unsecured; Redeemable/ Irredeemable; Registered / Bearer; Convertible/ Non-convertible, etc.	5. There are only two kinds of shares—Equity Shares and Preference Shares.
6. In the Company's Balance Sheet, Debentures are shown under "Long Term Borrowings".	6. In the Company's Balance Sheet, shares are shown under "Shareholder's Fund" detailed in 'Share Capital' of Notes to Accounts.
7. Debentures can be converted into other debentures or shares as per the terms of issue of debentures.	7. Shares cannot be converted into other shares in any circumstances.
8. Debentures cannot be forfeited for non-payment of call moneys.	8. Shares can be forfeited for non-payment of allotment and call moneys.
9. At maturity, debenture holders get back their money as per the terms and conditions of redemption.	9. Equity shareholders cannot get back their money before the liquidation of the company (however, preference shareholders can get back their money before liquidation).

10. At the time of liquidation, debenture holders are paid-off before the shareholders.	10. At the time of liquidation shareholders are paid at last, after paying debenture holders, Trade payable, etc.
-----------------------------------------------------------------------------------------	-------------------------------------------------------------------------------------------------------------------



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 secured by a charge upon some or all assets of the company. There are two types of charges: (i) Fixed charge; and (ii) Floating charge. A fixed charge is a mortgage on specific assets. These assets cannot be sold without the consent of the debenture holders. The sale proceeds of these assets are utilized first for repaying debenture holders. A floating charge generally covers all the assets of the company including future one.
- (b) *Unsecured or "Naked" Debentures*: These debentures are not secured by any charge upon any assets. A company merely promises to pay interest on due dates and to repay the amount due on maturity date. These types of debentures are very risky from the view point of investors.

2. Convertibility

- (a) *Convertible Debentures*: These are debentures which will be converted into equity shares (either at par or premium or discount) after a certain period of time from the date of its issue. These debentures may be fully or partly convertible. In future, these debenture holders get a chance to become the shareholders of the company.
- (b) *Non-Convertible Debentures*: These are debentures which cannot be converted into shares in future. As per the terms of issue, these debentures are repaid.

3. Permanence

- (a) *Redeemable Debentures*: These debentures are repayable as per the terms of issue, for example, after 8 years from the date of issue.

- (b) *Irredeemable Debentures:* These debentures are not repayable during the life time of the company. These are also called perpetual debentures. These are repaid only at the time of liquidation.

4. **Negotiability**

- (a) *Registered Debentures:* These debentures are payable to a registered holder whose name, address and particulars of holding is recorded in the Register of Debenture holders. They are not easily transferable. The provisions of the Companies Act, 2013 are to be complied with for effecting transfer of these debentures. Debenture interest is paid either to the order of registered holder as expressed in the warrant issued by the company or the bearer of the interest coupons.
- (b) *Bearer Debentures:* These debentures are transferable by delivery. These are negotiable instruments payable to the bearer. No kind of record is kept by the company in respect of the holders of such debentures. Therefore, the interest on it is paid to the holder irrespective of any identity. No transfer deed is required for transfer of such debentures.

5. **Priority**

- (a) *First Mortgage Debentures:* These debentures are payable first out of the property charged.
- (b) *Second Mortgage Debentures:* These debentures are payable after satisfying the first mortgage debentures.



3.6 **ISSUE OF DEBENTURES**

3.6.1 **Accounting entries for issue of redeemable debentures**

The issue of redeemable debentures can be categorized into the following:

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

Note: Redemption at a discount may be a rare circumstance in practical life.

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, the issue price is equal to par value, in this regard 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		

ILLUSTRATION 1

Amol Ltd. issued 40,00,000, 9% debentures of ₹ 50 each, payable on application as per term mentioned in the prospectus and redeemable at par any time after 3 years from the date of issue. Record necessary entries for issue of debentures in the books of Amol Ltd.

SOLUTION

Books of Amol Ltd.

Journal

Date	Particulars	L.F.	Debit Amount (₹)	Credit Amount (₹)
	Bank A/c Dr.		20,00,00,000	
	To Debenture Application A/c (Debenture application money received)			20,00,00,000
	Debenture Application A/c Dr.		20,00,00,000	
	To 9% Debentures A/c (Application money transferred to 9% debentures account consequent upon allotment)			20,00,00,000

2. **Debentures issued at Discount and Redeemable at par or at discount** : When debentures are issued at discount, issue price will be less than par value. The difference between the two is considered as loss on issue on debentures and is to be written-off over the life of debentures. The entries with regards to issue are given below :

- (a) For receipt of application money
- | | | |
|------------------------------|--|-----|
| Bank A/c | | Dr. |
| To Debenture Application A/c | | |
- (b) At the time of making allotment
- | | | |
|-------------------------------------|--|-----|
| (i) Debenture Application A/c | | Dr. |
| Discount on issue of debentures A/c | | Dr. |
| To ...% Debentures A/c | | |

ILLUSTRATION 2

Atul Ltd. issued 1,00,00,000, 8% debenture of ₹100 each at a discount of 10% redeemable at par at the end of 10th year. Money was payable as follows :

₹ 30 on application

₹ 60 on allotment

Record necessary journal entries regarding issue of debenture.

SOLUTION

Books of Atul Ltd.

Journal

Date	Particulars	L.F.	Debit	Credit
			(₹)	(₹)
	Bank A/c	Dr.	30,00,00,000	
	To Debenture Application A/c			30,00,00,000
	(Debenture application money received)			
	Debenture Application A/c	Dr.	30,00,00,000	
	To 8% Debentures A/c			30,00,00,000
	(Application money transferred to 8% debentures account consequent upon allotment)			

Debenture allotment A/c	Dr.	60,00,00,000	
Discount on issue of debentures A/c	Dr.	10,00,00,000	
To 8% Debentures A/c			70,00,00,000
(Amount due on allotment)			
Bank A/c	Dr.	60,00,00,000	
To Debenture Allotment A/c			60,00,00,000
(Money received consequent upon allotment)			

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

When debenture are issued at premium, the issue price is more than the par value. The premium is transferred to securities premium account. In this regard, the following journal entries are recorded:

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 premium value but redeemed at discount, then it means that the company will gain by paying less. This gain will not be recognised in the books at the time of issue of debentures as per the conservatism concept. The utilisation of premium on debentures shall be based on the provisions of Section 52 of Companies Act, 2013,

ILLUSTRATION 3

Koinal Chemicals Ltd. issued 15,00,000, 10% debenture of ₹ 50 each at premium of 10%, payable as ₹ 20 on application and balance on allotment. Debentures are redeemable at par after 6 years. All the money due on allotment was called up and received. Record necessary entries when premium money is included in application money.

SOLUTION**Books of Koinal Chemicals Ltd.****Journal**

When premium money is received along with application money:

Date	Particulars		Debit Amount (₹)	Credit Amount (₹)
	Bank A/c To Debenture Application A/c (Debenture application money received)	Dr.	3,00,00,000	3,00,00,000
	Debentures Application A/c To 10% Debentures A/c To Securities Premium A/c (Application money transferred to 10% debentures account and securities premium account consequent upon allotment)	Dr.	3,00,00,000	2,25,00,000 75,00,000
	Debenture Allotment A/c To 10% Debentures A/c (Call made consequent upon allotment)	Dr.	5,25,00,000	5,25,00,000
	Bank A/c To Debenture Allotment A/c (Call made consequent upon allotment money received)	Dr.	5,25,00,000	5,25,00,000

4. Debentures issued at par and redeemable at a premium

Where debentures are to be redeemed at premium, an extra entry is to be made at the time of issue and allotment of debentures. This extra entry is to be passed for providing premium payable on redemption. Debenture Redemption Premium Account is a personal account which represents a liability of the company in respect of premium payable on redemption.

In this case, the issue price is same as par value but the redemption value is more than the par value, therefore redemption premium is recorded as a loss on issue of debentures at the time of allotment of debentures. Following journal entries are recorded in this regard:

SOLUTION

Books of Modern Equipments Ltd.

Journal

Date	Particulars	Debit Amount (₹ Lakhs)	Credit Amount (₹ Lakhs)
	Bank A/c Dr. To Debentures application A/c (Debenture application money received)	120	120
	Debentures Application A/c Dr. To 12% Debentures A/c (Application money transferred to 12% debentures account consequent to allotment)	120	120
	Debentures Allotment A/c Dr. Loss on issue of Debentures A/c Dr. To 12% Debentures A/c To Debenture redemption premium A/c (Call made on allotment of debentures at par and entry for debentures redeemable at premium)	280 40	280 40
	Bank A/c Dr. To Debentures allotment A/c (Call made consequent upon allotment money received)	280	280

5. **Debentures Issued at discount and redeemable at premium**

In this situation the issue price is less than par value but redemption value is more than par value. The difference between the redemption price and the issue price is treated as discount/loss on issue of debentures. Suppose, a 10% debentures of ₹ 1,000 is issued at a discount of ₹ 100 and redeemable at a premium of ₹ 5 per debenture, the amount of loss will be equal to ₹ 1,005 – ₹ 900 = ₹ 105. This is to be treated as loss on issue. It is to be noted that premium on redemption of debentures is also credited by ₹ 5.

- (a) For the receipt of application money

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

- (b) At the time of making allotment

- (i) Transfer of application money to debenture account

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

- (ii) Call made consequent upon allotment of debentures at discount and redeemable at premium

Debenture Allotment A/c	Dr.	
Discount on issue of debenture A/c	Dr.	[Amount equal to the discount on issue of debenture]
Loss on issue of Debentures A/c	Dr.	[Amount equal to premium on redemption of debenture]

To ...% Debenture A/c

To Debenture redemption premium A/c

Alternatively, the discount on issue of debentures can be combined with loss on issue of debentures A/c as both discount and premium on redemption represent loss to the company. In that case, the journal entry will be

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 of debenture]

To ...% Debenture A/c

To Debenture redemption premium A/c

(c) For receipt of call made on allotment

Bank A/c Dr.

Discount on issue of debenture A/c Dr.

Loss on issue of Debentures A/c Dr.

To Debenture Allotment A/c

To Debenture redemption premium A/c

Alternatively, the discount on issue of debentures can be combined with loss on issue of debentures A/c as both discount and premium on redemption represent loss to the company. In that case, the journal entry will be

Bank A/c Dr.

Discount/Loss on issue of debentures A/c Dr.

To ...% Debentures A/c

To Debenture redemption premium A/c

ILLUSTRATION 5

Agrotech Ltd. issued 150 lakh 9% debentures of ₹ 100 each at a discount of 6%, redeemable at a premium of 5% after 3 years payable as: ₹ 50 on application and ₹ 44 on allotment. Record necessary journal entries for issue of debentures.

SOLUTION

Books of Agrotech Ltd.

Journal

Date	Particulars	L.F.	Debit Amount (₹ Lakhs)	Credit Amount (₹ Lakhs)
	Bank A/c Dr. To Debenture Application A/c (Debentures application money received)	Dr.	7,500	7,500
	Debenture Application A/c Dr. To 9% Debentures A/c (Application money transferred to 9% debentures account)	Dr.	7,500	7,500
	Debenture Allotment A/c Dr. Discount on issue of debentures Dr	Dr. Dr	6,600 900	

Loss on issue of debenture A/c	Dr.	750	
To 9% Debentures A/c			7,500
To Debenture redemption premium A/c			750
(Call made consequent upon allotment of debentures issued at discount and redeemable at premium)			
Bank A/c	Dr.	6,600	
To Debenture Allotment A/c			6,600
(Allotment amount received)			

Working Notes:

Amount of discount on issue = 150 Lakhs X ₹100 X 6% = ₹900 lakhs

Loss on issue of debentures = 150 Lakhs X ₹100 X 5% = ₹750 Lakhs

Alternatively, the discount on issue of debentures can be combined with loss on issue of debentures A/c as both discount and premium on redemption represent loss to the company. In that case, the journal entries will be

Books of Agrotech Ltd.

Journal

Date	Particulars	Debit Amount (₹ Lakhs)	Credit Amount (₹ Lakhs)
	Bank A/c	Dr. 7,500	
	To Debenture Application A/c		7,500
	(Debentures application money received)		
	Debenture Application A/c	Dr. 7,500	
	To 9% Debentures A/c		7,500
	(Application money transferred to 9% debentures account)		
	Debenture Allotment A/c	Dr. 6,600	
	Loss on issue of debenture A/c	Dr. 1,650	
	To 9% Debentures A/c		7,500
	To Debenture redemption premium A/c		7,50
	(Call made consequent upon allotment of debentures issued at discount and redeemable at premium)		

	Bank A/c	Dr.	6,600	
	To Debenture Allotment A/c			6,600
	(Allotment amount received)			

Working Notes :

Loss on issue of debentures =

(Amount of discount on issue + Premium payable on redemption) x No. of Debentures

$$= (6\% \text{ of ₹}100 + 5\% \text{ of ₹}100) \times 150 \text{ lakh}$$

$$= (\text{₹ } 6 + \text{₹ } 5) \times 150 \text{ lakh}$$

$$= \text{₹ } 1,650 \text{ lakh}$$

6. Debentures Issued at premium and redeemable at premium

In this situation, the issue price is more than par value and also redemption value is more than par value. The premium received at the time of issue of debentures is credited to Securities premium account and premium paid at the time of redemption is a loss to be provided at the time of issue of debentures. Suppose, a 10% debenture of ₹ 1,000 is issued at a premium of ₹ 100 and redeemable at a premium of ₹ 50 per debenture. In the given case ₹ 100 is to be credited to Securities premium account and ₹ 50 will be the loss to be provided at the time of issue of debentures. It is to be noted that premium on redemption of debentures is also credited by ₹ 50.

(a) For the receipt of application money

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

(b) At the time of making allotment

(i) Transfer of application money to debenture account

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

(ii) Call made consequent upon allotment 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 premium on Debentures A/c redemption]

Students can note that instead of passing the separate entries, a compound entry can 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

The Debenture Application A/c and Debenture allotment A/c are closed after the allotment of debentures. The net effect of the above 6 situations can be summarised as given below:

Condition under which debentures are issued	Debenture issued at par or discount or premium	Debenture redemption at premium
Debentures issued at par	Bank A/c Dr. To Debentures A/c (Face value)	Bank A/c Dr. Loss on issue of Debentures A/c Dr. To Debentures A/c (Face value) To Premium on Redemption of Debentures A/c
Debentures issued at premium	Bank A/c Dr. To Debentures A/c (Face value) To Securities premium (premium)	Bank A/c Dr. Loss on issue of Debentures A/c Dr. To Debentures A/c (Face value) To Securities premium (premium) To Premium on Redemption of Debentures A/c

Debentures issued at Discount	Bank A/c	Dr.	Bank A/c	Dr.
	Discount on issue of debentures A/c	Dr.	Discount on issue of Debentures A/c	Dr.
	To Debentures A/c (Face value)		Loss on issue of Debentures A/c	Dr.
			To Debentures A/c (Face value)	
			To Premium on Redemption of Debentures A/c	
			or	
			Bank A/c	Dr.
			Loss on issue of Debentures A/c	Dr.
			To Debentures A/c (Face value)	
			To Premium on Redemption of Debentures A/c	

When the debentures are redeemed at a premium (as per terms and conditions of issue), the premium payable on redemption should be recognised at the time of issue of debenture itself considering the principle of conservatism or prudence.

This recognition involves loss on issue of debentures A/c (i.e. discount on issue of debentures) and Premium on redemption A/c.

*Alternatively, the discount on issue of debentures, can be combined with loss on issue of debentures A/c as both discount and redemption premium represent loss to the company.

3.6.2 Accounting for issue of debentures payable in instalments

Just like shares, money payable on debentures may be paid either in full with application or by instalments. Accounting entries will differ to some extent in either case.

3.6.2.1 Debentures Payable in Full on Application

Where the amount due on debentures are payable in full on application, it is usual to open a separate Debentures Application Account for each class of debentures, such as 10% Debentures Application Account or 12% Debentures Application Account. These accounts record moneys received from the applicants of debentures. If an issue is over-subscribed, these accounts can be used to record the refund of moneys to the unsuccessful applicants. At the time of allotment of debentures, the amount in Debentures Application Account is transferred to the respective Debentures Account.

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

3.6.2.2 Debentures Issued at Par

The debentures which are issued at par are issued at the same price as their nominal value; that is, if a debenture with a nominal value of ₹ 100 is issued at par, the company receives ₹ 100.

The accounting entries would be as follows:

- (a) When cash is received

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

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

- (b) When excess 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 as per Board's Resolution
No....dated.....)

- (c) When the debentures are allotted

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

(Being the allotment of...debentures of ₹each as per Board's Resolution
No....dated.....)

- (d) On Allotment money being called

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

(Being Allotment Money Called)

- (e) On Allotment money being received

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

(Being Allotment money received)

- (f) On Debenture Call money being called
- | | | |
|-----------------------------|--|-----|
| Debenture Calls A/c | | Dr. |
| To % Debentures A/c | | |
| (Being Call money made due) | | |
- (g) On Debenture Call money being called
- | | | |
|-----------------------------|--|-----|
| Bank A/c | | Dr. |
| To Debenture Calls A/c | | |
| (Being Call money received) | | |

ILLUSTRATION 6

Simmons Ltd. issued 1,00,000, 12% Debentures of ₹100 each at par payable in full on application by 1st April, Application were received for 1,10,000 Debentures. Debentures were allotted on 7th April. Excess money refunded on the same date.

You are required to pass necessary Journal Entries (including cash transactions) in the books of the company.

SOLUTION**In the books of Simmons Limited**

Date	Particulars		₹ 000	₹ 000
April 1	Bank A/c	Dr.	11,000	11,000
	To Debentures Application A/c (Being money received on 1,10,000 debentures)			
April 7	Debentures Application A/c	Dr.	1,000	1,000
	To Bank A/c (Being money on 10,000 debentures refunded as per Board's Resolution No.....dated...)			
April 7	Debentures Application A/c	Dr.	10,000	10,000
	To Debentures A/c (Being the allotment of 1,00,000 debentures of ₹ 100 each at par, as per Board's Resolution No....dated...)			

3.6.2.3 Debentures Issued at a Premium

A company issues debentures at a premium when the market rate of interest is lower than the debentures interest rate. The debentures, which are issued at a premium, are issued at a higher

price than their nominal value; that is, if a debenture with a nominal value of ₹ 100 is issued at 10% premium, the company receives at ₹110 where the investor gets slightly less interest than stated in the debenture. For example, 12% Debentures of ₹100 issued at a premium of 10%. The investor will get ₹12 p.a. for his investment of 110. Therefore, the effective rate of interest on investment is $(12/110 \times 100) = 10.91\%$.

The premium on debentures is credited to 'Securities Premium Account' as 'Debentures' are covered in the definition of 'securities' specified in the clause (h) of section 2 of the Securities Contracts (Regulation) Act. Therefore, restriction of utilization of debentures (securities) premium will also be governed by Section 52 of the Companies Act, 2013.

The accounting entries would be as follows:

- (a) When cash is received

Bank A/c	Dr.	[Nominal value plus premium]
To Debentures Application A/c		
(Being money received on....debentures @ ₹ each including premium of ₹)		

- (b) When excess money is refunded

Debentures Application A/c	Dr.	
To Bank A/c		
(Being refund of money on....debentures @ ₹ each, as per Board's Resolution No.....dated....)		

- (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, as per Board's Resolution No....dated....)		

3.6.2.4 Debentures Issued at a Discount

The Companies Act does not impose any restriction on the price at which debentures can be issued. Unlike shares, there is no limit for discount on issue of debentures. This is why it is

very common for debentures to be issued at a discount. The debentures which are issued at a discount are issued at a lower price than nominal value, that is, if a debenture with a nominal value of ₹100 is issued at 10% discount, the company receives ₹90 only. The issue of debentures at a discount slightly increases the true rate of interest payable. For example, 12% Debentures of ₹100 issued at a discount of 10%. The Company will have to pay ₹12 for a loan of ₹90. Therefore, the true rate of interest is $(12/90 \times 100) = 13.33\%$.

The company issues debentures at a discount when the market rate of interest is higher than the debenture interest rate. Like shares, Debentures Account is credited with the nominal value. The difference between the nominal value of debentures and cash received is transferred to "Discount on Issue of Debentures Account. In the subsequent years, Discount on Issue of Debentures is written-off proportionately by charging to the Statement of Profit and Loss. It is considered a normal practice to amortize discount on issue of debentures over the period of benefit, i.e., normally 3 to 5 years. However, this cannot go beyond tenure of debentures.

The accounting entries would be as follows :

- (a) When Cash is received

Bank A/c	Dr. [Actual cash received]
To Debentures Application A/c	

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

- (b) When excess 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]
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 as per Board's Resolution No.....dated...)

In fact, the discount on issue of debentures is considered as incremental interest expense. The true expense (net borrowing cost) for a particular accounting period is, therefore, the total interest payment plus the discount amortised.

ILLUSTRATION 7

X Ltd. issued 1,00,000 12% Debentures of ₹100 each at a discount of 10% payable in full on application by 31st May, 2022. Applications were received for 1,20,000 debentures. Debentures were allotted on 9th June, 2022. Excess money was refunded on the same date. Pass necessary Journal Entries. Also show necessary ledger accounts.

SOLUTION

**In the books of X Limited
Journal Entries**

Date			₹ '000	₹ '000
2022	Particulars		₹ '000	₹ '000
May 31	Bank A/c Dr. To Debentures Application A/c (Being money received for 1,20,000 debentures @ ₹ 90 each)		10,800	10,800
June 9	Debentures Application A/c Dr. To Bank A/c (Being excess money on 20,000 debentures @ ₹ 90 refunded as per Board's Resolution No....dated....)		1,800	1,800
June 9	Debentures Application A/c Dr. Discount on Issue of Debentures A/c Dr. To 12% Debentures A/c (Being the allotment of 1,00,000 debentures of ₹ 100 each at a discount of ₹ 10 per debenture as per Board's Resolution No.....dated...)		9,000 1,000	10,000

Bank Account

Date	Particulars	₹	Date	Particulars	₹
31.5.2022	To 12% Debentures Application A/c	10,800	9.6.2022	By 12% Debentures Application A/c	1,800
			9.6.2022	By Balance c/d	9,000
		10,800			10,800

12% Debentures Account

Date	Particulars	₹	Date	Particulars	₹
30.6.2022	To Balance c/d	10,000	9.6.2022	By 12% Debentures Application A/c	9,000
			9.6.2022	By Discount on Issue of Debentures A/c	1,000
		10,000			10,000

Debentures Application Account

Date	Particulars	₹	Date	Particulars	₹
9.6.2022	To Bank A/c	1,800	31.5.2022	By Bank A/c	10,800
9.6.2022	To 12% Debentures A/c	9,000			
		10,800			10,800

Discount on Issue of Debentures Account

Date	Particulars	₹	Date	Particulars	₹
9.6.2022	To 12% Debentures A/c	1,000	30.6.2022	By Balance c/d	1,000
		1,000			1,000



3.7 ISSUE OF DEBENTURES AS COLLATERAL SECURITY

Collateral security means secondary or supporting security for a loan, which can be realised by the lender in the event of the original loan not being repaid on the due date. Under this arrangement, the borrower agrees that a particular asset or a group of assets will be realized and the proceeds there from will be applied to repay the loan in the event that the amount due, cannot be paid.

Sometimes companies issue their own debentures as collateral security for a loan or a fluctuating overdraft. When the loan is repaid on the due date, these debentures are at once released with the main security. In case, the company cannot repay its loan and the interest thereon on the due date, the lender becomes the debenture holder who can exercise all the rights of a debenture holder.

In such cases, the holder of such debentures is entitled to interest only on the amount of loan, but not on the debentures.

Accounting Entries

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

Method 1

Under this method, no entry is made in the books of account of the company at the time of making issue of such debentures. In the 'Notes to Accounts' of Balance Sheet, the fact of the debentures being issued and outstanding is shown by a note under the liability secured.

ILLUSTRATION 8

X Ltd. obtains a loan from IDBI of ₹1,00,00,000, giving as collateral security of ₹1,50,00,000 (of ₹ 10 each), 14%, First Mortgage Debentures.

SOLUTION

In the Notes to Accounts of Balance Sheet of X Ltd., it is shown as follows:

Notes to Accounts of X Limited as at...(includes)

<i>Long Term Borrowings</i>	₹
Secured Loan	
IDBI Loan	1,00,00,000

(Collaterally secured by issue of ₹ 1,50,00,000 14% First Mortgage Debentures)

Method 2

Under this method, the following entry is made to record the issue of such debentures:

Debentures Suspense Account	Dr.
To % Debentures Account	

(Being the issue of...debentures collaterally as per Board's Resolution No.....dated.....)

The Debentures Suspense Account will appear on the assets side of the Balance Sheet under Other Non- Current Assets and Debentures on the liabilities side of the Balance Sheet. When the loan is repaid, the entry is reversed in order to cancel it.

ILLUSTRATION 9

Taking the same information of the illustration 8, the entry on issue will be as follows :

In the Books of X Ltd.**Journal**

Date	Particulars	₹	₹
	Debitures Suspense A/c Dr. To 14% First Mortgage Debitures A/c (Being the issue of ₹ 15,00,000 debentures @ ₹10 collaterally as per Board's Resolution No...dated...)	1,50,00,000	1,50,00,000

Balance Sheet of X Limited as at....(Extracts)

Particulars	Notes No.	₹	₹
EQUITY AND LIABILITIES			
1. Non-Current Liabilities			
Long Term Borrowings	1	1,00,00,000	
Total		1,00,00,000	
ASSETS			
2. Non-current Assets			
Other non-current asset			
3. Current Assets			
Cash and cash equivalent		1,00,00,000	
Total		1,00,00,000	
Notes to accounts			
1. Long Term Borrowings			
Secured Loan			
IDBI Loan			1,00,00,000
14% First Mortgage Debitures		1,50,00,000	
Debiture Suspense Account		1,50,00,000	
(issue of ₹ 15,00,000 14% First Debitures as collateral security as per contra)			

- (c) To the banker as collateral security for a loan of ₹ 10,00,000 – ₹ 12,50,000 nominal value.
Pass necessary Journal Entries.

SOLUTION

In the books of X Company Ltd.
Journal Entries

Date	Particulars	₹	₹	
(a)	Bank A/c Dr.	22,50,000		
	To Debentures Application A/c		22,50,000	
	(Being the application money received on 5,000 debentures @ ₹ 450 each)			
	Debentures Application A/c Dr.	22,50,000		
(b)	Discount on issue of Debentures A/c Dr.	2,50,000		
	To 14% Debentures A/c		25,00,000	
	(Being the issue of 5,000 14% Debentures @ 90% as per Board's Resolution No....dated....)			
	Fixed Assets A/c Dr.	10,00,000		
(c)	To Vendor A/c		10,00,000	
	(Being the purchase of fixed assets from vendor)			
	Vendor A/c Dr.	10,00,000		
	Discount on Issue of Debentures A/c Dr.	2,50,000		
(c)	To 14% Debentures A/c		12,50,000	
	(Being the issue of debentures of ₹ 12,50,000 to vendor to satisfy his claim)			
(c)	Bank A/c Dr.	10,00,000		
	To Bank Loan A/c (See Note)		10,00,000	
(Being a loan of ₹ 10,00,000 taken from bank by issuing debentures of ₹ 12,50,000 as collateral security)				

Note : No entry is made in the books of account of the company at the time of making issue of such debentures. In the Balance Sheet due to the fact that the debentures being issued as collateral security and outstanding are shown under the respective liability.



3.9 TREATMENT OF DISCOUNT/LOSS ON ISSUE OF DEBENTURES

The discount on issue of debentures is amortised* over a period between the issuance date and redemption date. It should be written-off in the following manner depending upon the terms of redemption:

- (a) If the debentures are redeemable after a certain period of time, say at the end of 5 years, the total amount of discount should be written-off equally throughout the life of the debentures (applying the straight line method). The main advantage of this method is that it spreads the burden of discount equally over the years.
- (b) If the debentures are redeemable at different dates, the total amount of discount should be written-off in the ratio of debenture amount outstanding in each year. This method is suitable when debentures are redeemed by unequal instalments.

The accounting entries would be as follows :

Profit and Loss Account	Dr.
-------------------------	-----

To Discount on Issue of Debentures Account	
--------------------------------------------	--

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

Loss on issue of debentures is also a capital loss and should be written off in a similar manner as discount on debentures issued. In the balance sheet both the items (Discount and Loss) are shown as Non-current/current assets depending upon the period for which it has to be written off.

*Accounting Standard 16 Borrowing Costs states that ancillary borrowing costs and discounts or premiums related to borrowings can be amortized over the loan period. It also states that share issue expenses, discount on shares, and ancillary costs—such as discount premiums on borrowing—are excluded from the scope of Accounting Standard 26 Intangible Assets.

Keeping this in view, Guidance Note clarified that following the generally accepted accounting principle to amortize these expenses over the period of benefit, typically 3 to 5 years is acceptable.

ILLUSTRATION 11

HDC Ltd issues 1,00,000, 12% Debentures of ₹ 100 each at ₹ 94 on 1st January, 2022. Under the terms of issue, the debentures are redeemable at the end of 5 years from the date of the issue. Calculate the amount of discount to be written-off in each of the 5 years.

SOLUTION

Total amount of discount comes to ₹ 6,00,000 (₹6 X 1,00,000). The amount of discount to be written-off in each year is calculated as under :

Year end	Debentures outstanding	Ratio in which discount to be written-off	Amount of discount to be written-off
1 st	₹ 1,00,00,000	1/5	1/5th of ₹ 6,00,000 = ₹ 1,20,000
2 nd	₹ 1,00,00,000	1/5	1/5th of ₹ 6,00,000 = ₹ 1,20,000
3 rd	₹ 1,00,00,000	1/5	1/5th of ₹ 6,00,000 = ₹ 1,20,000
4 th	₹ 1,00,00,000	1/5	1/5th of ₹ 6,00,000 = ₹ 1,20,000
5 th	₹ 1,00,00,000	1/5	1/5th of ₹ 6,00,000 = ₹ 1,20,000

ILLUSTRATION 12

HDC Ltd. issues 2,00,000, 12% Debentures of ₹10 each at ₹9.40 on 1st January, 2022. Under the terms of issue, 1/5th of the debentures are annually redeemable by drawings, the first redemption occurring on 31st December, 2022. Calculate the amount of discount to be written-off from 2022 to 2026.

SOLUTION**Calculation of amount of discount to be written-off**

At the Year end	Debentures Outstanding before redemption	Ratio of benefit Derived	Amount of discount to be written-off
2022	₹ 20,00,000	5	5/15th of ₹ 1,20,000 = ₹ 40,000
2023	₹ 16,00,000	4	4/15th of ₹ 1,20,000 = ₹ 32,000
2024	₹ 12,00,000	3	3/15th of ₹ 1,20,000 = ₹ 24,000
2025	₹ 8,00,000	2	2/15th of ₹ 1,20,000 = ₹ 16,000
2026	₹ 4,00,000	<u>1</u>	1/15th of ₹ 1,20,000 = <u>₹ 8,000</u>
	TOTAL	15	₹ 1,20,000



3.10 INTEREST ON DEBENTURES

Interest payable on coupon debenture is treated as a charge against the profits of the company. Interest on debenture is paid periodically and is calculated at coupon rate on the nominal value of debentures. The company will pay interest net of tax to the debenture holders because the company is under obligation to deduct tax at source at the rates applicable as per the provisions of the Income tax act 1961. The companies will deposit the tax so deducted with income tax authorities. Following accounting entries are to be recorded in this regard:

1. *For making interest due*
 Interest A/c Dr.
 To Debenture holders' A/c
2. *For making payment of interest and deduction of tax at source (TDS)*
 Debenture holders A/c Dr.
 To TDS Payable A/c
 To Bank A/c
3. *For making payment of tax deducted at source*
 TDS payable A/c Dr.
 To Bank A/c
4. *For transferring interest to profit and loss account*
 Profit and Loss A/c Dr.
 To Interest A/c

ILLUSTRATION 13

A company issued 12% debentures of the face value of ₹10,00,000 at 10% discount on 1-1-2022. Debenture interest after deducting tax at source @ 10% was payable on 30th June and 31st of December every year. All the debentures were to be redeemed after the expiry of five year period at 5% premium.

Pass journal entries for the accounting year 2022.

SOLUTION

Journal Entries

			(₹)	(₹)
1-1-2022	Bank A/c	Dr.	9,00,000	

	Discount/Loss on Issue of Debentures A/c	Dr.	1,50,000	
	To 12% Debentures A/c			10,00,000
	To Premium on Redemption of Debentures A/c			50,000
	(For issue of debentures at discount redeemable at premium)			
30-6-2022	Debenture Interest A/c	Dr.	60,000	
	To Debenture holders A/c			54,000
	To Tax Deducted at Source A/c			6,000
	(For interest payable)			
31-12-2022	Debenture holders A/c	Dr.	54,000	
	Tax Deducted at Source A/c	Dr.	6,000	
	To Bank A/c			60,000
	(For payment of interest and TDS)			
31-12-2022	Debenture Interest A/c	Dr.	60,000	
	To Debenture holders A/c			54,000
	To Tax Deducted at Source A/c			6,000
	(For interest payable)			
31-12-2022	Debenture holders A/c	Dr.	54,000	
	Tax Deducted at Source A/c	Dr.	6,000	
	To Bank A/c			60,000
	(For payment of interest and tax)			
31-12-2022	Profit and Loss A/c	Dr.	1,20,000	
	To Debenture Interest A/c			1,20,000
	(For transfer of debenture interest to profit and loss account at the end of the year)			
31-12-2022	Profit and Loss A/c	Dr.	30,000	
	To Discount/Loss on issue of debenture A/c			30,000
	(For proportionate debenture discount and premium on redemption written off, i.e., 1,50,000 x 1/5)			

SUMMARY

- ◆ Debenture is one of the most commonly used debt instrument issued by the company to raise funds for the business. A debenture is a bond issued by a company under its seal, acknowledging a debt and containing provisions as regards repayment of the principal and interest. Money payable on debentures may be paid either in full with application or in instalments.
- ◆ Debenture holders are the creditors of the company whereas shareholders are the owners of the company. Debenture holders have no voting rights and consequently do not pose any threat to the existing control of the company. Shareholders have voting rights and consequently control the total affairs of the company.
- ◆ Debentures can be classified on the basis of: (1) Security; (2) Convertibility; (3) Permanence; (4) Negotiability; and (5) Priority.
- ◆ Issue of redeemable debentures can be categorized into the following:
 1. Debenture issued at par and redeemable at par or at a discount;
 2. Debenture issued at a discount and redeemable at par or at discount;
 3. Debenture issued at premium and redeemable at par or at discount;
 4. Debenture issued at par and redeemable at premium;
 5. Debenture issued at a discount and redeemable at premium;
 6. Debenture issued at premium and redeemable at premium;
- ◆ **Note:** In practical life, redemption of debentures at a discount is a rare situation.
- ◆ Collateral security means secondary or supporting security for a loan, which can be realised by the lender in the event of the original loan not being repaid on the due date. Under this arrangement, the borrower agrees that a particular asset or a group of assets will be realized and the proceeds there from will be applied to repay the loan in the event that the amount due, cannot be paid. Sometimes companies issue their own debentures as collateral security for a loan or a fluctuating overdraft.
- ◆ Debentures can also be issued for consideration other than for cash, such as for purchase of land, machinery, etc.
- ◆ The discount on issue of debentures is amortised over a period between the issuance date and redemption date. Loss on issue of debentures is also a capital loss and should be written off in a similar manner as discount on debentures issued. In the balance sheet both the items (Discount and Loss) are shown as Non-current/current assets depending upon the period for which it has to be written off.
- ◆ Interest payable on debentures is treated as a charge against the profits of the company. Interest on debenture is paid periodically and is calculated at coupon rate on the nominal value of debentures.

TEST YOUR KNOWLEDGE

True and False

1. *Debenture holder are the owners of the company.*
2. *Perpetual debentures are payable at the time of liquidation of the company.*
3. *Registered 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*
5. *Debentures suspense account appears on liability side of balance sheet.*
6. *If a company incurs loss, then it does not pay interest to the debenture holders.*
7. *At the time of liquidation, debenture holders are paid off after the shareholders.*
8. *Convertible debentures can be converted into equity shares.*
9. *Redeemable debentures are not payable during the life time of the company.*
10. *Debentures can be issued for a consideration other than for cash, such as for purchasing land, machinery etc.*

Multiple Choice Questions

1. *Premium on redemption of debentures account appearing in the balance sheet is _____.*
 - (a) *A nominal account – expenditure*
 - (b) *A nominal account - income*
 - (c) *A personal account _____.*
2. *Debenture interest*
 - (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_____.*
3. *F Ltd. purchased Machinery from G Company for a book value of ₹ 4,00,000. The consideration was paid by issue of 10% debentures of ₹ 100 each at a premium of 25%. The debenture account was credited with _____.*
 - (a) *₹ 4,00,000*

- (b) ₹ 5,00,000
- (c) ₹ 3,20,000
4. Which of the following is not a characteristic of Bearer Debentures?
- (a) They are treated as negotiable instruments
- (b) Their transfer requires a deed of transfer
- (c) They are transferable by mere delivery
5. When debentures are issued as collateral security, the final entry for recording the collateral debentures in the books is _____.
- (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.
6. When debentures are redeemable at different dates, the total amount of discount on issue of debentures should be written off
- (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
7. Debentures are issued at discount when
- (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
8. Interest payable on Debentures attract
- (a) Tax deducted at source
- (b) Goods and Service tax
- (c) Fringe benefit tax

Theoretical questions

1. Distinguish between debentures and shares.
2. Explain the purpose for raising of debenture by the company. Also give the main features of debentures.

Practical questions

1. Country Crafts Ltd. issued 1,00,000, 8% debentures of ₹ 100 each at premium of 5% payable fully on application and redeemable at premium of ₹ 10 Pass necessary journal entries at the time of issue.
2. Koinal Chemicals Ltd. issued 20,00,000, 10% debentures of ₹ 50 each at premium of 10%, payable as ₹ 20 on application and balance on allotment. Debentures are redeemable at par after 6 years. All the money due on allotment was called up and received. Record necessary entries when premium money is included in allotment money.
3. Kapil Ltd. issued 50,000, 12% Debentures of ₹ 100 each at a premium of 10% payable in full on application by 1st March, 2022. The issue was fully subscribed and debentures were allotted on 9th March, 2022.

Pass necessary Journal Entries (including cash transactions).

4. On 1st April 2022 Sheru Ltd. issued 1,00,000 12% debentures of ₹ 100 each at a discount of 5%, redeemable on 31st March, 2027. Issue was oversubscribed by 20,000 debentures, who were refunded their money. Interest is paid annually on 31st March. You are required to prepare:
 - (i) Journal Entries at the time of issue of debentures.
 - (ii) Discount on issue of Debenture Account
 - (iii) Interest account and Debenture holder Account assuming TDS is deducted @ 10%.
5. A Limited issued 14% Debentures of the nominal value of ₹ 10 each as follows:
 - (a) To sundry persons 1,00,000 Debentures for cash at 10% discount.
 - (b) To a vendor for purchase of Inventory worth ₹ 1,00,000, 8,000 debentures at 25% premium.
 - (c) To the banker as collateral security for a loan of ₹ 1,00,000 – ₹ 1,50,000 nominal value.

Pass necessary Journal Entries.

ANSWERS/HINTS

True and False

1. False: Debenture holder are the creditors of the company.
2. True: Perpetual debentures, also known as irredeemable debentures are not repayable during the life time of the company.
3. False: Registered debentures are not easily transferable by delivery. Bearer debentures are transferrable by delivery.
4. True: In case the company cannot repay its loan & the interest thereon on the due date, the lender becomes debenture holder & then only he is entitled to interest on debentures.
5. False: Debentures suspense account appears on asset side of balance sheet under non-current asset.
6. False: Even if the company incurs loss or earns profit, it has to pay the interest on debentures.
7. False: At the time of liquidation, debenture holders are paid off before shareholders on priority basis.
8. True: Convertible debentures can be converted into equity share after a certain period of time from the date of its issue.
9. False: These debentures are repayable as per the terms of issue, for example, after 8 years from the date of issue.
10. True: Debentures can be issued for a consideration other than for cash, such as for purchasing land, machinery etc.

Multiple Choice Questions

1.	(c)	2.	(a)	3.	(c)	4.	(b)	5.	(c)	6.	(a)
7.	(a)	8.	(a)								

Theoretical Questions

1. Refer para 3.4 for the distinction between Shares and Debentures.
2. Debenture is one of the most commonly used debt instrument issued by the company to raise funds for the business. The most common method of supplementing the capital available to a company is to issue debentures which may either be simple or

naked carrying no charge on assets, or mortgage debentures carrying either a fixed or a floating charge on some or all of the assets of the company.

For features of debentures refer para 3.3.

Practical Questions

1. Journal Entries in the Books of Country Crafts Ltd.

Date	Particulars	Debit Amount (₹'000)	Credit Amount (₹'000)
(a)	Bank A/c Dr. To Debenture Application A/c (Debenture application money received)	10,500	10,500
(b)	Debenture Application A/c Dr. Loss on Issue of Debenture A/c Dr. To Securities Premium A/c To 8% Debentures A/c To Premium on Redemption A/c (Debenture application money transferred to debenture account)	10,500 1,000	500 10,000 1,000

2. Journal Entries in the Books of Koinal Chemicals Ltd.

Particulars	Debit Amount (₹ lakhs)	Credit Amount (₹ lakhs)
Bank A/c Dr. To Debenture Application A/c (Debenture application money received)	400	400
Debentures Application A/c Dr. To 10% Debentures A/c (Debenture application money transferred to 10% debenture account consequent upon allotment)	400	400

Debenture allotment A/c	Dr.	700	
To 10% Debentures A/c			600
To Securities Premium A/c			100
(Call made on allotment of debenture including premium)			
Bank A/c	Dr.	700	
To Debenture Allotment A/c			700
(Money received consequent upon allotment)			

3. Journal Entries in the books of Kapil Limited

Date	Particulars	₹	₹
2022 March 1	Bank A/c To Debentures Application A/c (Being the money received on 50,000 debentures @ ₹ 110 each including premium of ₹ 10 each)	Dr. 55,00,000	55,00,000
March 9	Debentures Application A/c To 12% Debentures A/c To Securities Premium A/c (Being the allotment of 50,000 debentures of ₹ 100 each, premium @ ₹ 10 each transferred to Securities Premium Account as per Board's Resolution No....dated....)	Dr. 55,00,000	50,00,000 5,00,000

4. (i) Journal in the Books of Sheru Ltd.

Date	Particulars	LF	(₹ 00)	(₹ 00)
2022 Apr 1	Bank A/c To Debenture Application A/c (Being debenture application money received for 1,20,000 debentures)		1,14,000	1,14,000
	Debenture Application A/c	Dr.	1,14,000	
	Discount on Issue of Debenture A/c	Dr.	5,000	

To 12% Debenture A/c	1,00,000
To Bank A/c	19,000
(Being application money transferred to debenture account and excess refunded)	

(ii) **Discount on Issue of Debenture A/c**

Date	Particulars	₹'00	Date	Particulars	₹'00
1.4.22	To 12% Debentures A/c	5,000	31.3.23	By Profit & Loss A/c	1,000
		_____	31.3.23	By Balance c/d	<u>4,000</u>
		<u>5,000</u>			<u>5,000</u>
1.4.23	To Balance b/d	4,000	31.3.24	By Profit & Loss A/c	1,000
		_____	31.3.24	By Balance c/d	<u>3,000</u>
		<u>4,000</u>			<u>4,000</u>
1.4.24	To Balance b/d	3,000	31.3.25	By Profit & Loss A/c	1,000
		_____	31.3.25	By Balance c/d	<u>2,000</u>
		<u>3,000</u>			<u>3,000</u>
1.4.25	To Balance b/d	2,000	31.3.26	By Profit & Loss A/c	1,000
		_____	31.3.26	By Balance c/d	<u>1,000</u>
		<u>2,000</u>			<u>2,000</u>
1.4.26	To Balance b/d	<u>1,000</u>	31.3.27	By Profit & Loss A/c	<u>1,000</u>
		1,000			1,000

(iii) **Interest A/c**

Date	Particulars	₹'00	Date	Particulars	₹'00
31.3.23	To Debenture holder A/c	<u>12,000</u>	31.3.23	By Profit & Loss A/c	<u>12,000</u>
		<u>12,000</u>			<u>12,000</u>
31.3.24	To Debenture holder A/c	<u>12,000</u>	31.3.24	By Profit & Loss A/c	<u>12,000</u>
		<u>12,000</u>			<u>12,000</u>
31.3.25	To Debenture holder A/c	<u>12,000</u>	31.3.25	By Profit & Loss A/c	<u>12,000</u>
		<u>12,000</u>			<u>12,000</u>
31.3.26	To Debenture holder A/c	<u>12,000</u>	31.3.26	By Profit & Loss A/c	<u>12,000</u>
		<u>12,000</u>			<u>12,000</u>

31.3.27	To Debenture holder A/c	<u>12,000</u>	31.3.27	By Profit & Loss A/c	<u>12,000</u>
		12,000			12,000

Debentureholder A/c

Date	Particulars	₹'00	Date	Particulars	₹'00
31.3.23	To Bank A/c	10,800	31.3.23	By Interest A/c	12,000
31.3.23	To TDS A/c	<u>1,200</u>			_____
		<u>12,000</u>			<u>12,000</u>
31.3.24	To Bank A/c	10,800	31.3.24	By Interest A/c	12,000
31.3.24	To TDS A/c	<u>1,200</u>			_____
		<u>12,000</u>			<u>12,000</u>
31.3.25	To Bank A/c	10,800	31.3.25	By Interest A/c	12,000
31.3.25	To TDS A/c	<u>1,200</u>			_____
		<u>12,000</u>			<u>12,000</u>
31.3.26	To Bank A/c	10,800	31.3.26	By Interest A/c	12,000
31.3.26	To TDS A/c	<u>1,200</u>			_____
		<u>12,000</u>			<u>12,000</u>
31.3.27	To Bank A/c	10,800	31.3.27	By Interest A/c	12,000
31.3.27	To TDS A/c	<u>1,200</u>			_____
		<u>12,000</u>			<u>12,000</u>

5.

In the books of A Ltd.

Journal Entries

Date	Particulars	₹	₹
(a)	Bank A/c Dr.	9,00,000	
	To Debentures Application A/c		9,00,000
	(Being the application money received on 100,000 debentures @ ₹ 9 each)		
	Debentures Application A/c Dr.	9,00,000	
	Discount on issue of Debentures A/c Dr.	1,00,000	
	To 14% Debentures A/c		10,00,000
	(Being the issue of 100,000 14% Debentures @ 90% as per Board's Resolution No....dated....)		
(b)	Inventories A/c Dr.	1,00,000	
	To Vendor A/c		1,00,000

	(Being the purchase of inventories from vendor)		
	Vendor A/c Dr.	1,00,000	
	To 14% Debentures A/c		80,000
	To Securities Premium		20,000
	(Being the issue of 8,000 debentures of to vendor to satisfy his claim at premium of 25%)		
(c)	Bank A/c Dr.	1,00,000	
	To Bank Loan A/c (See Note)		1,00,000
	(Being a loan of ₹1,00,000 taken from bank by issuing debentures of ₹ 1,50,000 as collateral security)		

Note : No entry is made in the books of account of the company at the time of making issue of such debentures. In the Balance Sheet due to the fact that the debentures being issued as collateral security and outstanding are shown under the respective liability.

UNIT – 4: ACCOUNTING FOR BONUS ISSUE AND RIGHT ISSUE

LEARNING OUTCOMES

After studying this unit, you will be able to:

- ◆ Understand the provisions relating to issue of bonus shares and right shares;
- ◆ Account for bonus shares and rights issue in the books of issuing company;
- ◆ Understand the meaning of renunciation of right;
- ◆ Differentiate between cum-right and ex-right value of share;
- ◆ Calculate value of rights.

UNIT OVERVIEW

BONUS SHARES	<p>Bonus issue means an issue of additional shares to existing shareholders free of cost in proportion to their existing holding.</p> <p>A company may issue fully paid-up bonus shares to its shareholders out of—</p> <ul style="list-style-type: none"> (i) its free reserves; (ii) securities premium account; or (iii) capital redemption reserve account: <p>Bonus shares should not be issued out of revaluation reserves (i.e., reserves created by the revaluation of assets).</p>
RIGHT ISSUE	<p>Rights issue is an issue of rights to a company's existing shareholders that entitles them to buy additional shares directly from the company in proportion to their existing holdings, within a fixed time period. In a rights offering, the subscription price at which each share may be purchased is generally at a discount to the current market price. Rights are often transferable, allowing the holder to sell them in the open market. The difference between the cum-right and ex-right value of the share is the value of the right.</p>



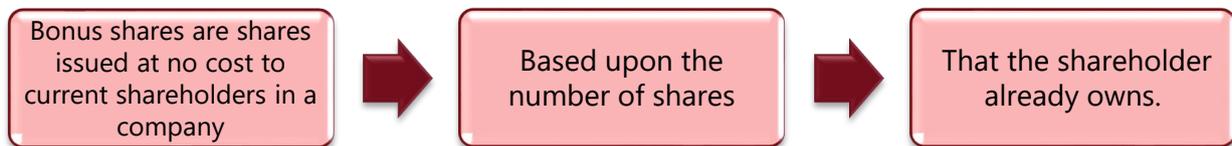
4.1 ISSUE OF BONUS SHARES

4.1.1 Introduction

A bonus share may be defined as issue of shares at no cost to current shareholders in a company, based upon the number of shares that the shareholder already owns. In other words, no new funds are raised with a bonus issue. While the issue of bonus shares increases the total number of shares issued and owned, it does not increase the net worth of the company. Although the total number of issued shares increases, the ratio of number of shares held by each shareholder remains constant.

Bonus issue is also known as 'capitalisation of profits'. Capitalisation of profits refers to the process of converting profits or reserves into paid up capital. A company may capitalise its profits or reserves which otherwise are available for distribution as dividends among the members by issuing fully paid bonus shares to the members.

If the subscribed and paid-up capital exceeds the authorised share capital as a result of bonus issue, a resolution shall be passed by the company at its general body meeting for increasing the authorised capital. A return of bonus issue along with a copy of resolution authorising the issue of bonus shares is also required to be filed with the Registrar of Companies.



Example 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?

Solution

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)

4.1.2 Provisions of the Companies Act, 2013

Section 63 of the Companies Act, 2013 deals with the issue of bonus shares. According to Sub-section (1) of Section 63, a company may issue fully paid-up bonus shares to its members, in any manner whatsoever, out of—

- (i) its free reserves*;
- (ii) the securities premium account; or
- (iii) the capital redemption reserve account:

Provided that no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

Sub-section (2) of Section 63 provides that no company shall capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares under sub-section (1), unless—

* As per Section 2(43) of the Companies Act, 2013, "free reserves" means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend. Provided that—

- (i) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or
- (ii) any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value, shall not be treated as free reserves.

- (a) it is authorised by its articles;
- (b) it has, on the recommendation of the Board, been authorised in the general meeting of the company;
- (c) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
- (d) it has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;
- (e) the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up.
- (f) it complies with such conditions as may be prescribed.

The company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same.

Sub-section (3) of the Section also provides that the bonus shares shall not be issued in lieu of dividend.

As per Para 39 (i) of Table F under Schedule I to the Companies Act, 2013, a company in general meeting may, upon the recommendation of the Board, resolve—

- (i)
 - (a) that it is desirable to capitalise any part of the amount for the time being standing to the credit of any of the company's reserve accounts, or to the credit of the profit and loss account, or otherwise available for distribution; and
 - (b) that such sum be accordingly set free for distribution in the specified manner amongst the members who would have been entitled thereto, if distributed by way of dividend and in the same proportions.
- (ii) The sum aforesaid shall not be paid in cash but shall be applied, subject to the provision contained in clause (iii), either in or towards— (a) paying up any amounts for the time being unpaid on any shares held by such members respectively; (b) paying up in full, unissued shares of the company to be allotted and distributed, credited as fully paid-up, to and amongst such members in the proportions aforesaid; partly in the way specified in (a) and partly in that specified in (b) above;

A securities premium account and a capital redemption reserve account may only be applied in the paying up of unissued shares to be issued to members of the company as fully paid bonus shares. In other words, securities premium account and capital redemption reserve **cannot** be applied towards payment of unpaid amount on any shares held by existing shareholders.

As per Section 63(2) of the Companies Act, 2013, bonus shares cannot be issued unless partly paid-up shares are made fully paid-up. Para 39(ii) of Table F under Schedule I to the Companies Act, 2013 allows use of free reserves for paying up amounts unpaid on shares held by existing shareholders.

On a combined reading of both the provisions, it can be said that free reserves may be used for paying up amounts unpaid on shares held by existing shareholders (though securities premium account and capital redemption reserve cannot be used).

4.1.3 Journal Entries

(A) (1) Upon the sanction of an issue of bonus shares

Capital Redemption Reserve Account	Dr.
Securities Premium Account ¹	Dr.
General Reserve Account	Dr.
Profit & Loss Account	Dr.
To Bonus to Shareholders Account.	

(2) Upon issue of bonus shares

Bonus to Shareholders Account	Dr.
To Share Capital Account.	

(B) (1) Upon 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) On making the final call due

Share Final Call Account	Dr.
To Share Capital Account.	

¹ As per SEBI Regulations, such securities premium should be realized in cash, whereas under the Companies Act, 2013, there is no such requirement. In accordance with Section 52, securities premium may arise on account of issue of shares other than by way of cash. Thus, for unlisted companies, securities premium (not realized in cash) may be used for issue of bonus shares, whereas the same cannot be used in case of listed companies.

(3) On adjustment of final call

Bonus to Shareholders Account Dr.
 To Share Final Call Account

ILLUSTRATION 1

Following items appear in the trial balance of Bharat Ltd. (a listed company) as on 31st March, 2022:

	₹
40,000 Equity shares of ₹ 10 each	4,00,000
Capital Redemption Reserve	55,000
Securities Premium (collected in cash)	30,000
General Reserve	1,05,000
Surplus i.e. credit balance of Profit and Loss Account	50,000

The company decided to issue to equity shareholders bonus shares at the rate of 1 share for every 4 shares held and for this purpose, it decided that there should be the minimum reduction in free reserves. Pass necessary journal entries.

SOLUTION**Journal Entries in the books of Bharat Ltd.**

		Dr.	Cr.
		₹	₹
Capital Redemption Reserve A/c	Dr.	55,000	
Securities Premium A/c	Dr.	30,000	
General Reserve A/c (b.f.)	Dr.	15,000	
To Bonus to Shareholders A/c			1,00,000
(Bonus issue of one share for every four shares held, by utilising various reserves as per Board's resolution dated.....)			
Bonus to Shareholders A/c	Dr.	1,00,000	
To Equity Share Capital A/c			1,00,000
(Capitalisation of profit)			

Working Note-

Number of Bonus shares to be issued- $(40,000 \text{ shares} / 4) \times 1 = 10,000 \text{ shares}$

Value of Bonus shares- $10,000 \text{ shares of ₹ 10 each} = ₹ 1,00,000$

ILLUSTRATION 2

Pass Journal Entries in the following circumstances:

- (i) A Limited company with subscribed capital of ₹ 5,00,000 consisting of 50,000 Equity shares of ₹ 10 each; called up capital ₹ 7.50 per share. A bonus of ₹ 1,25,000 declared out of General Reserve to be applied in making the existing shares fully paid up.
- (ii) A Limited company having fully paid up capital of ₹ 50,00,000 consisting of Equity shares of ₹ 10 each, had General Reserve of ₹ 9,00,000. It was resolved to capitalize ₹ 5,00,000 out of General Reserve by issuing 50,000 fully paid bonus shares of ₹ 10 each, each shareholder to get one such share for every ten shares held by him in the company.

SOLUTION

Journal Entries

			₹	₹
(i)	General Reserve A/c	Dr.	1,25,000	
	To Bonus to shareholders A/c			1,25,000
	(For making provision of bonus issue)			
(i)	Share Final Call A/c		1,25,000	
	To Equity share capital A/c			1,25,000
	(For final calls of ₹ 2.5 per share on 50,000 equity shares due as per Board's Resolution dated....)			
(i)	Bonus to shareholders A/c	Dr.	1,25,000	
	To Share Final Call A/c			1,25,000
	(For bonus money applied for call)			
(ii)	General Reserve A/c	Dr.	5,00,000	
	To Bonus to shareholders A/c			5,00,000
	(For making provision of bonus issue)			
(ii)	Bonus to shareholders A/c	Dr.	5,00,000	
	To Equity share capital A/c			5,00,000
	(For issue of 50,000 bonus shares at ₹ 10)			

ILLUSTRATION 3

Following notes pertain to the Balance Sheet of Solid Ltd. as at 31st March, 2022:

		₹
<i>Authorised capital :</i>		
10,000 12% Preference shares of ₹ 10 each		1,00,000
1,00,000 Equity shares of ₹ 10 each		<u>10,00,000</u>
		<u>11,00,000</u>
<i>Issued and Subscribed capital:</i>		
8,000 12% Preference shares of ₹ 10 each fully paid		80,000
90,000 Equity shares of ₹ 10 each, ₹ 8 paid up		7,20,000
<i>Reserves and Surplus :</i>		
General reserve		1,60,000
Revaluation reserve		35,000
Securities premium (collected in cash)		20,000
Profit and Loss Account		2,05,000
<i>Secured Loan:</i>		
12% Debentures @ ₹ 100 each		5,00,000

On 1st April, 2022 the Company has made final call @ ₹ 2 each on 90,000 equity shares. The call money was received by 20th April, 2022. Thereafter the company decided to capitalise its reserves by way of bonus at the rate of one share for every four shares held. Show necessary entries in the books of the company and prepare the extract of the Balance Sheet immediately after bonus issue assuming that the company has passed necessary resolution at its general body meeting for increasing the authorised capital.

SOLUTION**Journal Entries in books of Solid Ltd.**

			Dr.	Cr.
2022			₹	₹
April 1	Equity Share Final Call A/c	Dr.	1,80,000	
	To Equity Share Capital A/c			1,80,000
	(Final call of ₹ 2 per share on 90,000 equity shares due as per Board's Resolution dated...)			

April 20	Bank A/c	Dr.	1,80,000	1,80,000
	To Equity Share Final Call A/c (Final Call money on 90,000 equity shares received)			
	Securities Premium A/c	Dr.	20,000	2,25,000
	General Reserve A/c	Dr.	1,60,000	
Profit and Loss A/c (b.f.)	Dr.	45,000		
To Bonus to Shareholders A/c (Bonus issue @ one share for every four shares held by utilising various reserves as per Board's Resolution dated...)				
April 20	Bonus to Shareholders A/c	Dr.	2,25,000	2,25,000
	To Equity Share Capital A/c (Capitalization of profit)			

Balance Sheet (Extract) as at 30th April, 2022 (after bonus issue)

		Particulars	Notes	Amount (₹)
1		Equity and Liabilities		
		Shareholders' funds		
	a	Share capital	1	12,05,000
	b	Reserves and Surplus	2	1,95,000
2		Non-current liabilities		
	a	Long-term borrowings	3	<u>5,00,000</u>
		Total		<u>19,00,000</u>

Notes to Accounts

1	Share Capital	
	<u>Authorised share capital</u>	
	10,000 12% Preference shares of ₹ 10 each	1,00,000
	1,12,500 Equity shares of ₹ 10 each	<u>11,25,000</u>
	<u>Issued, subscribed and fully paid share capital</u>	
	8,000 12% Preference shares of ₹ 10 each	80,000
	1,12,500 Equity shares of ₹ 10 each, fully paid (Out of above, 22,500 equity shares @ ₹ 10 each were issued by way of bonus)	(A) <u>11,25,000</u>
	Total	<u>12,05,000</u>

2	Reserves and Surplus		
	Revaluation Reserve		35,000
	Securities Premium	20,000	
	Less: Utilised for bonus issue	<u>(20,000)</u>	Nil
	General reserve	1,60,000	
	Less: Utilised for bonus issue	<u>(1,60,000)</u>	Nil
	Profit & Loss Account	2,05,000	
	Less: Utilised for bonus issue	<u>(45,000)</u>	<u>1,60,000</u>
	Total		<u>1,95,000</u>
3	Long-term borrowings		
	Secured		
	12% Debentures @ ₹ 100 each		5,00,000

The authorised capital has been increased by sufficient number of shares. (11,25,000 – 10,00,000)

Working Note-

Number of Bonus shares to be issued $(90,000 \text{ shares} / 4) \times 1 = 22,500 \text{ shares}$

Note: It has to be ensured that the authorized capital after bonus issue should not be less than the issued share capital (including bonus issue) in all the practical problems. The authorized capital may either be increased by the amount of bonus issue or the value of additional shares [value of bonus shares issued less unused authorized capital (excess of authorized capital in comparison to the issued shares before bonus issue)].

ILLUSTRATION 4

Following notes pertain to the Balance Sheet of Preet Ltd. as at 31st March, 2022

	₹
Share capital:	
<i>Authorised capital:</i>	
15,000 12% Preference shares of ₹ 10 each	1,50,000
1,50,000 Equity shares of ₹ 10 each	<u>15,00,000</u>
	<u>16,50,000</u>
<i>Issued and Subscribed capital:</i>	
12,000 12% Preference shares of ₹ 10 each fully paid	1,20,000
1,35,000 Equity shares of ₹ 10 each, ₹ 8 paid up	10,80,000

Reserves and surplus:	
General Reserve	1,80,000
Capital Redemption Reserve	60,000
Securities premium (collected in cash)	37,500
Profit and Loss Account	3,00,000

On 1st April, 2022, the Company has made final call @ ₹2 each on 1,35,000 equity shares. The call money was received by 20th April, 2022. Thereafter, the company decided to capitalise its reserves by way of bonus at the rate of one share for every four shares held.

Show necessary journal entries in the books of the company and prepare the extract of the balance sheet as on 30th April, 2022 after bonus issue.

SOLUTION

Journal Entries in the books of Preet Ltd.

			₹	₹
1-4-2022	Equity share final call A/c	Dr.	2,70,000	
	To Equity share capital A/c (For final calls of ₹ 2 per share on 1,35,000 equity shares due as per Board's Resolution dated....)			2,70,000
20-4-2022	Bank A/c	Dr.	2,70,000	
	To Equity share final call A/c (For final call money on 1,35,000 equity shares received)			2,70,000
	Securities Premium A/c	Dr.	37,500	
	Capital Redemption Reserve A/c	Dr.	60,000	
	General Reserve A/c	Dr.	1,80,000	
	Profit and Loss A/c (b.f.)	Dr.	60,000	
	To Bonus to shareholders A/c (For making provision for bonus issue of one share for every four shares held)			3,37,500
	Bonus to shareholders A/c	Dr.	3,37,500	
	To Equity share capital A/c (For issue of bonus shares)			3,37,500

Extract of Balance Sheet as at 30th April, 2022 (after bonus issue)

		<i>Particulars</i>	<i>Notes</i>	<i>Amount (₹)</i>
1		Equity and Liabilities		
		Shareholders' funds		
	a	Share capital	1	18,07,500
	b	Reserves and Surplus	2	2,40,000
		Total		20,47,500

Notes to Accounts

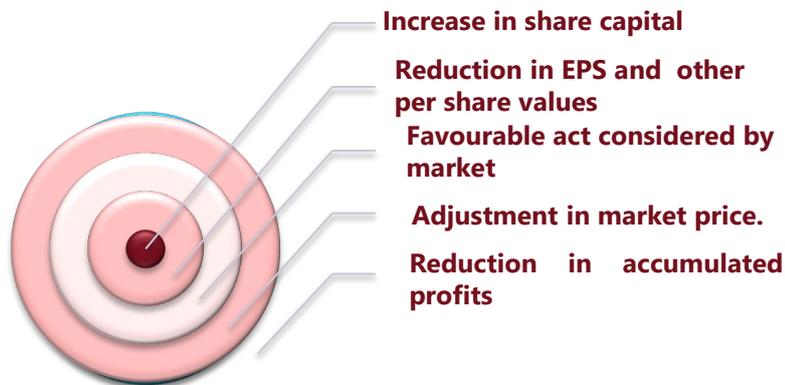
			₹
1.	Share Capital		
	Authorised Capital		
	15,000 12% Preference shares of ₹10 each		1,50,000
	1,68,750 Equity shares of ₹10 each (refer working note below)		16,87,500
	Issued and subscribed capital		
	12,000 12% Preference shares of ₹10 each, fully paid		1,20,000
	1,68,750 Equity shares of ₹10 each, fully paid (Out of above, 33,750 equity shares @ ₹10 each were issued by way of bonus)		16,87,500
	Total		18,07,500
2.	Reserves and surplus		
	Securities Premium	37,500	
	Less: Utilised for bonus issue	(37,500)	NIL
	Capital Redemption Reserve	60,000	
	Less: Utilised for bonus issue	(60,000)	NIL
	General Reserve	1,80,000	
	Less: Utilised for bonus issue	(1,80,000)	NIL
Profit and Loss Account	3,00,000		
Less: Utilised for bonus issue	(60,000)	2,40,000	

Working Notes:

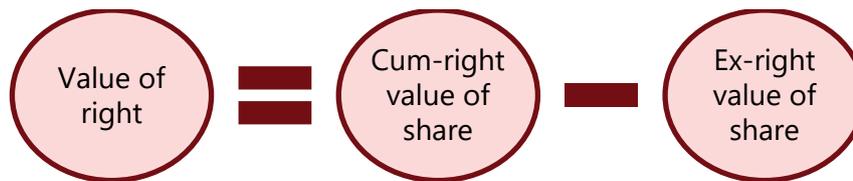
1. Number of Bonus shares to be issued-	₹
(1,35,000 shares / 4) X 1 = 33,750 shares	
2. The authorised capital should be increased as per details given below:	
Existing issued Equity share capital	13,50,000
Add: Issue of bonus shares to equity shareholders	<u>3,37,500</u>
	<u>16,87,500</u>

4.1.4 Effects of Bonus Issue

Bonus issue has following major effects:

**4.2 RIGHT ISSUE****4.2.1 Introduction**

Provisions of section 62(1)(a) of the Companies Act, 2013 govern any company, public or private, which is desirous of raising its subscribed share capital by issue of further shares. Whenever a company intends to issue new shares, the voting and governance rights of the existing shareholders may be diluted, if they are not allowed to preserve them. It may happen because new shareholders may subscribe to the issued share capital. Companies Act, 2013 allows existing shareholders to preserve their position by offering those newly issued shares at the first instance to them. The existing shareholders are given a right to subscribe these shares, if they like. However, if they do not desire to subscribe these shares, they are even given the right to renounce it in favour of someone else (unless the articles of the company prohibits such a right to renounce).



In nutshell, the existing shareholders have a right to subscribe to any fresh issue of shares by the company in proportion to their existing holding for shares. They have an implicit right to renounce this right in favour of anyone else, or even reject it completely. In other words, the existing shareholders have right of first refusal, i.e., the existing shareholders enjoy a right to either subscribe for these shares or sell their rights or reject the offer.

Example 2

Assume a company makes a right issue of 10,000 shares when its existing issued and subscribed capital is 100,000 shares. This enables any shareholder having 10 shares to subscribe to 1 new share. Hence X, an existing shareholder holding 1,000 shares, may subscribe to 100 shares as a matter of right. The existing share percentage of X was 1% (1,000 / 100,000). If X subscribes these shares, his percentage holding in the company will be maintained at 1% (1,100 / 1,10,000). However, if X does not mind his share 0.91% diluting (1,000 / 1,10,000), he may renounce the right in favour of any one else, say Y. Hence, these 100 shares will be issued to Y, at the insistence of X. X may charge Y for this privilege, which is technically termed as the value of right.

A company desirous of issuing new shares has to offer, as per Section 62(1) (a) of Companies Act 2013, the shares to existing equity shareholders through a letter of offer subject to the following conditions, namely:

- The offer shall be made by notice specifying the number of shares offered and limiting a time not being less than fifteen days and not exceeding thirty days from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined;
- Unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person; and the notice (referred to in above bullet point) shall contain a statement of this right;
- After the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may dispose of them in such manner which is not disadvantageous to the shareholders and the company.

Exceptions to the rights of existing equity shareholders

Section 62 recognises four situations under which the further shares are to be issued by a company, but they need not be offered to the existing shareholders.

The shares can be offered, without being offered to the existing shareholders, provided the company has passed a special resolution and shares are offered accordingly.

Situation 1

To employees under a scheme of employees' stock option subject to certain specified conditions

Situation 2

To any persons, either for cash or for a consideration other than cash, if the price of such shares is determined by the valuation report of a registered valuer subject to certain specified conditions.

Situation 3

Sometimes companies borrow money through debentures / loans and give their creditor an option to buy equity shares of a company. An option is a right, but not an obligation, to buy equity shares on a future date (expiry date) at a price agreed in advance (exercise price).

According to Section 62(3), nothing in this section shall apply to the increase of the subscribed capital of a company caused by the exercise of an option as a term attached to the debentures issued or loan raised by the company to convert such debentures or loans into shares in the company.

Provided that the terms of issue of such debentures or loan containing such an option have been approved before the issue of such debentures or the raising of loan by a special resolution passed by the company in general meeting.

Situation 4

It is a special situation where the loan has been obtained from the government, and government in public interest, directs the debentures / loan to be converted into equity shares.

According to Section 62(4), notwithstanding anything contained in sub-section (3), where any debentures have been issued, or loan has been obtained from any Government by a company, and if that Government considers it necessary in the public interest so to do, it may, by order, direct that such debentures or loans or any part thereof shall be converted into shares in the company on such terms and conditions as appear to the Government to be reasonable in the circumstances of the case even if terms of the issue of such debentures or the raising of such loans do not include a term for providing for an option for such conversion.

Financial effects of a further issue

The financial position of a business is contained in the balance sheet. Further issue of shares increase the amount of equity (net worth)² as well as the liquid resources (Bank). *The amount of equity is the product of further number of shares issued multiplied by issue price.* The issue price may be higher than the face value (issue at a premium). Companies Act does not allow issue of shares at a discount, except issue 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

if there are 10,000 shares with net worth of 1,25,000. The book value of one share is (₹ 125,000/ 10,000 shares) ₹ 12.50 per share. However, the market value may differ from the book value of shares. The market value of a company's shares represents the present value of future cash flows expected to be earned from the share in the form of dividends and capital gains from expected future share price appreciation.

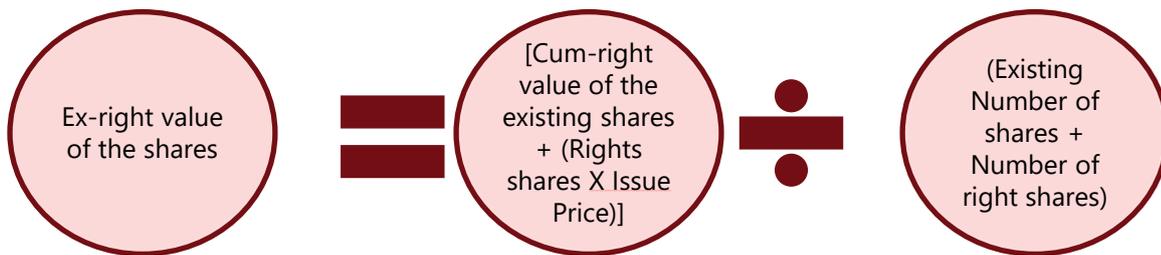
The market price, which exists before the rights issue, is termed as Cum-right Market Price of the share. If the company decides to issue further shares, it may affect the market value of the share. 'Theoretically', the value of a company's shares after a rights issue must equal the sum of market capitalisation immediately prior to rights issue and the cash inflows generated from the rights issue.

Normally, the further public issue to the existing shareholders are offered at a discounted price from the market value, to evoke positive response as well as to reward the existing shareholders.

Assume a company having a net worth of ₹ 250,000. 1,000 shares are issued (making it a right issue of 1:10; or 1 new share for 10 existing shares held) at a price of ₹ 14 per share. The existing worth of tangible assets held by the business shall become 264,000 (Existing net worth ₹ 250,000 + Fresh Issue ₹ 14,000). Equity shares shall correspondingly command a valuation of ₹ 264,000.

The market price of the shares after further issue of shares (right issue) is termed as Ex-right Market Price of the shares. Theoretical Ex-Rights Price is a deemed value, which is attributed to a company's share immediately after a rights issue transaction occurs. This price is going to prevail after the further issue of shares is executed.

² As per Section 2(57) of Companies Act 2013, "net worth" means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation.



Right of Renunciation

Right of renunciation refers to the right of the shareholder to surrender his right to buy the securities and transfer such right to any other person. Shareholders that have received right shares have three choices of what to do with the rights. They can act on the rights and buy more shares as per the particulars of the rights issue; they can sell them in the market; or they can pass on taking advantage of their rights (i.e., reject the right offer).

The renunciation of the right is valuable and can be monetised by the existing shareholders in well-functioning capital market. The monetised value available to the existing shareholders due to right issue is known as 'value of right'. If a shareholder decides to renounce all or any of the right shares in favour of his nominee, the value of right is restricted to the sale price of the renouncement of a right in favour of the nominee. In case the right issue offer is availed by an existing shareholder, the value of right is determined as given below:

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 X Issue Price)] / (Existing Number of shares + Number of right shares)

In our previous example, Ex-right value of share = [₹ 250,000 + (₹ 14 X 1,000 shares)] / 10,000 + 1,000 shares = ₹ 24

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

Example 3

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 X Cum-right Market Price
= 100 X 25 = ₹ 2,500

(a) If Narain exercises his right, he will pay ₹ 14X10 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 X 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.

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.

ILLUSTRATION 5

A company offers new shares of ₹ 100 each at 25% premium to existing shareholders on one for four bases. The cum-right market price of a share is ₹ 150. Calculate the value of a right. What should be the ex-right market price of a share?

SOLUTION

Ex-right value of the shares = (Cum-right value of the existing shares + Rights shares Issue Price) / (Existing Number of shares + No. of right shares)

$$= (\text{₹ } 150 \times 4 \text{ Shares} + \text{₹ } 125 \times 1 \text{ Share}) / (4 + 1) \text{ Shares}$$

$$= \text{₹ } 725 / 5 \text{ shares} = \text{₹ } 145 \text{ per share.}$$

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

$$= \text{₹ } 150 - \text{₹ } 145 = \text{₹ } 5 \text{ per share.}$$

Hence, any one desirous of having a confirmed allotment of one share from the company at ₹ 125 will have to pay ₹ 20 (4 shares X ₹ 5) to an existing shareholder holding 4 shares and willing to renounce his right of buying one share in favour of that person.

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 following journal entry will be made:

Bank A/c	Dr.	
		To Equity shares capital A/c

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

The accounting entry is usual and is

Bank A/c	Dr.	
		To Equity Share Capital A/c
		To Securities Premium A/c

Example 4

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.

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- $70,000/10 \times 1 = 7000$ shares.

Example 5

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.

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

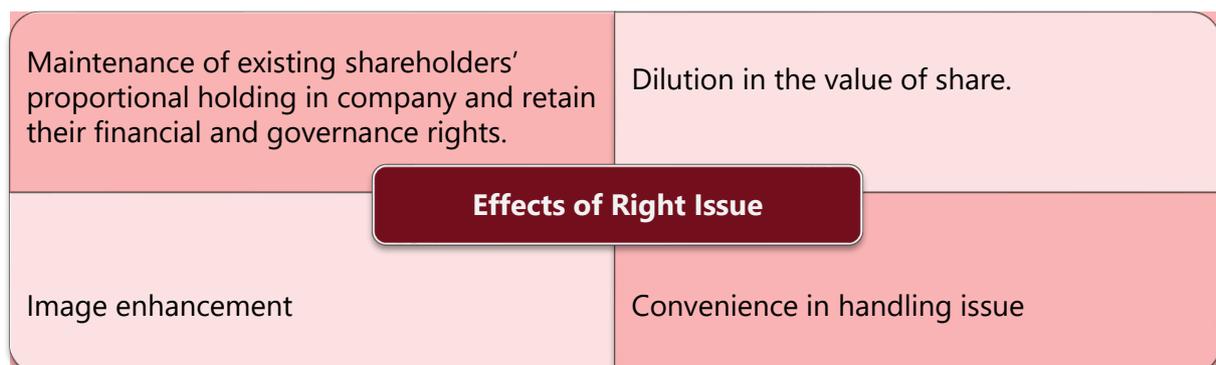
Advantages of Right Issue

1. Right issue enables the existing shareholders to maintain their proportional holding in the company and retain their financial and governance rights. It works as a deterrent to the management, which may like to issue shares to known persons with a view to have a better control over the company's affairs.
2. In well-functioning capital markets, the right issue necessarily leads to dilution in the value of share. However, the existing shareholders are not affected by it because getting new shares at a discounted value from their cum-right value will compensate decrease in the value of shares. The cum-right value is maintained otherwise also, if the existing shareholders renounce their right in favour of a third party.
3. Right issue is a natural hedge against the issue expenses normally incurred by the company in relation to public issue.
4. Right issue has an image enhancement effect, as public and shareholders view it positively.
5. The chance of success of a right issue is better than that of a general public issue and is logistically much easier to handle.

Disadvantages of Right Issue

1. The right issue invariably leads to dilution in the market value of the share of the company.
2. The attractive price of the right issue should be objectively assessed against its true worth to ensure that you get a bargained deal.

Effects of Right Issue



SUMMARY

- Bonus issue means an issue of additional shares free of cost to existing shareholders.
- Bonus Issue is also known as a "scrip issue" or "capitalization issue" or "capitalization of profits".
- Bonus issue has following major effects:
 - Share capital gets increased according to the bonus issue ratio
 - Effective Earnings per share, Book Value and other per share values stand reduced.
 - Markets take the action usually as a favourable act.
 - Market price gets adjusted on issue of bonus shares.
 - Accumulated profits get reduced.
- Bonus shares can be issued from following:
 - Free Reserves
 - Securities Premium collected in cash
 - Capital Redemption Reserve.
- Bonus issue cannot be made out of Revaluation Reserve created by revaluation of assets.
- A right issue is an offer of equity shares in a further issue of shares by a company to its existing shareholders, to enable them in maintaining their financial and governance interest in the company, if they so desire.
- The Right shares are normally offered at a price less than the cum-right value of the share, causing dilution in its value post-right issue. The value of share after right is termed as ex-right value (or average price) of the share. The difference between the cum-right and ex-right value (average price) of the share is called value of right.
- The accounting treatment of rights share is the same as that of issue of ordinary shares.
- The right issue offers considerable advantages to existing shareholders enabling them to maintain their rights in the company and is equally advantageous to the company for its relatively simple logistics and cost effectiveness as compared to a full blown public issue. However, the dilution in the value of the share is a dampener and a major limitation.

TEST YOUR KNOWLEDGE

True and false

1. *Earning per share gets increased after bonus issue.*
2. *Issued share capital including issue of rights shares and bonus shares may be more than the Authorised capital.*
3. *Rights issue of shares results in decrease of market value of per share in comparison to market price before 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.*

Multiple Choice Questions

1. *Which of the following cannot be used for issue of bonus shares as per the Companies Act?*
 - (a) *Securities premium account*
 - (b) *Revaluation reserve*
 - (c) *Capital redemption reserve*
2. *Which of the following statements is true with regard to declaring and issuing of Bonus Shares?*
 - (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.*
3. *Which of the following statement is true in case of bonus issue?*
 - (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).*
4. *Bonus issue is also known as*
 - (a) *Scrip issue.*
 - (b) *Capitalisation issue.*
 - (c) *Both (a) and (b).*

5. *The bonus issue is not made unless*
- (a) *Partly paid shares are made fully paid up.*
 - (b) *It is provided in its articles of association*
 - (c) *Both (a) and (b).*
6. *Bonus issue has the following effect*
- (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.*
7. *ABC Co. Ltd resolved to issue bonus shares. Which of the following is not a pre-requisite for issuance of bonus shares?*
- (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.*
8. *In case of further issue of shares, the right to renounce the shares in favour of a third party*
- (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).*
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*
- (a) *₹ 10*
 - (b) *₹ 20*
 - (c) *₹ 30*
10. A. *Right shares enable existing shareholders to maintain their proportional holding in the company.*
- B. *Right share issue does not cause dilution in the market value of the share.*

Which of the option is correct?

- (a) A-Correct; B Correct
- (b) A – Incorrect; B Correct
- (c) A - Correct; B – Incorrect
11. Ex-Rights price can be calculated by which of these formulas?
- (a) $(\text{Cum rights value of the existing shares} + \text{Rights share issue proceeds}) / (\text{existing number of shares} + \text{No. of right shares}).$
- (b) $(\text{Cum rights value of the existing shares} + \text{Rights share issue proceeds}) \times (\text{existing number of shares} + \text{No. of right shares}).$
- (c) $(\text{Cum rights value of the existing shares} - \text{Rights share issue proceeds}) / (\text{existing number of shares} - \text{No. of right shares}).$

Theoretical Questions

1. What is meant by Bonus issue? Explain its related provisions as per the Companies Act, 2013.
2. Explain the financial effects of a further issue of equity shares on the market value of the share.
3. What are the advantages and disadvantages of a rights issue?
4. What is meant by renunciation of rights shares by existing shareholder?

Practical Questions

1. Following items appear in the Trial Balance of Saral Ltd. as on 31st March, 2022:

Particulars	Amount
4,500 Equity Shares of ₹ 100 each	4,50,000
Securities Premium (collected in cash)	40,000
Capital Redemption Reserve	70,000
General Reserve	1,05,000
Profit and Loss Account (Cr. Balance)	65,000

The company decided to issue to equity shareholders bonus shares at the rate of 1 share for every 3 shares held. Company decided that there should be the minimum reduction in free reserves. Pass necessary Journal Entries in the books Saral Ltd.

2. The following notes pertain to Brite Ltd.'s Balance Sheet as at 31st March, 2022:

Notes	₹ in Lakhs
(1) <i>Share Capital</i>	
<i>Authorised :</i>	
20 crore shares of ₹ 10 each	<u>20,000</u>
<i>Issued and Subscribed :</i>	
10 crore Equity Shares of ₹ 10 each	10,000
2 crore 11% Cumulative Preference Shares of ₹ 10 each	2,000
<i>Total</i>	12,000
<i>Called and paid up:</i>	
10 crore Equity Shares of ₹ 10 each, ₹ 8 per share called and paid up	8,000
2 crore 11% Cumulative Preference Shares of ₹ 10 each, fully called and paid up	2,000
<i>Total</i>	10,000
(2) <i>Reserves and Surplus :</i>	
<i>Capital Redemption Reserve</i>	1,485
<i>Securities Premium (collected in cash)</i>	2,000
<i>General Reserve</i>	1,040
<i>Surplus i.e. credit balance of Profit & Loss Account</i>	273
<i>Total</i>	4,798

On 2nd April 2022, the company made the final call on equity shares @ ₹ 2 per share. The entire money was received in the month of April, 2022.

On 1st June 2022, the company decided to issue to equity shareholders bonus shares at the rate of 2 shares for every 5 shares held . Pass journal entries for all the above mentioned transactions. Also prepare the notes on Share Capital and Reserves and Surplus relevant to the Balance Sheet of the company immediately after the issue of bonus shares.

3. Following notes pertain to the Balance Sheet of Manoj Ltd. as at 31st March, 2022

Authorised capital:	₹
30,000 12% Preference shares of ₹ 10 each	3,00,000
3,00,000 Equity shares of ₹ 10 each	30,00,000
	33,00,000

<i>Issued and Subscribed capital:</i>	
24,000 12% Preference shares of ₹ 10 each fully paid	2,40,000
2,70,000 Equity shares of ₹ 10 each, ₹ 8 paid up	21,60,000
<i>Reserves and surplus:</i>	
General Reserve	3,60,000
Capital Redemption Reserve	1,20,000
Securities premium (collected in cash)	75,000
Profit and Loss Account	6,00,000

On 1st April, 2022, the Company has made final call @ ₹ 2 each on 2,70,000 equity shares. The call money was received by 20th April, 2022. Thereafter, the company decided to capitalise its reserves by way of bonus at the rate of one share for every four shares held.

Show necessary journal entries in the books of the company and prepare the extract of the balance sheet as on 30th April, 2022 after bonus issue.

- A company has decided to increase its existing share capital by making rights issue to its existing shareholders. The company is offering one new share for every two shares held by the shareholder. The market value of the share is ₹ 240 and the company is offering one share of ₹ 120 each. Calculate the value of a right. What should be the ex-right market price of a share?
- A Ltd company having share capital of 25,000 equity shares of ₹10 each decides to issue rights share at the ratio of 1 for every 4 shares held at par value. Assuming all the share holders accepted the rights issue and all money was duly received, pass journal entries in the books of the company.
- Following notes pertain to the Balance Sheet of Mars Company Limited as at 31st March 2022:

	₹
<i>Authorised capital:</i>	
50,000 12% Preference shares of ₹ 10 each	5,00,000
5,00,000 Equity shares of ₹ 10 each	50,00,000
	55,00,000
<i>Issued and Subscribed capital:</i>	
50,000 12% Preference shares of ₹ 10 each fully paid	5,00,000

4,00,000 Equity shares of ₹ 10 each, ₹ 8 paid up	32,00,000
<i>Reserves and surplus:</i>	
General Reserve	1,60,000
Capital Redemption Reserve	2,40,000
Securities premium (collected in cash)	2,75,000
Revaluation Reserve	1,00,000
Profit and Loss Account	16,00,000

On 1st April, 2022, the Company has made final call @ ₹ 2 each on 4,00,000 equity shares. The call money was received by 25th April, 2022. Thereafter, on 1st May 2022 the company decided to capitalise its reserves by way of bonus at the rate of one share for every four shares held, it decided that there should be minimum reduction in free reserves.

On 1st June 2022, the Company issued Rights shares at the rate of two shares for every five shares held on that date at issue price of ₹ 12 per share. All the rights shares were accepted by the existing shareholders and the money was duly received by 20th June 2022.

Show necessary journal entries in the books of the company for bonus issue and rights issue.

ANSWERS/ HINTS

True and False

1. False. Earnings per share gets decreased after bonus issue.
2. False. Issued share capital including issue of rights shares and bonus shares is always less than or equal to Authorised capital.
3. True. Rights issue of shares results in decrease of market value of per share in comparison to market price before rights issue.
4. False. Right shares are normally offered at a price less than the cum-right value of the share, causing dilution in its value post-right issue.

Multiple Choice Questions

1.	(b)	2.	(b)	3.	(c)	4.	(c)	5.	(c)	6.	(a)
7.	(c)	8.	(c)	9.	(b)	10.	(c)	11.	(a)		

Theoretical Questions

1. Bonus Issue means an offer of free additional shares to existing shareholders. A company may decide to distribute further shares as an alternative to increase the dividend pay-out. For details, refer para 4.1.1 & 4.1.2.
2. The financial position of a business is contained in the balance sheet. Further issue of shares increases the amount of share capital as well as the liquid resources (Bank). The amount of share capital issued is the product of further number of shares issued multiplied by issue price. The issue price may be higher than the face value (issue at a premium).
3. Rights issue is an issue of rights to a company's existing shareholders that entitles them to buy additional shares directly from the company in proportion to their existing holdings, within a fixed time period. For advantages and disadvantages of right issue, refer para 4.2.3.
4. In a situation where existing shareholder does not intend to subscribe to the rights issue of a company, he may give up his right in favour of another person for a consideration. Such giving up of rights is called renunciation of rights.

Practical Questions

1. **Journal Entries in the books of Saral Ltd.**

2022		Dr.	Cr.
	Capital Redemption Reserve A/c	Dr.	70,000
	Securities Premium A/c	Dr.	40,000
	General Reserve A/c (b.f.)	Dr.	40,000
	To Bonus to Shareholders A/c		1,50,000
	(Bonus issue of one shares for every three shares held, by utilising various reserves as per Board's resolution dated.....)		
	Bonus to Shareholders A/c	Dr.	1,50,000
	To Equity Share Capital A/c		1,50,000
	(Capitalisation of profit)		

Working Note- Number of bonus shares to be issued- $4500 / 3 \times 1 = 1500$ shares

2. Journal Entries in the books of Brite Ltd.

2022		Dr. ₹ in lakhs	Cr. ₹ in lakhs
April 2	Equity Share Final Call A/c Dr. To Equity Share Capital A/c (Final call of ₹ 2 per share on 10 crore equity shares made due)	2,000	2,000
	Bank A/c Dr. To Equity Share Final Call A/c (Final call money on 10 crore equity shares received)	2,000	2,000
June 1	Capital Redemption Reserve A/c Dr. Securities Premium A/c Dr. General Reserve A/c (b.f.) Dr. To Bonus to Shareholders A/c (Bonus issue of two shares for every five shares held, by utilising various reserves as per Board's resolution dated.....)	1,485 2,000 515	4,000
	Bonus to Shareholders A/c Dr. To Equity Share Capital A/c (Capitalisation of profit)	4,000	4,000

Notes to Accounts

		₹ in lakhs
1.	Share Capital	
	Authorised share capital:	
	20 crore shares of ₹ 10 each	<u>20,000</u>
	Issued, subscribed and fully paid up share capital:	
	14 crore Equity shares of ₹ 10 each, fully paid up (Out of the above, 4 crore equity shares @ ₹ 10 each were issued by way of bonus)	14,000
	2 crore, 11% Cumulative Preference share capital of ₹ 10 each, fully paid up	<u>2,000</u>
		<u>16,000</u>

2.	Reserves and Surplus:		
	Capital Redemption reserve	1,485	
	<i>Less:</i> Utilised for bonus issue	(1,485)	-
	Securities Premium	2,000	
	<i>Less:</i> Utilised for bonus issue	(2,000)	-
	General Reserve	1,040	
	<i>Less:</i> Utilised for bonus issue	(515)	525
	Surplus (Profit and Loss Account)		273
	Total		798

3. Journal Entries in the books of Manoj Ltd.

			₹	₹
1-4-2022	Equity share final call A/c	Dr.	5,40,000	
	To Equity share capital A/c			5,40,000
	(For final calls of ₹ 2 per share on 2,70,000 equity shares due as per Board's Resolution dated....)			
20-4-2022	Bank A/c	Dr.	5,40,000	
	To Equity share final call A/c			5,40,000
	(For final call money on 2,70,000 equity shares received)			
	Securities Premium A/c	Dr.	75,000	
	Capital redemption Reserve A/c	Dr.	1,20,000	
	General Reserve A/c	Dr.	3,60,000	
	Profit and Loss A/c (b.f.)	Dr.	1,20,000	
	To Bonus to shareholders A/c			6,75,000
	(For making provision for bonus issue of one share for every four shares held)			
	Bonus to shareholders A/c	Dr.	6,75,000	
	To Equity share capital A/c			6,75,000
	(For issue of bonus shares)			

Extract of Balance Sheet as at 30th April, 2022 (after bonus issue)

		₹
<i>Authorised Capital</i>		
30,000 12% Preference shares of ₹10 each		3,00,000
3,37,500 Equity shares of ₹10 each (refer W.N.)		<u>33,75,000</u>
<i>Issued and subscribed capital</i>		
24,000 12% Preference shares of ₹10 each, fully paid		2,40,000
3,37,500 Equity shares of ₹10 each, fully paid		33,75,000
(Out of the above, 67,500 equity shares @ ₹10 each were issued by way of bonus shares)		
<i>Reserves and surplus</i>		
Capital Redemption Reserve	1,20,000	
Less: Utilised for bonus issue	<u>(1,20,000)</u>	NIL
Securities premium	75,000	
Less: Utilised for bonus issue	<u>(75,000)</u>	NIL
General Reserve	3,60,000	
Less: Utilised for bonus issue	<u>(3,60,000)</u>	NIL
Profit and Loss Account	6,00,000	
Less: Utilised for bonus issue	<u>(1,20,000)</u>	4,80,000

Working Note:

- Number of bonus shares to be issued- $2,70,000/4 \times 1 = 67,500$ shares
- The authorised capital should be increased as per details given below: ₹

Existing issued Equity share capital	27,00,000
<i>Add:</i> Issue of bonus shares to equity shareholders	<u>6,75,000</u>
	<u>33,75,000</u>

4. Ex-right value of the shares = (Cum-right value of the existing shares + Rights shares x Issue Price) / (Existing Number of shares + No. of right shares)
- = (₹ 240 x 2 Shares + ₹ 120 x 1 Share) / (2 + 1) Shares
- = ₹ 600 / 3 shares = ₹ 200 per share.

Value of right = Cum-right value of the share – Ex-right value of the share
 = ₹ 240 – ₹ 200 = ₹ 40 per share.

Hence, any one desirous of having a confirmed allotment of one share from the company at ₹ 120 will have to pay ₹ 80 (2 shares x ₹ 40) to an existing shareholder holding 2 shares and willing to renounce his right of buying one share in favour of that person.

5. **Journal Entry in the books of A Ltd.**

		₹	₹
Bank A/c	Dr.	62,500	
To Equity share capital A/c			62,500
(For rights share issued at par value in the ratio of 1:4 equity shares due as per Board's Resolution dated....)			

Working Note:

Number of Rights shares to be issued- 25,000/4x1= 6,250 shares

6. **Journal Entries in the books of Mars Ltd.**

2022		Dr.	Cr.
		₹	₹
April 1	Equity Share Final Call A/c To Equity Share Capital A/c (Final call of ₹ 2 per share on 4,00,000 equity shares made due)	Dr. 8,00,000	8,00,000
April 25	Bank A/c To Equity Share Final Call A/c (Final call money on equity shares received)	Dr. 8,00,000	8,00,000
May 1	Capital Redemption Reserve A/c Securities Premium A/c General Reserve A/c Profit and Loss A/c (b.f.)	Dr. Dr. Dr. Dr.	2,40,000 2,75,000 1,60,000 3,25,000

June 20	To Bonus to Shareholders A/c (Bonus issue of one shares for every four shares held, by utilising various reserves as per Board's resolution dated.....)		10,00,000
	Bonus to Shareholders A/c	Dr.	10,00,000
	To Equity Share Capital A/c (Capitalisation of profit)		10,00,000
	Bank A/c	Dr.	24,00,000
	To Securities Premium A/c		4,00,000
	To Equity Share Capital A/c (Being Rights issue of 2 shares for every 5 shares held as per board resolution dated)		20,00,000

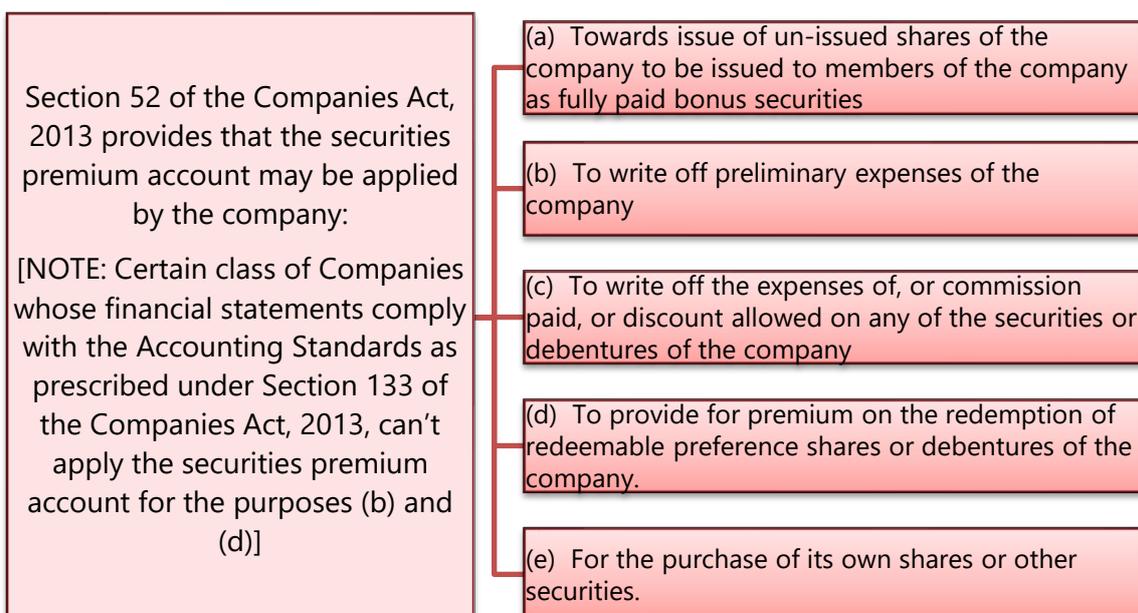
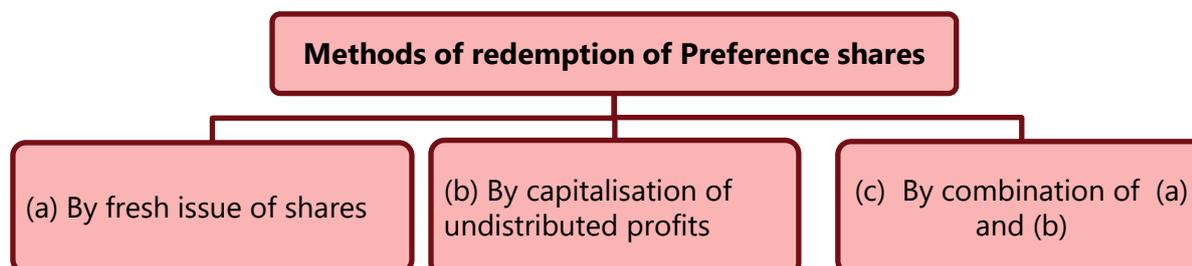
UNIT – 5: REDEMPTION OF PREFERENCE SHARES

LEARNING OUTCOMES

After studying this unit, you will be able to:

- ◆ understand the meaning of redemption and the purpose of issuing redeemable preference shares;
- ◆ learn various provisions of the Companies Act, 2013 regarding preference shares and their redemption;
- ◆ familiarise yourself with various methods of redemption of fully paid-up preference shares by:
 - (i) Fresh issue of shares; Or
 - (ii) Capitalisation of divisible or undistributed profits; Or
 - (iii) Combination of (i) and (ii) above;
- ◆ understand the logic behind the creation of Capital Redemption Reserve;
- ◆ learn the accounting treatment for redemption of:
 - (i) fully paid-up preference shares;
 - (ii) partly called-up preference shares; and
 - (iii) fully called-up but partly paid-up preference shares.

UNIT OVERVIEW



5.1 INTRODUCTION

Redemption is the process of repaying an obligation, at prearranged amounts and timings. It is a contract specifying the obligation to redeem preference shares within or at the end of a given time period at an agreed price. These shares are issued on the terms that shareholders will at a future date be repaid the amount which they invested in the company (apart from the frequent payments of a specified amount of dividend as return on investment during the tenure of the preference shares). The redemption date is the maturity date, which specifies when repayment is scheduled to take place and is usually printed on the preference share certificate. Through the process of redemption, a company can also adjust its financial structure, for example, by eliminating preference shares and replacing those with other securities if future growth of the company makes such change advantageous.



5.2 PURPOSE OF ISSUING REDEEMABLE PREFERENCE SHARES

A company may issue redeemable preference shares because of the following:

1. It is a proper way of raising finance in a dull primary market.
2. A company may face difficulty in raising share capital, as its shares are not traded on the stock exchange. Potential investors who may, hesitate in putting money into shares that cannot easily be sold may be encouraged to invest if the shares are redeemable by the company.
3. The preference shares may be redeemed when there is a surplus of capital and the surplus funds cannot be utilised in the business for profitable use.
4. No dividend is required to be paid, if there is loss or no profit, whereas interest is payable on debentures or loans even in case of loss. In other words, preference dividend declared / paid continues to be regarded as an appropriation of profits (similar treatment is given for equity shares), as against interest on debentures, which is a charge against profits.

In India, the issue and redemption of preference shares is governed by Section 55 of the Companies Act, 2013.



5.3 PROVISIONS OF THE COMPANIES ACT (SECTION 55)

A company limited by shares if so authorised by its Articles, may issue preference shares which at the option of the company, are liable to be redeemed within a period, normally not exceeding 20 years from the date of their issue. It should be noted that:

- (a) no shares can be redeemed except out of divisible or distributable profit, (i.e. out of the profit of the company which would otherwise be available for dividend) or out of proceeds of fresh issue of shares made for the purpose of redemption;
- (b) no such shares can be redeemed unless they are fully paid;
- (c) (i) in case of such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under Section 133, the premium, if any, payable on redemption shall be provided for out of the profits of the company, before the shares are redeemed:

Provided also that premium, if any, payable on redemption of any preference shares issued on or before the commencement of this Act by any such company shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

- (ii) in case of other companies (not falling under (i) above), the premium, if any payable on redemption shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

(Refer to the Note given in para 5.4.1 for the basis applied in the Illustrations in this Chapter.)

- (d) where any such shares are proposed to be redeemed out of the profits of the company, there shall, out of the divisible profits, i.e. the profits which would otherwise have been available for dividends, be transferred to a reserve account to be called Capital Redemption Reserve Account, a sum equal to the nominal amount of the shares redeemed; and the provisions of the Act relating to the reduction of the share capital of a company shall, except as provided in the Section, apply as if the Capital Redemption Reserve (CRR) Account were the paid-up share capital of the company. The utilisation of CRR Account is further restricted to issuance of fully paid-up bonus shares only.

From the legal provision outlined above, it is apparent that on the redemption of redeemable preference shares out of accumulated divisible profits, it will be necessary to transfer to the Capital Redemption Reserve Account an amount equal to the amount repaid on the redemption of preference shares on account of face value less proceeds of a fresh issue of shares made for the purpose of redemption. The object is that with the repayment of redeemable preference shares, the security for creditors/ bankers, etc. should not be reduced. At times, a part of the preference share capital may be redeemed out of accumulated divisible profits and the balance out of a fresh issue.



5.4 METHODS OF REDEMPTION OF FULLY PAID-UP SHARES

Redemption of preference shares means repayment by the company of the obligation on account of shares issued. According to the Companies Act, 2013, preference shares issued by a company must be redeemed within the maximum period (normally 20 years) allowed under the Act. Thus, a company cannot issue irredeemable preference shares.

Section 55 of the Companies Act, 2013, deals with provisions relating to redemption of preference shares. It ensures that there is no reduction in shareholders' funds due to

redemption and, thus, the interest of outsiders is not affected. For this, it requires that either fresh issue of shares is made, or distributable profits are retained and transferred to 'Capital Redemption Reserve Account'.

The rationale behind these provisions is to protect the interest of outsiders to whom the amount is payable before redemption of preference share capital. The interest of outsiders is protected if the nominal value of capital redeemed is substituted, thus, ensuring the same amount of shareholders' fund.

- In case of redemption of preference shares out of proceeds of a fresh issue of shares, replacement of capital and tangible assets is obvious.
- If redemption is done out of distributable profits, replacement of capital is ensured in an indirect manner by retention of profit by transfer to Capital Redemption Reserve. In this case, the amount which would have otherwise gone to shareholders in the form of dividend is retained in the business and is used for settling the claim of preference shareholders. Thus, there is no additional drain from the net assets of the Company. The transfer of divisible profits to Capital Redemption Reserve makes them non-divisible profits. As Capital Redemption Reserve can be used only for issue of fully paid bonus shares, profits retained in the business ultimately get converted into share capital.

Security cover available to outside stakeholders depends upon called-up capital as well as uncalled capital to be demanded by the company as per its requirements. To ensure that the interests of outsiders are not reduced, Section 55 provides for redemption of only fully paid-up shares.

From the above paras, it can be concluded that the 'gap' created in the company's capital by the redemption of redeemable preference shares must be filled in by:

- (a) the proceeds of a fresh issue of shares; or
- (b) the capitalisation of undistributed profits (by creating Capital Redemption Reserve); or
- (c) a combination of (a) and (b) above.

5.4.1 Redemption of Preference Shares by Fresh Issue of Shares

One of the methods for redemption of preference shares is to use the proceeds of a fresh issue of shares. A company can issue new shares (equity shares or preference shares) and the proceeds from such new shares can be used for redemption of preference shares.

The proceeds from issue of debentures cannot be utilised for the purpose.

A problem arises when a fresh issue is made for the purpose of redemption of preference shares, at a premium. The point to ponder is that whether the proceeds of a fresh issue of shares will include the amount of securities premium for the purpose of redemption of preference shares.

For securities premium account, Section 52 of the Companies Act, 2013 provides that the securities premium account may be applied by the company;

- (a) Towards issue of un-issued shares of the company to be issued to members of the company as fully paid bonus securities
- (b) To write off preliminary expenses of the company
- (c) To write off the expenses of, or commission paid, or discount allowed on any of the securities or debentures of the company
- (d) To provide for premium on the redemption of redeemable preference shares or debentures of the company.
- (e) For the purchase of its own shares or other securities.

Note: It may be noted that certain class of Companies whose financial statements comply with the Accounting Standards as prescribed under Section 133 of the Companies Act, 2013, can't apply the securities premium account for the purposes (b) and (d) mentioned above.

Note: All the questions in this chapter have been solved on the basis that the companies referred in the questions are governed by Section 133 of the Companies Act, 2013 and comply with the Accounting Standards prescribed for them. Accordingly the balance in securities premium account has not been utilized for the purpose of premium payable on redemption of preference shares.

Any other way, except the above prescribed ways, in which securities premium account is utilised will be in contravention of law.

Thus, the proceeds of a fresh issue of shares will not include the amount of securities premium for the purpose of redemption of preference shares.

Reasons for issue of New Equity Shares

A company may prefer issue of new equity shares for the following reasons:

- (a) When the company has come to realise that the capital is needed permanently and it makes more sense to issue Equity Shares in place of Redeemable Preference Shares as Preference Shares carry a fixed rate of dividend.

- (b) When the balance of profit, which would otherwise be available for dividend, is insufficient.
- (c) When the liquidity position of the company is not good enough.

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

Following are the advantages of redemption of preference shares by the issue of fresh equity shares:

- (1) No cash outflow of money – now or later.
- (2) New equity shares may be valued at a premium.
- (3) Shareholders retain their equity interest.

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

The disadvantages are:

- (1) There will be dilution of future earnings;
- (2) Share-holding in the company is changed if the fresh issue is made to outsiders. In case the fresh issue is made to existing shareholders in proportion to their shareholding (i.e., rights issue), the disadvantage of change in shareholding pattern can be mitigated.

5.4.2 Accounting Entries

1. When new shares are issued at par

Bank Account Dr.
 To Share Capital Account

(Being the issue ofshares of ₹.....each for the purpose of redemption of preference shares, as per Board's Resolution No..... dated.....)

2. When new shares are issued at a premium

Bank Account Dr.
 To Share Capital Account

 To Securities Premium Account

(Being the issue ofshares of ₹.....each at a premium of ₹.....each for the purpose of redemption of preference shares as per Board's Resolution No..... dated.....)

3. When preference shares are redeemed at par
 Redeemable Preference Share Capital Account Dr.
 To Preference Shareholders Account
4. 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
5. When payment is made to preference shareholders
 Preference Shareholders Account Dr.
 To Bank Account
6. For adjustment of premium on redemption
 Profit and Loss Account Dr.
 To Premium on Redemption of Preference Shares Account

ILLUSTRATION 1

Hinduja Company Ltd. had 5,000, 8% Redeemable Preference Shares of ₹ 100 each, fully paid up. The company decided to redeem these preference shares at par by the issue of sufficient number of equity shares of ₹ 10 each fully paid up at par. You are required to pass necessary Journal Entries including cash transactions in the books of the company.

SOLUTION

In the books of Hinduja Company Ltd.

Journal Entries

Date	Particulars	Dr. (₹)	Cr. (₹)
	Bank A/c Dr. To Equity Share Capital A/c (Being the issue of 50,000 Equity Shares of ₹10 each at par for the purpose of redemption of preference shares, as per Board Resolution No.dated.....)	5,00,000	5,00,000

	8% Redeemable Preference Share Capital A/c To Preference Shareholders A/c (Being the amount payable on redemption of preference shares transferred to Preference Shareholders Account)	Dr.	5,00,000	5,00,000
	Preference Shareholders A/c To Bank A/c (Being the amount paid on redemption of preference shares)	Dr.	5,00,000	5,00,000

ILLUSTRATION 2

C Ltd. had 10,000, 10% Redeemable Preference Shares of ₹ 100 each, fully paid up. The company decided to redeem these preference shares at par, by issue of sufficient number of equity shares of ₹ 10 each at a premium of ₹ 2 per share as fully paid up. You are required to pass necessary Journal Entries including cash transactions in the books of the company.

SOLUTION**In the books of C Ltd.****Journal Entries**

Date	Particulars		Dr. (₹)	Cr. (₹)
	Bank A/c To Equity Share Capital A/c To Securities Premium A/c (Being the issue of 1,00,000 Equity Shares of ₹10 each at a premium of ₹2 per share as per Board's Resolution No..... dated.....)	Dr.	12,00,000	10,00,000 2,00,000
	10% Redeemable Preference Share Capital A/c To Preference Shareholders A/c (Being the amount payable on redemption of preference shares transferred to Preference Shareholders A/c)	Dr.	10,00,000	10,00,000
	Preference Shareholders A/c To Bank A/c (Being the amount paid on redemption of preference shares)	Dr.	10,00,000	10,00,000

Note: Amount required for redemption is ₹ 10,00,000. Therefore, face value of equity shares to be issued for this purpose must be equal to ₹ 10,00,000. Premium received on new issue cannot be used to finance the redemption.

ILLUSTRATION 3

G India Ltd. had 9,000 10% redeemable Preference Shares of ₹ 10 each, fully paid up. The company decided to redeem these preference shares at par by the issue of sufficient number of equity shares of ₹ 9 each fully paid up.

You are required to pass necessary Journal Entries including cash transactions in the books of the company.

SOLUTION

In the books of G India Limited

Journal

Date	Particulars		Dr. (₹)	Cr. (₹)
	Bank A/c To Equity Share Capital A/c (Being the issue of 10,000 Equity Shares of ₹9 each at par, as per Board's Resolution No.....Dated.....)	Dr.	90,000	90,000
	10% Redeemable Preference Shares Capital A/c To Preference Shareholders A/c (Being the amount payable on redemption of preference shares transferred to Preference Shareholders A/c)	Dr.	90,000	90,000
	Preference Shareholders A/c To Bank A/c (Being the amount paid on redemption of preference shares)	Dr.	90,000	90,000

5.4.3 Calculation of Minimum Fresh Issue of Shares

Sometimes, examination problem does not specify the number of shares to be issued for the purpose of redemption of preference shares and requires that the minimum number of shares should be issued to ensure that provisions of Section 55 of the Companies Act, 2013, are not violated. This is done in four steps as given below:

- (1) In such cases, the maximum amount of reserves and surplus available for redemption is ascertained taking into account the balances appearing in the balance sheet before

redemption and the additional information provided in the problem. For example, if balance of general reserve in the balance sheet is ₹1,00,000 and additional information provides that the Board of Directors have decided that the balance of general reserve should not be less than ₹40,000 under any circumstances, then, the maximum amount of general reserve available for redemption is ₹ 60,000.

- (2) After ascertaining the maximum amount of reserves and surplus available for redemption, adjustment for premium on redemption payable out of profits is made and then it is compared with the nominal value of shares to be redeemed. By comparison, one gets the minimum proceeds of fresh issue as Section 55 permits redemption either out of proceeds of fresh issue or out of divisible profits. Thus,

Minimum Proceeds of Fresh Issue of shares :

Nominal value of preference shares to be redeemed – Maximum amount of reserve and surplus available for redemption.

- (3) After computation of minimum proceeds, the minimum number of shares to be issued are determined by dividing minimum proceeds by the proceeds of one share. This is done as follows:

Minimum Number of Shares = Minimum proceeds to comply with Section 55/ face value of one share

Proceeds of one share mean the par value of a share issued, if it is issued at par or premium. However, in case of issue of share at a discount, it refers to the discounted value.

- (4) Minimum number of shares calculated as per (3) above, needs to be adjusted due to various reasons. Firstly, shares fractions cannot be issued. Thus, if minimum number of shares as per (3) above includes a fraction, it must be approximated to the next higher figure to ensure that provisions of Section 55 are not violated. Secondly, if the examination problem states that the proceeds/number of shares should be a multiple of say, 10 or 50 or 100, then again the next higher multiple should be considered.

ILLUSTRATION 4

The Board of Directors of a Company decided to issue minimum number of equity shares of ₹9 to redeem ₹5,00,000 preference shares. The maximum amount of divisible profits available for redemption is ₹3,00,000. Calculate the number of shares to be issued by the company to ensure that the provisions of Section 55 are not violated. Also determine the number of shares if the company decides to issue shares in multiples of 50 only.

SOLUTION

Nominal value of preference shares	₹ 5,00,000
Maximum possible redemption out of profits	₹ 3,00,000
Minimum proceeds of fresh issue	₹ 5,00,000 – 3,00,000 = ₹ 2,00,000
Proceed of one share	= ₹ 9
Minimum number of shares	= $\frac{2,00,000}{9} = 22,222.22$ shares

As fractional shares are not permitted, the minimum number of shares to be issued is 22,223 shares.

If shares are to be issued in multiples of 50, then the next higher figure which is a multiple of 50 is 22,250. Hence, minimum number of shares to be issued in such a case is 22,250 shares.

5.4.4 Fresh Issue at a Premium and Minimum Fresh Issue

The calculation of minimum number of shares, when fresh issue is at a premium should be handled very carefully. Minimum fresh issue cannot be calculated unless one knows the profits available for replacement of preference shares and profit available for replacement cannot be determined unless one knows the portion of profit available for redemption which is required for paying premium on redemption. To tackle this, assume that profits available for redemption is not required for paying premium on redemption of preference shares. In other words, it means that securities premium including premium on fresh issue is comparatively more than premium on redemption.

If the above assumption holds good, minimum number of shares can be calculated in a simple manner without use of equation. But, if above condition does not hold good, then an equation is used to determine the minimum number of shares.

5.4.5 Minimum Fresh Issue to Provide Funds for Redemption

Besides, ensuring compliance with Section 55, the fresh issue of shares is made to provide funds for making payment to preference shareholders. To calculate minimum number of fresh shares to be issued to provide funds, amount payable to preference shareholders is compared with funds available for redemption and the balance of funds to be raised by fresh issue of shares are calculated. The amount to be raised is divided by the issue price of a share (amount payable by shareholder including premium, if any, on fresh issue) to compute the minimum number of shares to be issued.

ILLUSTRATION 5

X Ltd. gives you the following information as at 31st March, 2023:

	Particulars	₹
	EQUITY AND LIABILITIES	
1.	Shareholders' funds	
	a Share capital	2,90,000
	b Reserves and Surplus	48,000
2.	Current liabilities	
	Trade Payables	56,500
	ASSETS	
1.	Property, Plant and Equipment	3,45,000
2.	Non-current investments	18,500
3.	Current Assets	
	Cash and cash equivalents (bank)	31,000

The share capital of the company consists of ₹ 50 each equity shares of ₹ 2,25,000 and ₹ 100 each Preference shares of ₹ 65,000(issued on 1.4.2021). Reserves and Surplus comprises Profit and Loss Account only.

In order to facilitate the redemption of preference shares at a premium of 10%, the Company decided:

- (a) to sell all the investments for ₹ 15,000.
- (b) to finance part of redemption from company funds, subject to, leaving a bank balance of ₹ 12,000.
- (c) to issue minimum equity share of ₹ 50 each share to raise the balance of funds required.

You are required to pass the necessary Journal Entries to record the above transactions.

SOLUTION**Journal**

Date	Particulars	Dr. (₹)	Cr. (₹)
	Bank A/c	Dr. 37,500	
	To Share Application A/c		37,500
	(For application money received on 750 shares @ ₹ 50 per share)		

Share Application A/c	Dr.	37,500	
To Equity Share Capital A/c			37,500
(For disposition of application money received)			
Preference Share Capital A/c	Dr.	65,000	
Premium on Redemption of			
Preference Shares A/c	Dr.	6,500	
To Preference Shareholders A/c			71,500
(For amount payable on redemption of preference shares)			
Bank A/c	Dr.	15,000	
Profit and Loss A/c (loss on sale) A/c	Dr.	3,500	
To Investment A/c			18,500
(For sale of investments at a loss of ₹ 3,500)			
Profit and Loss A/c	Dr.	27,500	
To Capital Redemption Reserve A/c			27,500
(For transfer to CRR out of divisible profits an amount equivalent to excess of nominal value of preference shares over proceeds (face value of equity shares) i.e., ₹ 65,000 - ₹ 37,500)			
Preference Shareholders A/c	Dr.	71,500	
To Bank A/c			71,500
(For payment of preference shareholders)			
Profit and Loss A/c	Dr.	6,500	
To Premium on Redemption of Preference Shares A/c			6,500
(For writing off premium on redemption out of profits)			

Working Note:**Calculation of Number of Shares:**

	₹
Amount payable on redemption (₹ 65,000 + 10% of ₹ 65,000)	71,500
Less: Sale price of investment	<u>(15,000)</u>
	56,500
Less: Available bank balance (31,000 - 12,000)	<u>(19,000)</u>
Funds from fresh issue	<u>37,500</u>

∴ No. of shares = 37,500/50=750 shares



5.5 REDEMPTION OF PREFERENCE SHARES BY CAPITALISATION OF UNDISTRIBUTED DIVISIBLE PROFITS

Another method for redemption of preference shares, as per the Companies Act, is to use the distributable profits in place of issuing new shares. When shares are redeemed by utilising distributable profit, an amount equal to the face value of shares redeemed is transferred to Capital Redemption Reserve Account by debiting the distributable profit. In other words, some of the distributable profits are kept aside to ensure that it can never be distributed to shareholders as dividend.

Profit or a portion of profit that can be otherwise legally distributed as dividend to the shareholders is known as Divisible or Distributable Profit.

In this connection, the provisions of the Companies Act state 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 to be called the Capital Redemption Reserve Account sum equal to the nominal amount of the shares redeemed'.

Note: Only Divisible Profits can be used to create Capital Redemption Reserve, Non-Divisible Profits cannot be used for this purpose.

5.5.1 Advantages of redemption of preference shares by capitalisation of undistributed divisible profits

The advantages of redemption of preference shares by capitalisation of undistributed divisible profits are:

- (1) No change in the percentage of equity share-holding of the company;
- (2) Surplus funds can be used.

5.5.2 Disadvantages of redemption of preference shares by capitalisation of undistributed divisible profits

The disadvantage of redemption of preference shares by capitalisation of undistributed profits is that there will be a reduction in liquidity or assets may need to be sold such as investments.

Accounting Entries**1. 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 amount transferred to Capital Redemption Reserve Account as per the requirement of the Act).

2. 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)

3. When shares are redeemed at a premium

Redeemable Preference Share Capital Account Dr.

Premium on Redemption of Preference Shares Account Dr.

To Preference Shareholders Account

(Being the amount payable on redemption transferred to Preference Shareholders Account)

4. When payment is made to preference shareholders

Preference Shareholders Account Dr.

To Bank Account

(Being the payment to preference shareholders as per terms)

5. 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)

ILLUSTRATION 6

The following are the extracts from the Balance Sheet of ABC Ltd. as on 31st December, 2022.

Share capital: 40,000 Equity shares of ₹ 10 each fully paid – ₹ 4,00,000; 1,000 10% Redeemable preference shares of ₹ 100 each fully paid – ₹ 1,00,000.

Reserve & Surplus: Capital reserve – ₹ 50,000; Securities premium – ₹ 50,000; General reserve – ₹ 75,000; Profit and Loss Account – ₹ 35,000

On 1st January 2023, the Board of Directors decided to redeem the preference shares at par by utilisation of reserve.

You are required to pass necessary Journal Entries including cash transactions in the books of the company.

SOLUTION

**In the books of ABC Limited
Journal Entries**

Date	Particulars		Dr. (₹)	Cr. (₹)
2023 Jan 1	10% Redeemable Preference Share Capital A/c To Preference Shareholders A/c (Being the amount payable on redemption transferred to Preference Shareholders Account)	Dr.	1,00,000	1,00,000
	Preference Shareholders A/c To Bank A/c (Being the amount paid on redemption of preference shares)	Dr.	1,00,000	1,00,000
	General Reserve A/c Profit & Loss A/c To Capital Redemption Reserve A/c (Being the amount transferred to Capital Redemption Reserve Account as per the requirement of the Act)	Dr. Dr.	75,000 25,000	1,00,000

Note: Securities premium and capital reserve (not being distributable profits) cannot be utilised for transfer to Capital Redemption Reserve.

5.5.3 Redemption of Preference Shares by combination of Fresh Issue and Capitalisation of Undistributed divisible Profits

A company can redeem the preference shares partly from the proceeds from new issue and partly out of profits. In order to fill in the 'gap' between the face value of shares redeemed and the proceeds of new issue, a transfer should be made from distributable profits (Profit & Loss Account, General Reserve and other Free Reserves) to Capital Redemption Reserve Account.

Formula:

(i)	Amount to be Transferred to Capital Redemption Reserve	₹
	Face value of shares redeemed	***
	Less: Proceeds from new issue	***

(ii)	Proceeds to be collected from New Issue	₹
	Face value of shares redeemed	***
	Less: Profits available for distribution as dividend	***

The term 'proceeds from fresh/new issue' shall be interpreted as:

- Amount credited to Share Capital, in case of issue at par
- Amount credited to Share Capital, in case of issue at premium. Though premium is received which is credited to the Securities Premium A/c, the same shall not be regarded as 'proceeds', because if it were to be treated as such, the transfer of distributable profits to the Capital Redemption Reserve would be lower by the amount of the premium received.
- Amount received (i.e., debited to Cash/Bank), in case of issue at a discount.

Note: Section 53 of the Companies Act, 2013 prohibits issue of shares at a discount, except in case of issue of Sweat Equity Shares as outlined in Section 54.

ILLUSTRATION 7

C Limited had 3,000, 12% Redeemable Preference Shares of ₹ 100 each, fully paid up. The company had to redeem these shares at a premium of 10%.

It was decided by the company to issue the following:

- 25,000 Equity Shares of ₹ 10 each at par,
- 1,000 14% Debentures of ₹ 100 each.

The issue was fully subscribed and all amounts were received in full. The payment was duly made. The company had sufficient profits. Show Journal Entries in the books of the company.

SOLUTION

In the books of C Limited
Journal Entries

Date	Particulars	Dr. (₹)	Cr. (₹)
	Bank A/c Dr. To Equity Share Capital A/c (Being the issue of 25,000 equity shares of ₹ 10 each at par as per Board's resolution No.....dated.....)	2,50,000	2,50,000
	Bank A/c Dr. To 14% Debenture A/c (Being the issue of 1,000 Debentures of ₹ 100 each as per Board's Resolution No.....dated.....)	1,00,000	1,00,000
	Profit & Loss A/c Dr. To Capital Redemption Reserve A/c (Being the amount transferred to Capital Redemption Reserve Account as per the requirement of the Act)	50,000	50,000
	12% Redeemable Preference Share Capital A/c Dr. Premium on Redemption of Preference Shares A/c Dr. To Preference Shareholders A/c (Being the amount payable on redemption transferred to Preference Shareholders Account)	3,00,000 30,000	3,30,000
	Preference Shareholders A/c Dr. To Bank A/c (Being the amount paid on redemption of preference shares)	3,30,000	3,30,000
	Profit & Loss A/c Dr. To Premium on Redemption of Preference Shares A/c (Being the adjustment of premium on redemption against Profits & Loss Account)	30,000	30,000

Working Note:**Amount to be transferred to Capital Redemption Reserve Account**

Face value of shares to be redeemed	3,00,000
Less: Proceeds from new issue	<u>(2,50,000)</u>
Total Balance	<u>50,000</u>

ILLUSTRATION 8

The capital structure of a company consists of 20,000 Equity Shares of ₹ 10 each fully paid up and 1,000 8% Redeemable Preference Shares of ₹ 100 each fully paid up (issued on 1.4.2021).

Undistributed reserve and surplus stood as: General Reserve ₹ 80,000; Profit and Loss Account ₹ 20,000; Investment Allowance Reserve out of which ₹ 5,000, (not free for distribution as dividend) ₹ 10,000; Securities Premium ₹ 2,000, Cash at bank amounted to ₹ 98,000. Preference shares are to be redeemed at a Premium of 10% and for the purpose of redemption, the directors are empowered to make fresh issue of Equity Shares at par after utilising the undistributed reserve and surplus, subject to the conditions that a sum of ₹ 20,000 shall be retained in general reserve and which should not be utilised.

Pass Journal Entries to give effect to the above arrangements.

SOLUTION

In the books of
Journal Entries

Date	Particulars	Dr. (₹)	Cr. (₹)
	Bank A/c Dr. To Equity Share Capital A/c (Being the issue of 2,500 Equity Shares of ₹ 10 each at a premium of Re. 1 per share as per Board's Resolution No.....dated.....)	25,000	25,000
	General Reserve A/c Dr. Profit & Loss A/c Dr. Investment Allowance Reserve A/c Dr. To Capital Redemption Reserve A/c (Being the amount transferred to Capital Redemption Reserve Account as per the requirement of the Act)	60,000 10,000 5,000	75,000
	8% Redeemable Preference Share Capital A/c Dr.	1,00,000	

Premium on Redemption of Preference Shares A/c To Preference Shareholders A/c (Being the amount paid on redemption transferred to Preference Shareholders Account)	Dr.	10,000	1,10,000
Preference Shareholders A/c To Bank A/c (Being the amount paid on redemption of preference shares)	Dr.	1,10,000	1,10,000
Profit & Loss A/c To Premium on Redemption of Preference Shares A/c (Being the premium payable on redemption is adjusted against Profit & Loss Account)	Dr.	10,000	10,000

Working Note:

No of Shares to be issued for redemption of Preference Shares:

Face value of shares redeemed ₹ 1,00,000

Less: Profit available for distribution as dividend:

General Reserve : ₹(80,000-20,000) ₹ 60,000

Profit and Loss (20,000 – 10,000 set aside for adjusting premium payable on redemption of preference shares) ₹10,000

Investment Allowance Reserve: (₹ 10,000-5,000) ₹ 5,000 (₹ 75,000)

₹ 25,000

Therefore, No. of shares to be issued = ₹ 25,000/₹10 = 2,500 shares.

5.5.4 Sale of Investments to Provide Sufficient Funds for Redemption

Companies may have sufficient investments, which can be sold, in the market to arrange funds for redemption of preference shares.



5.6 REDEMPTION OF PARTLY CALLED-UP PREFERENCE SHARES

One of the conditions of redemption is that only fully paid up preference shares can be redeemed by a company. Hence:

- 1) If the problem states that it is decided to redeem preference shares which are partly called up, then it is assumed that the final call on these shares is demanded and received before proceeding with redemption of these shares.
- 2) If information about both fully paid and partly paid preference shares is provided, then, it is presumed that only fully paid shares are to be redeemed and partly paid shares are left intact.
- 3) The company can forfeit the shares, if the call money is not received by the company in spite of giving opportunity to pay the same via reminders.

ILLUSTRATION 9

The Balance Sheet of XYZ Ltd. as at 31st March, 2021 inter alia includes the following information:

	₹
50,000, 8% Preference Shares of ₹100 each, ₹70 paid up	35,00,000
1,00,000 Equity Shares of ₹100 each fully paid up	1,00,00,000
Securities Premium	5,00,000
Capital Redemption Reserve	20,00,000
General Reserve	50,00,000
Bank	15,00,000

Under the terms of their issue, the preference shares are redeemable on 31st March, 2022 at 5% premium. In order to finance the redemption, the company makes a rights issue of 50,000 equity shares of ₹ 100 each at ₹ 110 per share, ₹ 20 being payable on application, ₹ 35 (including premium) on allotment and the balance on 1st January, 2023. The issue was fully subscribed and allotment made on 1st March, 2022. The money due on allotment were duly received by 31st March, 2022. The preference shares were redeemed after fulfilling the necessary conditions of Section 55 of the Companies Act, 2013.

You are asked to pass the necessary Journal Entries. (Ignore date column)

SOLUTION

Journal Entries

		₹	₹
8% Preference Share Final Call A/c	Dr.	15,00,000	
To 8% Preference Share Capital A/c			15,00,000
(For final call made on preference shares @ ₹ 30 each to make them fully paid up)			
Bank A/c	Dr.	15,00,000	
To 8% Preference Share Final Call A/c			15,00,000
(For receipt of final call money on preference shares)			
Bank A/c	Dr.	10,00,000	
To Equity Share Application A/c			10,00,000
(For receipt of application money on 50,000 equity shares @ ₹ 20 per share)			
Equity Share Application A/c	Dr.	10,00,000	
To Equity Share Capital A/c			10,00,000
(For capitalisation of application money received)			
Equity Share Allotment A/c	Dr.	17,50,000	
To Equity Share Capital A/c			12,50,000
To Securities Premium A/c			5,00,000
(For allotment money due on 50,000 equity shares @ ₹ 35 per share including a premium of ₹ 10 per share)			
Bank A/c	Dr.	17,50,000	
To Equity Share Allotment A/c			17,50,000
(For receipt of allotment money on equity shares)			
General Reserve A/c	Dr.	27,50,000	
To Capital Redemption Reserve A/c			27,50,000
(For transfer of CRR the amount not covered by the proceeds of fresh issue of equity shares i.e., 50,00,000 - 10,00,000 - 12,50,000)			
8% Preference Share Capital A/c	Dr.	50,00,000	

Premium on Redemption of Preference Shares A/c To Preference Shareholders A/c (For amount payable to preference shareholders on redemption at 5% premium)	Dr.	2,50,000	52,50,000
Preference Shareholders A/c To Bank A/c (For amount paid to preference shareholders)	Dr.	52,50,000	52,50,000
General Reserve A/c To Premium on Redemption A/c (For writing off premium on redemption of preference shares)	Dr.	2,50,000	2,50,000

Note: On the redemption of redeemable preference shares out of accumulated divisible profits, it will be necessary to transfer to the Capital Redemption Reserve Account an amount equal to the amount repaid on the redemption of preference shares on account of face value less proceeds of a fresh issue of shares made for the purpose of redemption.



5.7 REDEMPTION OF FULLY CALLED BUT PARTLY PAID-UP PREFERENCE SHARES

The problem of unpaid calls on fully called up shares may be studied under following categories:

5.7.1 When the amount of calls-in-arrears is received by the company

If the amount of unpaid calls is received by the Company before redemption, the entry passed is as under:

Bank A/c	Dr.
To Calls-in-Arrears A/c	

After receipt of calls in arrears, the shares become fully paid up and then, company can proceed with redemption in the normal course.

5.7.2 In case of Forfeited Shares

If in spite of receiving a proper notice from the company, the shareholders fail to pay the unpaid calls, the Board of Directors may decide to forfeit the shares and cancel these shares

instead of reissuing the forfeited shares because redemption of these shares is due immediately or in near future. In this case, the journal entry for forfeiture is passed as usual, which will be as follows:

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: But it should be noted, in this case, that the number of shares to be redeemed will be reduced by the number of shares so forfeited. Further, since the preference shares are getting redeemed, the forfeited shares will not be reissued and hence the balance in the Shares Forfeited A/c should be transferred to Capital Reserve by passing the following journal entry:

Shares Forfeited A/c Dr.

To Capital Reserve A/c

ILLUSTRATION 10

With the help of the details in Illustration 9 above and further assuming that the Preference Shareholders holding 2,000 shares fail to make the payment for the Final Call made under Section 55, you are asked to pass the necessary Journal Entries and show the relevant extracts from the balance sheet as on 31st March, 2022 with the corresponding figures as on 31st December, 2021 assuming that the shares in default are forfeited after giving proper notices. (Ignore date column)

SOLUTION

Journal Entries

		₹	₹
	8% Preference Share Final Call A/c Dr.	15,00,000	
	To 8% Preference Share Capital A/c		15,00,000
	(For final call made on preference shares @ ₹ 30 each to make them fully paid up)		
	Bank A/c Dr.	14,40,000	
	Calls in arrears A/c	60,000	
	To 8% Preference Share Final Call A/c		15,00,000
	(For receipt of final call money on preference shares)		

Preference Share Capital A/c (2000 X ₹ 100)	Dr.	2,00,000	
To Calls in Arrears A/c (2000 X ₹ 30)			60,000
To Shares Forefeited A/c (2000 X ₹ 70)			1,40,000
(For Shares Forefeited after shareholders fail to pay the Final Call)			
Bank A/c	Dr.	10,00,000	
To Equity Share Application A/c			10,00,000
(For receipt of application money on 50,000 equity shares @ ₹ 20 per share)			
Equity Share Application A/c	Dr.	10,00,000	
To Equity Share Capital A/c			10,00,000
(For capitalisation of application money received)			
Equity Share Allotment A/c	Dr.	17,50,000	
To Equity Share Capital A/c			12,50,000
To Securities Premium A/c			5,00,000
(For allotment money due on 50,000 equity shares @ ₹ 35 per share including a premium of ₹ 10 per share)			
Bank A/c	Dr.	17,50,000	
To Equity Share Allotment A/c			17,50,000
(For receipt of allotment money on equity shares)			
General Reserve A/c	Dr.	25,50,000	
To Capital Redemption Reserve A/c			25,50,000
(For transfer of CRR the amount not covered by the proceeds of fresh issue of equity shares i.e., 48,00,000 – 10,00,000 – 12,50,000)			
8% Preference Share Capital A/c	Dr.	48,00,000	
Premium on Redemption of Preference Shares A/c	Dr.	2,40,000	
To Preference Shareholders A/c			50,40,000
(For amount payable to preference shareholders on redemption at 5% premium)			
Preference Shareholders A/c	Dr.	50,40,000	
To Bank A/c			50,40,000
(For amount paid to preference shareholders)			

General Reserve A/c	Dr.	2,40,000	
To Premium on Redemption A/c			2,40,000
(For writing off premium on redemption of preference shares)			
Shares Forfeited A/c	Dr.	1,40,000	
To Capital Reserve A/c			1,40,000
(For transferring balance to Capital Reserve A/c after redemption of preference shares)			

Note: Amount received (excluding premium) on fresh issue of shares till the date of redemption should be considered for calculation of proceeds of fresh issue of shares. Thus, proceeds of fresh issue of shares ₹ 22,50,000 (₹10,00,000 application money plus ₹ 12,50,000 received on allotment towards share capital) will be considered.

SUMMARY

- Redemption is the process of repaying an obligation, at prearranged amount and timing.
- In India, the issue and redemption of preference shares is governed by Section 55 of the Companies Act, 2013.
- A company limited by shares if so authorised by its Articles, may issue preference shares which at the option of the company*, are liable to be redeemed. It should be noted that:
 - (a) no shares can be redeemed except out of profit of the company which would otherwise be available for dividend or out of proceeds of fresh issue of shares made for the purpose of redemption;
 - (b) no such shares can be redeemed unless they are fully paid;
- * A company cannot issue irredeemable preference shares.
- Methods of redemption of fully paid-up preference shares: (i) by Fresh issue of shares; (ii) by Capitalisation of undistributed profits; (iii) Combination of (i) and (ii),

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.
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.
3. The balance in forfeited shares account can be used for transfer to capital redemption reserve account.
4. Capital redemption reserve cannot be used for writing off miscellaneous expenses and losses

Multiple Choice Questions

1. Securities premium cannot be used to _____.
 - (a) Issue bonus shares
 - (b) Redeem preference shares
 - (c) Write-off preliminary expenses
2. S Ltd. issued 2,000, 10% Preference shares of ₹ 100 each at par on 1.4.2022, 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 = ?
 - (a) ₹ 50,000
 - (b) ₹ 40,000
 - (c) ₹ 2,00,000
3. Which of the following cannot be used for the purpose of creation of capital redemption reserve account?
 - (a) Profit and loss account (credit balance)

- (b) General reserve account
- (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
- (a) Issue of fully paid bonus shares
- (b) Writing off losses of the company
- (c) For purchase of own securities
5. Which of the following can be utilized for redemption of preference shares?
- (a) The proceeds of fresh issue of equity shares
- (b) The proceeds of issue of debentures
- (c) The proceeds of issue of fixed deposit
6. Preference shares amounting to ₹2,00,000 (already issued on 1.4.2022) 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 = ?
- (a) ₹1,05,000
- (b) ₹1,00,000
- (c) ₹2,00,000

Theoretical Questions

1. What is the purpose of issuing redeemable preference shares?
2. What are the provisions of the Companies Act, 2013 related with redemption of preference shares? Explain in brief.

Practical Questions

1. The books of B Ltd. showed the following balance on 31st December, 2023:
30,000 Equity Shares of ₹10 each fully paid; 18,000 12% Redeemable Preference Shares of ₹10 each fully paid; 4,000 10% Redeemable Preference Shares of ₹10 each, ₹8 paid up (all shares issued on 1st April, 2022).
Undistributed Reserve and Surplus stood as: Profit and Loss Account ₹80,000; General Reserve ₹1,20,000; Securities Premium Account ₹15,000 and Capital Reserve ₹21,000.
For redemption, 3,000 equity shares of ₹10 each are issued at 10% premium. At the same time, Preference shares are redeemed on 1st January, 2024 at a premium of ₹2

per share. The whereabouts of the holders of 100 shares of ₹ 10 each fully paid are not known.

A bonus issue of equity share was made at par, two shares being issued for every five held on that date out of the Capital Redemption Reserve Account. However, equity shares, issued for redemption are not eligible for bonus.

Show the necessary Journal Entries to record the transactions. (Ignore date column)

ANSWERS/ HINTS

True and false

1. False: When shares are redeemed by utilising distributable profit, an amount equal to the face value of shares redeemed is transferred to Capital Redemption Reserve account by debiting the distributable profit.
2. True: 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 the premium on the redemption of redeemable preference shares.
3. False: The balance in Forfeited shares account cannot be used for transfer to capital redemption reserve account.
4. True: Capital redemption reserve cannot be used for writing off miscellaneous expenses and losses.

Multiple Choice Questions

1.	(b)	2.	(a) ¹	3.	(c)	4.	(b)	5.	(a)	6.	(b) ²
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Theoretical Questions

1. A company may issue redeemable preference shares to raise finance in a dull primary market. Preference shares may be redeemed when there is a surplus of capital and the surplus funds cannot be utilised in the business for profitable use. For details, refer para 5.2 of the chapter.
2. Section 55 of the Companies Act, 2013, deals with provisions relating to redemption of preference shares. It ensures that there is no reduction in shareholders' funds due

¹ 2,00,000 – 1,50,000

² 2,00,000 – 1,00,000

to redemption and, thus, the interest of outsiders is not affected. For details, refer para 5.3 of the chapter.

Practical Questions

1.

In the books of B Limited

Journal Entries

Particulars	Dr. (₹)	Cr. (₹)
12% Redeemable Preference Share Capital A/c	Dr. 1,80,000	
Premium on Redemption of Preference Shares A/c	Dr. 36,000	
To Preference Shareholders A/c		2,16,000
(Being the amount payable on redemption of 18,000 12% Redeemable Preference Shares transferred to Shareholders Account)		
Preference Shareholders A/c	Dr. 2,14,800	
To Bank A/c		2,14,800
(Being the amount paid on redemption of 17,900 preference shares)		
Bank A/c	Dr. 33,000	
To Equity Shares Capital A/c		30,000
To Securities Premium A/c		3,000
(Being the issue of 3,000 Equity Shares of ₹ 10 each at a premium of 10% as per Board's Resolution No..... Dated.....)		
General Reserve A/c	Dr. 1,20,000	
Profit & Loss A/c	Dr. 30,000	
To Capital Redemption Reserve A/c		1,50,000
(Being the amount transferred to Capital Redemption Reserve A/c as per the requirement of the Act.)		
Capital Redemption Reserve A/c	Dr. 1,20,000	
To Bonus to Shareholders A/c		1,20,000
(Being the amount appropriated for issue of bonus share in the ratio of 5:2 as per shareholders Resolution No..... dated...)		

Bonus to Shareholders A/c	Dr.	1,20,000	
To Equity Share Capital A/c			1,20,000
(Being the utilisation of bonus dividend for issue of 12,000 equity shares of ₹ 10 each fully paid)			
Profit & Loss A/c	Dr.	36,000	
To Premium on Redemption of Preference Shares A/c			36,000
(Being premium on redemption of preference shares adjusted against to Profit & Loss Account)			

Working Note:

- (1) Partly paid-up preference shares cannot be redeemed.
- (2) Amount to be Transferred to Capital Redemption Reserve Account
- | | |
|------------------------------------------------------------|-------------------|
| Face value of share to be redeemed | ₹ 1,80,000 |
| <i>Less:</i> Proceeds from fresh issue (excluding premium) | <u>(₹ 30,000)</u> |
| | <u>₹ 1,50,000</u> |
- (3) No bonus shares on 3,000 equity shares issued for redemption.

Note: Bonus shares does not result in receipt of cash, and hence the increase in share capital on account of bonus issue cannot be considered in determination of amount to be transferred to Capital Redemption Reserve.

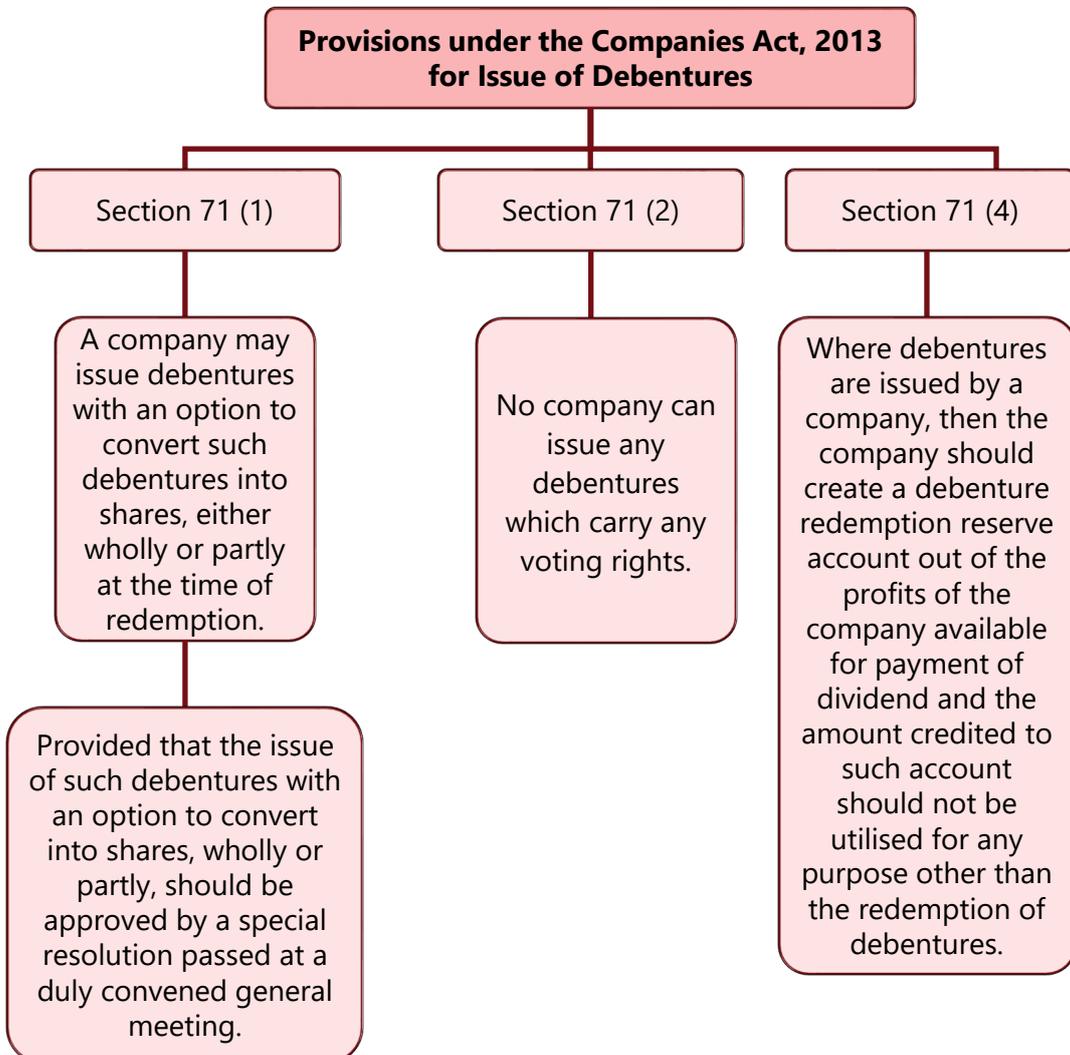
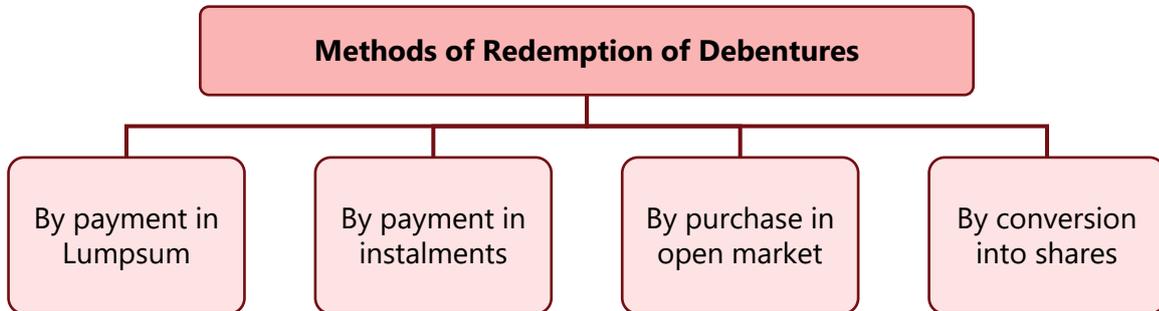
UNIT – 6: REDEMPTION OF DEBENTURES

LEARNING OUTCOMES

After studying this unit, you will be able to:

- ◆ Understand about the redemption of debentures;
- ◆ Understand the requirement of creation of a Debenture Redemption Reserve and creation of Debenture Redemption Fund (i.e. making investments for purpose of redemption of debentures);
- ◆ Understand various methods of redemption of debentures;
- ◆ Understand the accounting treatment of redemption of debentures;
- ◆ Solve problems based on redemption of debentures.

UNIT OVERVIEW





6.1 INTRODUCTION

A debenture is an instrument issued by a company under its seal, acknowledging a debt and containing provisions as regards repayment of the principal and interest.

Under Section 71 (1) of the Companies Act, 2013, a company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption.

Provided that the issue of debentures with an option to convert such debentures into shares, wholly or partly, should be approved by a special resolution passed at a duly convened general meeting.

Section 71 (2) further provides that no company can issue any debentures which carry any voting rights.

Section 71 (4) provides that where debentures are issued by a company, the company should create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account should not be utilized by the company for any purpose other than the redemption of debentures.

Basic provisions

If a charge has been created on any asset or the entire assets of the company,

- the nature of the charge
- the asset(s) charged

are described therein.

- Since the charge is not valid unless registered with the Registrar, his certificate registering the charge is printed on the bond.
- It is also customary to create a trusteeship in favour of one or more persons in the case of mortgage debentures. The trustees of debenture holders have all powers of a mortgage of a property and can act in whatever manner they think necessary to safeguard the interest of debenture holders.

Note: Issue of debentures has already been discussed in detail in unit 3 of Chapter 11.



6.2 REDEMPTION OF DEBENTURES

Debentures are usually redeemable i.e. either redeemed in cash or convertible to equity shares after a time period.

Redeemable debentures may be **redeemed**:

- after a **fixed number** of years; or
- any time after a **certain number of years** has elapsed since their issue; or
- on giving a **specified notice**; or
- by **annual drawing**.

A company may also purchase its debentures, as and when convenient, in the open market. When the debentures are quoted at a discount on the Stock Exchange, it may be profitable for the company to purchase and cancel them.



6.3 DEBENTURE REDEMPTION RESERVE

A company issuing debentures may be required to create a debenture redemption reserve account out of the profits available for distribution of dividend and amounts credited to such account cannot be utilised by the company for any other purpose except for redemption of debentures. Such an arrangement would ensure that the company will have sufficient liquid funds for the redemption of debentures at the time they fall due for payment.

An appropriate amount is transferred from profits every year to Debenture Redemption Reserve and its investment is termed as Debenture Redemption Reserve Investment (or Debenture Redemption Fund). In the last year or at the time of redemption of debentures, Debenture Redemption Reserve Investments are encashed and the amount so obtained is used for the redemption of debentures.

6.3.1 Requirement to create Debenture Redemption Reserve

Section 71 of the Companies Act 2013 covers the requirement of creating a debenture redemption reserve account. Section 71 states as follows:

- (1) Where a company issues debentures under this section, it should create a debenture redemption reserve account out of its profits which are available for distribution of dividend every year until such debentures are redeemed.
- (2) The amounts credited to the debenture redemption reserve should not be utilised by the company for any purpose except for the purpose aforesaid.

- (3) The company should pay interest and redeem the debentures in accordance with the terms and conditions of their issue.
- (4) Where a company fails to redeem the debentures on the date of maturity or fails to pay the interest on debentures when they fall due, the Tribunal may, on the application of any or all the holders of debentures or debenture trustee and, after hearing the parties concerned, direct, by order, the company to redeem the debentures forthwith by the payment of principal and interest due thereon.

6.3.2 Balance in Debenture Redemption Reserve (DRR)

When the company decides to establish the Debenture Redemption Reserve Account, the amount indicated by the Debenture Redemption Reserves tables is credited to the Debenture Redemption Reserve account and debited to profit and loss account. That shows the intention of the company to set aside sum of money to build up a fund for redeeming debentures. Immediately, the company should also purchase outside investments. The entry for the purpose naturally will be to debit Debenture Redemption Reserve Investments and credit Bank.

6.3.3 Adequacy of Debenture Redemption Reserve (DRR)

As per Rule 18 (7) of the Companies (Share Capital and Debentures) Amendment Rules, 2019, the company shall comply with the requirements with regard to Debenture Redemption Reserve (DRR) and investment or deposit of sum in respect of debentures maturing during the year ending on the 31st day of March of next year (*refer para 6.4 below*), in accordance with the conditions given below—

the Debenture Redemption Reserve shall be created out of the profits of the company available for payment of dividend; the limits with respect to adequacy of DRR and investment or deposits, as the case may be, shall be as under:

S. No	Debentures issued by	Adequacy of Debenture Redemption Reserve (DRR)
1	All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures	No DRR is required
2	Other Financial Institutions (FIs) within the meaning of clause (72) of section 2 of the Companies Act, 2013	DRR will be as applicable to NBFCs registered with RBI (as per (3) below)
3	For listed companies (other than AIFIs and Banking Companies as specified in Sr. No. 1 above):	

4	a.	All listed NBFCs (registered with RBI under section 45-IA of the RBI Act,) and listed HFCs (Housing Finance Companies registered with National Housing Bank) for both public as well as privately placed debentures	No DRR is required
	b.	Other listed companies for both public as well as privately placed debentures	No DRR is required
	For unlisted companies (other than AIFs and Banking Companies as specified 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

6.3.4 Investment of Debenture Redemption Reserve (DRR) Amount

Further, as per Rule 18 (7) of the Companies (Share Capital and Debentures) Amendment Rules, 2019, following companies

- (a) All listed NBFCs
- (b) All listed HFCs
- (c) All other listed companies (other than AIFs, Banking Companies and Other FIs); and
- (d) All unlisted companies which are not NBFCs and HFCs

shall on or before the 30th day of April in each year, in respect of debentures issued, deposit or invest, as the case may be, a sum which should not be less than 15% of the amount of its debentures maturing during the year ending on the 31st day of March of next year, in any one or more of the following methods, namely:

- (a) in deposits with any scheduled bank, free from charge or lien;
- (b) in unencumbered securities of the Central Government or of any State Government;
- (c) in unencumbered securities mentioned 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 which is notified under clause (f) of Section 20 of the Indian Trusts Act, 1882.

The amount deposited or invested, as the case may be, above should not be utilised for any purpose other than for the redemption of debentures maturing during the year referred to above.

Provided that the amount remaining deposited or invested, as the case may be, shall not at any time fall below 15% of the amount of debentures maturing during the 31st day of March of that year.

In case of partly convertible debentures, DRR shall be created in respect of non-convertible portion of debenture issue.

The amount credited to DRR shall not be utilised by the company except for the purpose of redemption of debentures.

Note: It should be noted that appropriation to DRR can be made any time before redemption and Investments in specified securities as mentioned above can be done before 30th April for the debentures maturing that year, however, for the sake of simplicity and ease, it is advisable to make the appropriation and investment immediately after the debentures are allotted assuming that the company has sufficient amount of profits (issued if allotment date is not given in the question). Also, in some cases, the date of allotment could be missing, in such cases the appropriation and investments should be done on the first day of that year for which ledgers accounts are to be drafted.

6.3.5 Journal Entries

The necessary journal entries passed in the books of a company are given below:

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 receipt of 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*

* Considering the fact that interest is received each year through cash/bank account and it is not re-invested. In the illustrations given in the chapter, the same has been considered and hence interest on DRR investment is not credited to DRR A/c but taken to P&L A/c.

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

Redemption of debentures must be done according to the terms of issue of debentures and any deviation therefrom will be treated as a default by the company.

Redemption by paying off the debt on account of debentures issued can be done in any one of the three methods viz:

6.4.1 By payment in lumpsum

Under payment in lumpsum method, at maturity or at the expiry of a specified period of debenture the payment of entire debenture is made in one lot or even before the expiry of the specified period.

6.4.2 By payment in Instalments

Under payment in instalments method, the payment of specified portion of debenture is made in instalments at specified intervals.

6.4.3 Purchase of Debentures in Open Market

Debentures sometimes are purchased in open market. This is not covered in the chapter as it has been specifically excluded from the syllabus at Foundation level.

ILLUSTRATION 1

The following balances appeared in the books of a company (unlisted company other than AIFI, Banking company, NBFC and HFC) as on December 31, 2021: 6% Mortgage 10,000 debentures of ₹ 100 each; Debenture Redemption Reserve (for redemption of debentures) ₹ 50,000; Investments in deposits with a scheduled bank, free from any charge or lien ₹ 1,50,000 at interest 4% p.a. receivable on 31st December every year. Bank balance with the company is ₹ 9,00,000.

The Interest on debentures had been paid up to December 31, 2021.

On February 28, 2022, the investments were realised at par and the debentures were paid off at 101, together with accrued interest.

Write up the concerned ledger accounts (excluding bank transactions). Ignore taxation.

SOLUTION

6% Mortgage Debentures Account

2022			₹	2022			₹
Feb. 28	To	Debenture-holders A/c	10,00,000	Jan. 1	By	Balance b/d	10,00,000

Premium on Redemption of Debentures Account

2022			₹	2022			₹
Feb. 28	To	Debenture-holders A/c	10,000	Feb. 28	By	Profit and loss A/c	10,000

Debentures Redemption Reserve Investment Account

2022			₹	2022			₹
Jan. 1	To	Balance b/d	1,50,000	Feb. 28	By	Bank	1,50,000

Debenture Interest Account

2022			₹	2022			₹
Feb. 28	To	Bank (10,000 x 100 x 6% x 2/12)	10,000	Feb. 28	By	Profit & Loss A/c	10,000

Bank A/c

2022			₹	2022			₹
Jan 01	To	Balance b/d	9,00,000	Feb. 28	By	Debenture-holders (10,000 x 101)	10,10,000
Feb 28	To	Interest on Debentures Redemption Investments (1,50,000 x 4% x 2/12)	1,000				
	To	Debentures Redemption Reserve investment A/c	1,50,000		By	Debenture Interest A/c	10,000
			10,51,000		By	Balance c/d	31,000
							10,51,000

Debenture Redemption Reserve Account

2022			₹	2022			₹
Feb 28	To	General Reserve-note	1,00,000	Jan.1	By	Balance b/d	50,000
			_____	Jan.1	By	Profit & Loss (b/f)	<u>50,000</u>
			1,00,000				1,00,000

Note

Amount to be transferred to DRR before the redemption = ₹ 1,00,000 [i.e. 10% of (10,000 X 100)].

ILLUSTRATION 2

The following balances appeared in the books of Paradise Ltd (unlisted company other than AIFI, Banking company, NBFC and HFC) as on 1-4-2021:

- (i) 12 % Debentures ₹ 7,50,000
- (ii) Balance of DRR ₹ 25,000

(iii) DRR Investment 1,12,500 represented by 10% ₹ 1,125 Secured Bonds of the Government of India of ₹ 100 each.

Annual contribution to the DRR was made on 31st March every year. On 31-3-2022, balance at bank was ₹ 7,50,000 before receipt of interest. The investment were realised at par for redemption of debentures at a premium of 10% on the above date.

You are required to prepare the following accounts for the year ended 31st March, 2022:

- (1) Debentures Account
- (2) DRR Account
- (3) DRR Investment Account
- (4) Bank Account
- (5) Debenture Holders Account.

SOLUTION

1. 12% Debentures Account

Date	Particulars	₹	Date	Particulars	₹
31 st March, 2022	To Debenture holders A/c	7,50,000	1 st April, 2021	By Balance b/d	7,50,000
		7,50,000			7,50,000

2. DRR Account

Date	Particulars	₹	Date	Particulars	₹
31 st March, 2022	To General reserve A/c (Refer Note)	75,000	1 st April, 2021	By Balance b/d	25,000
		75,000	1 st April, 2021	By Profit and loss A/c (Refer Note)	50,000
					75,000

3. 10% Secured Bonds of Govt. (DRR Investment) A/c

		₹			₹
1 st April, 2021	To Balance b/d	1,12,500	31 st March, 2022	By Bank A/c	1,12,500
		1,12,500			1,12,500

4. Bank A/c

		₹			₹
31 st March, 2022	To Balance b/d	7,50,000	31 st March, 2022	By Debenture holders A/c	8,25,000
	To Interest on DRR Investment (1,12,500 x 10%)	11,250			

	To DRR Investment A/c	1,12,500		By Balance c/d	48,750
		8,73,750			8,73,750

5. Debenture holders A/c

		₹			₹
31 st March, 2022	To Bank A/c	8,25,000	31 st March, 2022	By 12% Debentures	7,50,000
				By Premium on redemption of debentures (7,50,000 X 10%)	75,000
		8,25,000			8,25,000

Note –

Calculation of DRR before redemption = 10% of ₹ 7,50,000 = 75,000

Available balance = ₹ 25,000

DRR required = 75,000 – 25,000 = ₹ 50,000.

ILLUSTRATION 3

XYZ Ltd. has issued 1,000, 12% convertible debentures ₹100 each redeemable after a period of five years. According to the terms & conditions of the issue, these debentures were redeemable at a premium of 5%. The debenture holders also had the option at the time of redemption to convert 20% of their holdings into equity shares of ₹ 10 each at a price of ₹ 20 per share and balance in cash. Debenture holders amounting ₹ 20,000 opted to get their debentures converted into equity shares as per terms of the issue. You are required to calculate the number of shares issued and cash paid for redemption of ₹ 20,000 debenture holders.

SOLUTION

	Number of debentures
Debenture holders opted for conversion (20,000 /100)	<u>200</u>
Option for conversion	20%
Number of debentures to be converted (20% of 200)	40
Redemption value of 40 debentures at a premium of 5% [40 x (100+5)]	₹ 4,200
Equity shares of ₹ 10 each issued on conversion [₹ 4,200/ ₹ 20]	210 shares

Calculation of cash to be paid :	₹
Number of debentures	200
Less: number of debentures to be converted into equity shares	<u>(40)</u>
	<u>160</u>

Redemption value of 160 debentures (160 × ₹ 105) ie. ₹ 16,800.

ILLUSTRATION 4

The Balance Sheet of BEE Co. Ltd. (unlisted company other than AIFI, Banking company, NBFC and HFC) as at 31st March, 2021 is as under:

Particulars	Note No	₹
I. Equity and liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	2,00,000
(b) Reserves and Surplus	2	1,20,000
(2) Non-current liabilities		
(a) Long term borrowings	3	1,20,000
(3) Current Liabilities		
(a) Trade payables		1,15,000
Total		5,55,000
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	4	1,15,000
(2) Current assets		
(a) Inventories		1,35,000
(b) Trade receivables		75,000
(c) Cash and bank balances	5	2,30,000
Total		5,55,000

Notes to Accounts

			₹
1. Share Capital			
Authorised share capital			
30,000 shares of ₹ 10 each fully paid			<u>3,00,000</u>
Issued and subscribed share capital			
20,000 shares of ₹ 10 each fully paid			<u>2,00,000</u>
2. Reserve and Surplus			
Profit & Loss Account			1,20,000
3. Long term borrowings			
12% Debentures			1,20,000
4. Property, Plant and Equipment			
Freehold property			1,15,000
5. Cash and bank balances			
Cash at bank	2,00,000		
Cash in hand	<u>30,000</u>		2,30,000

At the Annual General Meeting, it was resolved:

- To give existing shareholders the option to purchase one ₹ 10 share at ₹ 15 for every four shares (held prior to the bonus distribution). This option was taken up by all the shareholders.
- To issue one bonus share for every five shares held.
- To repay the debentures at a premium of 3%. The DRR Investments realised at par as per existing Book value.

Give the necessary journal entries for these transactions.

SOLUTION**Journal of BEE Co. Ltd.**

		Dr. ₹	Cr. ₹
Bank A/c	Dr.	75,000	
To Equity Shareholders A/c			75,000
(Application money received on 5,000 shares @ ₹ 15 per share to be issued as rights shares in the ratio of 1:4)			

Equity Share Shareholders A/c To Equity Share Capital A/c To Securities Premium A/c (Share application money on 5,000 shares @ ₹ 10 per share transferred to Share Capital Account, and ₹ 5 per share to Securities Premium Account vide Board's Resolution dated...)	Dr.	75,000	
			50,000
			25,000
Securities Premium A/c Profit & Loss A/c To Bonus to Shareholders A/c (Amount transferred for issue of bonus shares to existing shareholders in the ratio of 1:5 vide General Body's resolution dated...)	Dr. Dr.	25,000 25,000	
			50,000
Bonus to Shareholders A/c To Equity Share Capital A/c (Issue of bonus shares in the ratio of 1 for 5 vide Board's resolution dated...)	Dr.	50,000	
			50,000
Profit and Loss A/c To Debenture Redemption Reserve (for DRR created 10% x 1,20,000)	Dr.	12,000	
			12,000
Debenture Redemption Reserve Investment A/c To Bank A/c (for DRR Investment created 15% x 1,20,000)	Dr.	18,000	
			18,000
12% Debentures A/c Premium Payable on Redemption A/c @ 3% To Debenture holders A/c (Amount payable to debentures holders)	Dr. Dr.	1,20,000 3,600	
			1,23,600
Profit and loss A/c To Premium Payable on Redemption A/c (Premium payable on redemption of debentures charged to Profit & Loss A/c)	Dr.	3,600*	
			3,600
Debenture Redemption Reserve A/c To General Reserve (for DRR transferred to general reserve)	Dr.	12,000	
			12,000
Bank A/c	Dr.	18,000	

To Debenture Redemption Reserve Investment (for DRR Investment realised)		18,000
Debenture holders A/c	Dr.	1,23,600
To Bank A/c (Amount paid to debenture holders on redemption)		1,23,600

* In the absence of details of the term of debentures (redemption period), the entire redemption premium was charged to profit & loss A/c of the year.

SUMMARY

- Debentures may create a charge against some or all the assets of the company.
- Charge may be fixed or floating, depends upon the condition of issue.
- Debentures may be redeemed after a fixed number of years or after a certain period has elapsed.
- For redemption of debentures, certain companies are required to create Debenture Redemption Reserve.
- Methods of redemption: lumpsum payment and payment in instalments.

TEST YOUR KNOWLEDGE

True and False

1. Amounts credited to the debenture redemption reserve may be utilised by the company for any 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).
3. Under payment in instalments method, the payment of entire debenture is made in one lot.
4. At redemption of debentures, DRR should be transferred to general reserve.

Multiple Choice Questions

1. Which of the following statements is true?
 - (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.
2. Which of the following statements is false?
- (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.
3. For debentures issued by unlisted companies (other than AIFs, Banking companies, NBFCs and HFCs), Debentures Redemption reserve will be considered adequate if it is:
- (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.
4. 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
- (a) Profit of ₹600.
- (b) Profit of ₹400.
- (c) Loss of ₹400

Theoretical Questions

1. What is meant by redemption of debentures? Explain.
2. Write short note on Debenture Redemption Reserve.

Practical Questions

1. A company had issued 20,000, 13% debentures of ₹ 100 each on 1st April, 2021. The debentures are due for redemption on 1st July, 2022. The terms of issue of debentures provided that they were redeemable at a premium of 5% and also conferred option to the debenture holders to convert 20% of their holding into equity shares (Nominal value ₹ 10) at a price of ₹ 15 per share. Debenture holders holding 2,500 debentures did not exercise the option. Calculate the number of equity shares to be allotted to the debenture holders exercising the option to the maximum.

2. *Libra Limited (a listed company) recently made a public issue in respect of which the following information is available:*

- (a) *No. of partly convertible debentures issued- 2,00,000; face value and issue price- ₹ 100 per debenture.*
- (b) *Convertible portion per debenture- 60%, date of conversion- on expiry of 6 months from the date of closing of issue.*
- (c) *Date of closure of subscription lists- 1.5.2021, date of allotment- 1.6.2021, rate of interest on debenture- 15% payable from the date of allotment, value of equity share for the purpose of conversion- ₹ 60 (Face Value ₹ 10).*
- (d) *No. of debentures applied for- 2,00,000.*
- (e) *Interest payable on debentures half-yearly on 30th September and 31st March.*

Write relevant journal entries for all transactions arising out of the above during the year ended 31st March, 2022 (including cash and bank entries).

3. *Case Ltd. (unlisted company other than AIFI, Banking company, NBFC and HFC) provides the following information as at 31st March, 2022:*

Particulars	₹
Shareholder's Funds	
(a) <i>Share Capital</i>	
<i>Authorized share capital:</i>	
<i>45,000 equity shares of ₹ 10 each fully paid</i>	4,50,000
<i>Issued and subscribed share capital:</i>	
<i>30,000 equity shares of ₹ 10 each fully paid</i>	3,00,000
(b) <i>Reserves and Surplus</i>	
<i>Profit & Loss Account</i>	1,62,000
<i>Debenture Redemption Reserve</i>	18,000
Non-current liabilities	
(a) <i>Long term borrowings</i>	
<i>12% Debentures</i>	1,80,000
Current Liabilities	
(a) <i>Trade payables</i>	1,72,500

Non-current assets	
(a) Property, Plant and Equipment (Freehold property)	1,72,500
(b) Non-current Investment: DRR Investment	27,000
Current assets	
(a) Inventories	2,02,500
(b) Trade receivables	1,12,500
(c) Cash and bank balances:	
Cash at bank	2,73,000
Cash in hand	45,000

At the Annual General Meeting on 1.4.2022, it was resolved:

- (a) To give existing shareholders the option to purchase one ₹ 10 share at ₹ 15 for every four shares (held prior to the bonus distribution). This option was taken up by all the shareholders.
- (b) To issue one bonus share for every five shares held.
- (c) To repay the debentures at a premium of 3%. The DRR Investments realised at par as per existing Book value.

Give the necessary journal entries for these transactions.

ANSWERS/ HINTS

True and False

1. False: Amounts credited to the debenture redemption reserve should not be utilised by the company for any purpose except for the purpose other than for redemption of debentures.
2. True: 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 DRR.
3. False: under payment in instalments method, the payment of specified portion of debentures are made in instalments at specified intervals.
4. True: DRR is transferred to general reserve at the time of redemption of debentures.

Multiple Choice Questions

1.	(c)	2.	(b)	3.	(b)	4.	(b)				
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Theoretical Questions

1. Debentures are usually redeemable i.e. either redeemed in cash or convertible after a time period.

Redeemable debentures may be **redeemed**:

- after a **fixed number** of years; or
- any time after a **certain number of years** has elapsed since their issue; or
- on giving a **specified notice**; or
- by **annual drawing**.

For details, refer para 6.2 of the chapter.

2. A company issuing debentures may be required to create a debenture redemption reserve account out of the profits available for distribution of dividend and amounts credited to such account cannot be utilised by the company except for redemption of debentures. Such an arrangement would ensure that the company will have sufficient liquid funds for the redemption of debentures at the time they fall due for payment. For details, refer para 6.3.

Practical Questions

1. **Calculation of number of equity shares to be allotted**

	Number of debentures
Total number of debentures	20,000
<i>Less:</i> Debenture holders not opted for conversion	<u>(2,500)</u>
Debenture holders opted for conversion	<u>17,500</u>
Option for conversion	20%
Number of debentures to be converted (20% of 17,500)	3,500
Redemption value of 3,500 debentures at a premium of 5% [3,500 x (100+5)]	₹ 3,67,500
Equity shares of ₹ 10 each issued on conversion [₹ 3,67,500/ ₹ 15]	24,500 shares

2.

Journal Entries in the books of Libra Ltd.

Journal Entries

Date	Particulars	Amount ₹ Dr.	Amount ₹ Cr.
1.5.2021	Bank A/c Dr. To Debenture Application A/c (Application money received on 2,00,000 debentures @ ₹ 100 each)	2,00,00,000	2,00,00,000
1.6.2021	Debenture Application A/c Dr. To 15% Debentures A/c (Allotment of 2,00,000 debentures to applicants)	2,00,00,000	2,00,00,000
1.6.2021	Debenture Redemption Investment A/ Dr. To Bank A/c (2,00,000 X 100 x 15% X 40%) (Being Investments made for redemption purpose)	12,00,000	12,00,000
30.9.2021	Debenture Interest A/c Dr. To Bank A/c (Interest paid on debentures for 4 months @ 15% on ₹ 2,00,00,000)	10,00,000	10,00,000
31.10.2021	15% Debentures A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (Conversion of 60% of debentures into shares of ₹ 60 each with a face value of ₹ 10)	1,20,00,000	20,00,000 1,00,00,000
31.3.2022	Debenture Interest A/c Dr. To Bank A/c (Interest paid on debentures for the half year) (Refer working note)	7,50,000	7,50,000

Working Note:

Calculation of Debenture Interest for the half year ended 31st March, 2022

On ₹ 80,00,000 for 6 months @ 15% = ₹ 6,00,000

On ₹ 1,20,00,000 for 1 months @ 15% = ₹ 1,50,000

₹7,50,000

3. Journal Entries in the Books of Case Ltd.

		Dr.₹	Cr.₹
Bank A/c	Dr.	1,12,500	
To Equity Shareholders A/c			1,12,500
(Application money received on 7,500 shares @ ₹ 15 per share to be issued as rights shares in the ratio of 1:4)			
Equity Shareholders A/c	Dr.	1,12,500	
To Equity Share Capital A/c			75,000
To Securities Premium A/c			37,500
(Share application money on 7,500 shares @ ₹ 10 per share transferred to Share Capital Account, and ₹ 5 per share to Securities Premium Account vide Board's Resolution dated...)			
Securities Premium A/c	Dr.	37,500	
Profit & Loss A/c	Dr.	37,500	
To Bonus to Shareholders A/c			75,000
(Amount transferred for issue of bonus shares to existing shareholders in the ratio of 1:5 vide General Body's resolution dated...)			
Bonus to Shareholders A/c	Dr.	75,000	
To Equity Share Capital A/c			75,000
(Issue of bonus shares in the ratio of 1 for 5 vide Board's resolution dated...)			
12% Debentures A/c	Dr.	1,80,000	
Premium Payable on Redemption A/c (@ 3%)	Dr.	5,400	
To Debenture holders A/c			1,85,400

(Amount payable to debentures holders)			
Profit and loss A/c	Dr.	5,400*	
To Premium Payable on Redemption A/c			5,400
(Premium payable on redemption of debentures charged to Profit & Loss A/c)			
Debenture Redemption Reserve A/c	Dr.	18,000	
To General Reserve			18,000
(For DRR transferred to general reserve)			
Bank A/c	Dr.	27,000	
To Debenture Redemption Reserve Investment			27,000
(for DRR Investment realised)			
Debenture holders A/c	Dr.	1,85,400	
To Bank A/c			1,85,400
(Amount paid to debenture holders on redemption)			

* In the absence of details of the term of debentures (redemption period), the entire redemption premium was charged to profit & loss A/c of the year.