ଓଡ଼ିଶା ରାଜ୍ୟ ମୁକ୍ତ ବିଶ୍ୱବିଦ୍ୟାଳୟ, ସମ୍ବଲପୁର, ଓଡ଼ିଶା
Odisha State Open University, Sambalpur, Odisha
Established by an Act of Government of Odisha.

Diploma in Accounting (DIA)

DIA-5

Company Account

Block

1

UNIT –I: Company - An Introduction

UNIT-II : Issue of Shares

UNIT-II : Forfeiture of Shares

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UNIT-I: COMPANY: AN INTRODUCTION

Learning objectives:

After studying this lesson, you will be able to know:

Meaning of company, its salient features, Nature of company, Kinds of companies, Advantages and Disadvantages of company formation, Promotion, incorporation, capital subscription and commencement of companies its difference with partnership, difference between private limited and public limited company.

Structure:

1.1 Introduction

1.2 Meaning and definition of company,

1.3 Nature and characteristics of company.

3.4 Kinds of companies

1.5 Promotion, incorporation, capital subscription and commencement of companies

1.6 Advantages and Disadvantages of company formation.

1.7 Difference between company and partnership

1.8 Difference between private limited and public limited company

1.1 Introduction:

The evolution of a new form of business organization like the company was a historical necessity, because of the limitation of capital, liability, managerial skill and others of the sole proprietorship and partnership could not meet the growing demand of current scenario. The joint stock companies first evolved into private limited companies and latter n public limited companies comes out at the middle.

1.2 Meaning & definition of company:

The word company is derived from the Latin word which referred to an association of person who took their bread together. In other word “Company” implied a group of people who ate together. In general company means an association of persons formed for the economic gain of its partners. In the legal sense, a company is an association

of both natural and artificial persons and it is incorporated under the existing law of a company.

Definition of company:

A company may be defined as an artificial legal person having an independent legal entity with a common seal, limited liability, transferable shares and perpetual succession.

According to section 3(1) of the companies act 1956, a company means, "A company formed and registered under this act or an existing company.

According to section2(20) of the companies act 2013, "A company means a company incorporated under this act or under any previous company law."

1.3 Nature and characteristics of a company:

A company is an artificial judicial person, it empowered by the memorandum of association which is the charter of the company. Within this power a company can do all acts as a human being can do.

1. Voluntary association: A company is a voluntary association of persons, i.e. there is no compulsion to become its member nor to give up its membership.

2. Incorporated association: A company has to be incorporated or registered under the companies act. Minimum number of members required to form a public company is seven two in case of a private company and one for "One person company".

3. Artificial person: Registration gives the birth of a company. It does not take birth like natural person but enjoy all the rights of a natural person. Being an artificial person, it has to depend up on natural person to sue others or sued by others.

4. Company seal: A common seal of a company is of great importance. It acts as the official signature of the company. Any document bearing the common seal of the company and signed by two directors, legally binds the company.

5. Limited liability: A share holder's liability is limited to the amount unpaid on the shares, irrespective of losses of the organization. In case of shares limited by guarantee, share holders are liable to pay the guaranteed amount at the time of winding up.

6. Termination of existence: Being an artificial person, it does not die like a natural person. The existence of a company is terminated only on winding up.

7. Separate property: Being a legal person, it is capable of owning , and disposing of property in its own name.

8. Transferability of shares: The shares of the company are transferable. Public company has no restriction on transfer of shares. Transfer of share in private company is restricted by its articles.

1.4 Kinds of companies

The kinds of companies that can be promoted and registered under the companies act 2013, are as under.

1. On the basis of incorporation:

a. Chartered company: It is created by the charter or special sanction granted by the head of the state giving certain rights to a body of persons for undertaking commercial activities in specified areas. Ex- East India company

b. Statutory company: Statutory company come into existence under the at passed by the legislature of the country or state to run the enterprises of social or natural importance.

Ex- Indian rail

c. Registered companies: Company which is registered with the registrar of the companies under the provisions of the companies act of the country is called register companies.

Ex- all the public companies

2. On the basis of liability

a. Companies limited by shares: Where the liability of the share holder is limited to the amount unpaid on the shares held by them. Such companies are very common in India.

b. Companies limited by guaranty: where the liability of the share holder is limited to an amount, the share holders undertake to contribute to the asset of the company on the event of its winding up.

c. Unlimited company: Where the liability of the share holder is not limited by their unpaid amount or assured contributions. Share holder of the company is liable for dues in proportion to their interest in the company.

3. On the basis of number of share holder and transferability of shares:

a. Private company: A private company is a company which has a minimum paid up capital of Rs. 1lakh or higher as prescribed by the law and

(1) Which restricts the right to transfer the shares.

(2) Limits the number of share holder to 50.

(3) Prohibits invitation to the public to subscribe for shares.

(4) Prohibits acceptance of deposits from public.

b. Public company: A public company means a company which:

(1) is not a private company.

(2) Has a minimum paid up capital of Rs. 5lakhs.

c. One person company: One person company is a one share holder corporate entity, where legal and financial liability is limited to the company only. Which is the implementation of the companies act, 2013, a single person can constitute a company.

4. On the basis of ownership:

a. Holding company: Company which controls the management of another company is called holding company.

b. Subsidiary company: The company in which the holding company controls the composition of the board of directors. Exercise or control more than fifty percent of the total share capital.

c. Government companies: Government company may be defined as any company in which not less than fifty one percent of the paid up share capital is held by the central government or by any state government or both.

d. Associate company: Associate company means a company in which other company has a control of at least twenty percent of total share capital or of business decisions but not a subsidiary company.

5. On the basis of nationality:

a. Inland company: An inland company is one that is incorporated in India and is operating under the provisions of the Act. But some companies are governed by a separate Act for control and management. Ex- Banking, insurance companies etc.

b. Foreign company: Foreign company means any company or body corporate incorporated outside India which,

(1) Has a business in India whether by itself or through an agent, physically or virtually, and

(2) Conducts any business in India in any other manner.

6. On the basis of business activities:

a. Manufacturing companies: Company mainly engaged in any type of manufacturing activities, although they have other business are primarily engaged as manufacturing activities.

b. Service companies: Company mainly engaged in any type of service activities are termed as service companies. Such as communication, transport, consultancy etc.

c. Finance companies: It is a non-banking institution which carries on business like making loan or advances, acquisition of shares, bond, carrying on life or general insurance etc.

d. Charitable companies: Companies engaged to protect and promote the interest of commerce, art, science, sports, education for the betterment of the society.

1.5 Formation of company:

A joint stock company is said to be formed when it is incorporated or registered under the companies Act. The whole process of company formation may be divided into the following four stages.

1. Promotion stage

2. Incorporation stage

3. Capital subscription stage

4. Commencement business

Promotion:

Meaning of promotion: promotion is the first stage in the formation of a company. It implies the discovery of a business idea, implementation of idea, and arrangement of capital with infrastructure and meet the requirement of the law to materialise the idea to business.

According to Guthmann and Dougall, “Promotion starts with the conception of the idea from which the business is to evolve and continues down to the point at which the business is full, read up to begin operations in a going concern.”

Stages of promotion:

1. Discovery of idea: Business opportunities begin with the new idea. Idea first gives the light to take the advantage of the up tapped opportunity. When an entrepreneur or promoter understands that there is an opportunity to get some handsome return, the idea is said to have been conceived. Idea may be to start a business, supply the product or raw material for finished goods and to expand or combine the existing business.

2. Preliminary investigation: Preliminary investigation constitutes the second important stage of company promotion. At this stage the soundness of the business is studied by the promoter. The soundness of the venture is studied by ascertaining the hidden weakness of the plan and also finding whether the venture is suitable for the consumer or not. The promoter makes a rough estimate about the cost of the project, estimated sales and estimated income resulting from the venture. The viability and profitability of the project is accounted for while making preliminary investigation at promotion stage.

3. Detailed Investigation: The first and second stage of promotion has given a wide range of encouragement to the promoter and he got inspired at this stage. After preliminary investigation, the promoter goes for detailed investigation of his ideas with the help of different experts like engineer, chemist, financial experts and market analysis experts. Detailed investigation gives a good picture regarding the soundness of the project because at this stage the promoter is in a better position to know the capital requirement, place of location, size of the unit, demand for the product in the market and the probable prices of the product. The knowledge about the various branches is obtained from the experts.

4. Assembling: When all the parameters of starting a company are found favorable at detailed investigation stage, the promoter goes for giving a concrete shape to the business. At detailed investigation stage, the promoter is satisfied regarding the practicability and profitability of the proposed venture. After being satisfied he proceeds for the next stage called assembling which means getting the support and consent of some other persons to act as directors or founders arranging suitable site for the company and arrangement for patents. At this stage all the steps for setting up a company is accounted for. The promoter also enters into contract with the government and other agencies for necessary clearance and license of the business.

2. Registration of a Company:

It is registration that brings a company into existence. A company is properly formed only when it is duly registered under the Companies Act.

Procedure of Registration:

In order to get the company registered, the important documents required to be filed with the Registrar of Companies are as follows.

1. Memorandum of Association: It is to be signed by a minimum of 7 persons for a public company and by in case of a pvt company. It must be properly stamped.

2. Articles of Association: This document is signed by all those persons who have signed the Memorandum of Association.

3. List of Directors: A list of directors with their names, address and occupation is to be prepared and filed with the Registrar of Companies.

4. Written consent of the Directors: A written consent of the directors that they have agreed to act as directors has to be filed with the Registrar along with a written undertaking to the effect that they will take qualification shares and will pay for them.

5. Notice of the Address of the Registered Office: It is also customary to file the notice of the address of the company's registered office at the time of incorporation. It is to be given within 30 days after the date of incorporation.

6. Statutory Declaration: A statutory declaration by

a. any advocate of the Supreme Court or

b. of a High Court, or

c. an attorney or pleader entitled to appear before a High Court or

d. a practicing chartered accountant in India, who engages in the Company formation or

e. by a person indicated in the articles as director, managing director, Secretary or manager of the company, mentioning that the requisites of the Act and the rules there under have been complied with. It is to be filed with the Registrar of Companies.

When the required documents have been filed with the Registrar along with the prescribed fee, the Registrar scrutinizes the documents. If the Registrar is satisfied, the name of the company is entered in the register. Then the Registrar issues a certificate known as Certificate of Incorporation.

3. Certificate of Incorporation

On the registration of Memorandum of Association, Articles of Association and other documents, the Registrar will issue a certificate known as the 'Certificate of Incorporation'. The issue of certificate is the evidence of the fact that the company is incorporated and the requirements of the Companies Act have been complied with.

4. Certificate of Commencement of Business

As soon as a private company gets the certification of incorporation, it can commence its business. A public company can commence its business only after getting the 'certificate of commencement of businesses. After the company gets the certificate of incorporation, a public company issues a prospectus for inviting the public to subscribe to its share capital. It fixes the minimum subscription. Then it is required to sell the minimum number of shares mentioned in the prospectus. After completing the sale of the required number of shares, a certificate is sent to the Registrar along with a letter from the bank stating that all the money is received. The Registrar then scrutinizes the documents. If he is satisfied he issues a certificate known as 'Certificate of Commencement of Business'. This is the conclusive evidence for the Commencement of Business.

1.6 Advantages of Company form of Organisation:

The company form of organisation has been successful in almost all countries of the world. This form is suitable where large resources are required and the production has to be carried out on a large scale. The number of joint stock companies has shown a phenomenal increase in the twentieth century.

Some of the merits of company form of organization are discussed below:

1. Accumulation of Large Resources: The main drawback of the sole trade and partnership concerns has been the scarcity of resources. The resources of a sole trader and of partners being limited, these enterprises have always suffered for want of funds. A company can collect large sum of money from large number of shareholders. There is no limit on the number of shareholders in a public company. If need for more funds arises, the number of shareholders can be increased. Joint stock companies are suitable for those businesses where large resources are required.

2. Limited Liability: The liability of members in a company form of organisation is limited to the nominal value of the shares they have acquired. If a person has purchased a share of Rs. 100, his liability is limited to Rs. 100 only. If the share is partly paid, then he can be required to pay only the unpaid value of the share. In no case the total payment will exceed Rs. 100. The limited liability encourages many

persons to invest in shares of joint stock companies. Many persons will be reluctant to invest in those enterprises where liability is unlimited.

3. Continuity of Existence: When a company is incorporated, it becomes a separate legal entity. It is an entity with perpetual succession. The members of a company may go on changing from time to time but that does not affect the continuity of a company. The death or insolvency of members does not in any way affect the corporate existence of the company. The continuity of a company is not only in the interests of the members but is also beneficial for the society. The discontinuation of a company may cause wastage of resources and inconvenience to the consumers.

4. Efficient Management: In company form of organisation, ownership is separate from management. It enables the company to appoint expert and qualified persons for managing various business functions. The availability of large-scale resources enables the company to attract talented persons by offering them higher salaries and better career opportunities. The efficient management will help the company to expand and diversify its activities.

5. Economies of Large Scale Production: With the availability of large resources, the company can organise production on a big scale. The increase in scale and size of the business will result in economies in production, purchase, marketing and management, etc. These economies will enable the company to produce goods at a lower cost, thus resulting in more profits. The company will help consumers by providing them with cheaper goods and will also be able to accumulate more resources for further expansion.

6. Transferability of Shares: The shares of a public company are freely transferable. A shareholder can dispose of his shares at any time when the market conditions are favourable or he is in need of money. The company does not return share-money before its winding up but shareholders can easily sell their shares through stock exchange markets.

Stock Exchange provides a ready market for the purchase and sale of shares. The facility of transferring shares encourages many persons to invest. This provides liquidity to the investor and stability to the company. On the other hand, partnership form of organisation does not provide free transferability of shares.

7. Ability to Cope with Changing Business Environments: The present business enterprises operate under uncertain economic and technological environments. Technological changes are taking place every day. The needs of consumers are varied and changing, to cope with the changing economic environment every business is required to invest money on research and developmental programmes. Sole trade concern or partnership firms cannot afford to spend money on research work. Joint

stock companies can afford to invest money on research projects. It will enable them to cope with changing business conditions.

8. Diffused Risk: In sole trade and in partnership business, the risk is shared by a small number of persons. Further uncertainties discourage them from taking up new ventures for fear of risk. In company form of organisation, the number of contributories is large; so risk is shared by a large number of persons. The burden to be shared by different individuals becomes insignificant. It enables companies to take up new ventures.

9. Democratic Set-up: The values of shares are generally small. It enables persons with low incomes to purchase the shares of companies. Shareholders come from all walks of life. Every individual has an opportunity to become a shareholder. Secondly, the Board of Directors is elected by the members. So members have a say in deciding the policies of the company. The company form of organisation is democratic both from ownership and management side.

10. Social Benefits: The company form of organisation mobilises scattered savings of the community. These savings can be better used for productive purposes. The companies also enable financial institutions to invest their money by providing them avenues. It also enables the utilisation of natural resources for better productive uses. Large-scale production enjoys a number of economies enabling low cost of production. The society is supplied with enough quantity of goods.

11 Perpetual Existences: Deaths, insanity, insolvency of shareholders or directors do not affect the company's existence. A company has a separate legal entity with perpetual succession.

12. Expansion Potential: As there is no limit to the maximum number of shareholders in a public limited company, expansion of business is easy by issuing new shares and debentures. Companies normally use their reserves for expansion purposes.

Disadvantages of Company Form of Organisation:

The company form of organisation suffers from the following drawbacks:

1. Difficulty of Formation: Promotion of a company is not an easy task. A number of stages are involved in company promotion. The suitability of a particular type of business is to be decided first. A number of persons should be ready to associate for getting a company incorporated. A lot of legal formalities are required to be performed at the time of registration. The shares will have to be sold during the particular time. Promotion of a company is both expensive and risky.

2. Separation of Ownership and Management: The ownership and management of public company is in different hands. The owners i.e., shareholders play an insignificant role in the working of the company. On the other hand, control is in the hands of those who have no stakes in the company. The management may indulge in speculative business activities. There is no direct relationship between efforts and rewards. The profits of the company belong to shareholders and the Board of Directors are paid only a commission. The management does not take personal interest in the working of the company as is the case in partnership and sole-trade business.

3. Evils of Factory System: The company form of organisation leads to large-scale production. The evils of factory system like insanitation, air pollution, congestion of cities are attributed to joint stock companies. Joint stock companies facilitate formation of business combinations which ultimately leads to the monopolistic control and exploitation of consumers.

4. Speculation in Shares: The joint stock companies facilitate speculation in the shares at stock exchanges. The prices of shares depend upon both economic and non-economic factors. The speculators try to fluctuate the prices of shares according to their suitability. The stock exchanges will not help the growth of healthy investment when speculative activities are being carried on. The management of joint stock companies also sometimes encourage speculation in shares for their personal gains.

5. Fraudulent Management: The promoters and directors may indulge in fraudulent practices. The management is in the hands of those persons who have not invested much in the company. The Company Law has devised methods to check fraudulent practices but they have not proved enough to check them completely.

6. Lack of Secrecy: The management of companies remains in the hands of many persons. Everything is discussed in the meetings of Board of Directors. The trade secrets cannot be maintained. In case of sole trade and partnership concerns such secrecy is possible because a few persons are involved in management.

7. Delay in Decision-making: In company form of organization no single individual can make a policy decision. All important decisions are taken either by the Board of Directors or are referred to general house. Decision-taking process is time consuming. If some business opportunity arises and a quick decision is needed, it will not be possible to arrange meetings all of a sudden. So many opportunities may be lost because of a delay in decision-making.

8. Concentration of Economic Power: The company form of organization has helped concentration of economic power in a few hands. Some persons become directors in a number of companies and try to formulate policies which promote their own interests.

The shares of a number of companies are purchased to create subsidiary companies. Interlocking of direction-ship and establishment of subsidiary companies have facilitated concentration of economic power in the hands of a few business houses.

9. Excessive State Regulations: A large number of rules and regulations are framed for the working of the companies. The companies will have to follow rules even for their internal working. The government tries to regulate the working of the companies because large public money is involved. The formalities are many and the penalties for their non-compliance are heavy. This often detracts companies from their main objectives for which they have been formed.

10. Restrictions: Compared to proprietorship and partnership, a company has to comply with more legal requirements. It consumes considerable time and effort.

11. Management Mischief's: Sometimes the managers and directors misuse the company resources for their personal benefits. This brings losses to the company and company is closed.

12. Lack of Personal Interest: Unlike proprietorship and partnership, the day-to-day affairs of a company are looked after by salaried managers. Since they are the employees not the owners, they do have hardly any personal interest and commitment in the company. This may result in inefficiency and, in turn, losses.

1.7 Difference between Partnership Firm and Company:

1. A partnership is an agreement between two or more persons who come together to carry out a business, and share profit & losses mutually. A company is an incorporated association, also called an artificial person having separate identity, common seal and perpetual succession.

2. The registration of the partnership firm is not compulsory whereas to form a company; it needs to be registered.

3. For the creation of a partnership, there must be at least two partners. For the formation of a company, there must be at least 2 members in case of private companies and 7 in regard to public companies.

4. The limit for the maximum number of partners in a partnership firm is 100. On the other hand, the maximum number of partners in case of a public company is unlimited and in the case of a private company that limit is 50.

5. The next major difference between them is, there is no minimum capital requirement for starting a partnership firm. Conversely, the minimum capital requirement for a public company is 5 lakhs and for a private company it is 1 lakh.

6. In the event of dissolution of the partnership firm, there are no legal formalities. In opposition to this, a company has many legal formalities for winding up.

7. A partnership firm can be dissolved by any one of the partners. In contrast to this, the company cannot be wound up, by any one of the members.

8. A partnership firm is not bound to use the word limited or private limited at the end of its name while a company has to add the word 'limited' if it is a public company and 'private limited' if it is a private company.

9. The liability of the partners is unlimited whereas the liability of the company is limited to the extent of shares held by every member or guarantee given by them.

10. As a company is an artificial person so that it can enter into contracts in its own name, the members are not held liable for the acts of the company. But in the case of a partnership firm, a partner can enter into a contract in their own name with the mutual consent of the other partners, and they can also be sued for the acts done by the firm.

11. The accounts of a company should be audited by a qualified auditor. But in the case of a partnership, the accounts need not be audited. Even though the partners decide to arrange for the audit of their firm, the auditor need not be a qualified person. The powers, duties and liabilities of an auditor of a company are regulated by the Companies Act. But in the case of a partnership audit, the duties are governed by the provisions of the contract entered into by the partners with the auditor.

12. In case of a company, a shareholder is not regarded as its agent in dealing with third parties. But in case of a partnership, a partner is an agent of the firm and of all other partners in dealing with third parties.

13. Since they are more in number, most of the shareholders of the company may not know each other. We cannot expect that all the shareholders are just and honest to one another. But in the case of a partnership, the partners know each other thoroughly. The partnership agreement is based on utmost good faith. So the partners are to be just and honest to one another.

14. The management of a company is in the hands of a group of elected representatives of the shareholders. Even this group finds it difficult to administer the day-to-day affairs of the company. It is carried on mostly by salaried people. Such people cannot be expected to take active part in the management as the owners. But in the case of a partnership, the management is in the hands of the partners themselves.

They work in absolute sincerity. They can give personal attention to the customers and thus strengthen the customer-firm relationship.

15. In case of companies, taking decisions on important issues requires a fairly long time. But in case of a partnership firm, quick decisions are possible.

16. Joint stock company is the only business organization which is authorized to borrow money through the issue of debentures. A partnership firm cannot issue debentures.

17. The outsiders who deal with a company should be aware of the provisions of its Articles of Association. This is because, the restriction on directors affect the outsiders. But in case of a partnership, restriction on any partner does not affect the outsiders. So they need not be aware of the provisions of the partnership deed.

18. The companies have to file their documents, returns, reports, balance sheet, profit and loss account etc. with the Registrar. Some of them are open to public. So, there is no secrecy at all in case of companies. But in case of a partnership, the firm need not prepare and file such documents. So its secrets are not leaked out. Outsiders cannot know the in and outs of the firm. Even people with limited resources can become the shareholders of a big company. This tempts them to save something out of their income for future. This is a green signal for capital formation in the country. Such a capital formation is not possible in the case of a partnership

19. A company is regulated and controlled by the Companies Act. But a partnership firm is regulated by the Partnership Act, 1932.

20. A company should be compulsorily registered under the Companies Act. Its formation is very difficult. But registration of a partnership firm is not compulsory under the Partnership Act. The firm is based on the partnership deed. Its formation is very easy.

21. A company is a body corporate and a legal person having a corporate personality distinct from its members. The members are not liable for the acts of the company. But a partnership has no legal existence distinct from its members. Partners are liable for the acts of the firm.

22. Shares of a company are freely transferable unless restricted by the Articles. But a partner cannot transfer his share without the consent of all other partners.

3.8Difference between Private Ltd and Public Ltd Company

A ‘Company’ is an association of persons, incorporated under The Indian Companies Act, 2013 or any other previous act. There are some companies registered under this

act, some of them are public limited company while others are a private limited company. The difference between public and private company is given as under:

1. Minimum number of members: Private limited company 2, Public Company 7.

2. Maximum number of members: Private Ltd. Company 50, no restriction of maximum number of members in a Public Company.

3. Number of Directors: A Private Company may have 2 directors, whereas a Public Company must have at least 3 directors.

4. Special privileges : A Private Company enjoys some special privileges, which are not available to a Public Company.

5. Misapplication of pre-emptive rights: Unlike a private company, a public company may not exclude altogether the preferential rights conferred by law on its existing equity shareholders to subscribe for new shares or other equity securities and which it offers for subscription in cash: it may only dis-apply those provisions for a limited period.

6. Distribution of profits: unlike a private company, a public company is prohibited from making a distribution if its net assets are less than the aggregate in value of its called-up share capital and its un-distributable reserves. The distribution must not reduce the amount of those assets to less than that aggregate.

7. Company secretary: A private company does not have to appoint a company secretary, unless its Articles require it to do so. A public company must have a company secretary and it is the duty of the directors of a public company to take all reasonable steps.

8. Form and filing of accounts: A public company must submit its accounts to its members in a general meeting within 6 months of the end of its accounting period: a private company has up to 9 months. A small or medium-sized private company may be exempt from the obligation of having its accounts audited and may file abbreviated accounts.

9. Financial assistance: All companies are prohibited from giving financial assistance, either directly or indirectly, for the acquisition of their own shares. However, a private limited company is permitted to do so if a special resolution is passed following a statutory declaration of solvency by the directors and a report by the auditors.

10. Redemption or purchase of own shares out of capital: a private company may not only purchase its own shares or redeem any shares issued as redeemable shares out of

its distributable profits (as may a public company), but may also effect such a purchase or redemption by applying assets representing its capital and non-distributable reserves. A public company has to apply to the High Court if it wishes to reduce its share capital;

11. Disclosure of interests in shares: Persons entitled to interests in the shares of a private company carrying full voting rights need not disclose them to the company, and the company is not required to keep a register of such interests. A person who acquires an interest in the shares with voting rights in a public company may, in certain circumstances, come under an obligation to notify the company of his interest. A public company is required to keep a register of interests in its shares.

12. Sole director: A private company may have a sole director, whereas every public company[2] must have two directors.

13. Meetings and shareholder resolutions: A public company must hold an Annual General Meeting within 6 months of its financial year end. A private company does not need to hold an AGM unless its Articles require one.

14. Appointment of directors: Directors of a private company can be appointed at a general meeting by a composite resolution without further authorization. At a general meeting of a public company, a single resolution appointing two or more directors may not be moved unless agreed by the general meeting without any vote being given against it.

Sum up: A company is an "artificial person", invisible, intangible, created by or under law, with a discrete legal personality, perpetual succession, and a common seal It. is not affected by the death, insanity, or insolvency of an individual member.

Key words: Artificial person, voluntary association, chartered company, unlimited company, private company, public company, holding company, subsidiary company, government company, inland company, foreign company, chartered company.

Self Assessment Questions:

1 What do you mean by company? What are the characteristics of it?

2. Discuss the different kinds of company performing in India.

3. Describe the nature of Joint Stock Company.

4. State the different stages of formation of a company.

5. Highlights the advantages of Joint Stock Company.

6. Distinguish company from partnership

7. Differentiate private company from public company.

Model questions:

1. Describe the different stages of promotion of a company.

2. What do you mean by registration of company? What are the processes of registration of company?

3. What are the Disadvantages of company organization as compare to other organizations?

4. Distinguish between certificate of commencement and certificate of incorporation.

Further readings:

1. Modern Accountancy: Hanif and Mukherjee, volume –I, Tata Mcgrewhill.

2. Higher secondary Accounting: Biswal and Sharma.

3. Financial Accounting: P.C. Tulsian, Pearson.

4. An Introduction to Accountancy: S.N. Maheshwari, S.K. Maheshwari. Vikas.

UNIT-II : ISSUE OF SHARES

Learning objective:

After studying this lesson, you will be able to know: meaning of share, nature of share, kinds of share, meaning and classification of share capital. Definition, features, merits, demerits and kinds of equity and preference share. Difference between equity and preference share, methods of issue of share, sweat equity share, right share, bonus share, over subscription and under subscription, difference between reserve capital and capital reserve.

Structure:

2.1 Introduction:-

The dictionary meaning of share is part or unit but on the view of share capital of a company , it has special meaning . Total share capital of a company is divided into number of parts , each part is called a share , so a share is a fractional part of the total capital of a company . For example : If the total capital of a company is rs. 2,00,000 dividend upto 20,000 units of rs 10 each , each unit of rs 10 will be treated as a share.

2.2 Meaning and definitions:-

According to companies act 2013 , A share can be defined as " A share in the share capital of a company and includes stock expect where a distinction between stock and share is expressed or implied."

According to Lord Lind Ley, " The proportion of a capital to which , each member i entitled to his share ."

Thus a share is a fractional part of the share capital and forms the baris of ownership interest in a company. The persons who contribute money through shares are called hare holder.

2.3 Nature of shares:

Like goods shares can be bought, sold, hypothecated and bequeathed. the nature of shares can be summed up as under

1. Nominal Value : Each share must have its nominal value.

2. Equal denomination : All the shares in a company of same class are of equal denomination.

3. Right and interest : Every share holder of a company has certain right and interest. i.e. right to dividend , right to vote etc.

4. Number : Each share shall be distinguished by its appropriate number.

2.4 Kinds of shares:

Before the introduction of companies act a company limited by shares as allowed to issue three types of shares ,

a. Deferred shares

b. Equity Shares

c. Preference shares

But the companies act 1956 and 2013 provides that a company limited by shares can issue only equity and preference shares. However, an independent private company can still issue differed shares.

2.5 Meaning & Classification of share capital:

The amounts invested by the shareholders towards the face value of shares are collectively known as share capital. Every company should have his capital to finance activities.

Share capital of a company can be divided into following categories;

1. Authorised capital: This is the maximum limit of a company is authorised to rise, beyond which company can't raise unless the capital clause is altered.

2. Issued capital: This is the part of authorise capital which has been alter for cash, for consideration other than cash or a bonus share.

3. Subscribed capital: It is that potion of issued capital which has been subscribed by the public.

4. Called up: It is that portion of subscribed capital which the shareholder are asked to pay too the company.

5.Calledup Capital: The amount of capital which has been actually paid by the shareholder to the company.

6. Reserve Capital: A portion of uncalled capital which the company decided to retain in the funds of the shareholder liquidation.

1.6 Ordinary or Equity Share:

Equity shares mean those shares which do not enjoy any preferential right as payment of dividend and repayment of capital at the time of liquidation. After satisfying the rights of preference shares the equity shares shall be entitled t share in the residual amount of the distributable profit of the company.

Features of equity shares;

1. Voting Right: quit shareholders are entitled to cast the voting rights in the annual general meeting.

2. No Fixed Dividend: Equity share holders are not entitled to get fixed dividend. If the company fails to earn any profit no dividend is paid to them.

3. No Preference: At the time of liquidation preference shareholders are paid first from surplus then equity shareholder for their capital contribution to the company.

Merits of equity shares

1. Face value of equity shares is less as compared to preference shares.

2. Equity share holders are paid higher dividend when company earns maximum profit.

3. Equity shares are more liquid as compare to preference shares.

4. These shareholders enjoy voting rights.

5. Equity dividend is not a charge against profit.

6. It gives maximum return in the long run.

7. Equity capital can be used for a long period of time.

8. Equity share holders enjoy benefit of trading on equity and right issue.

Kinds of equity share:

1. Equity shares with voting rights.

2. Equity shares without voting rights.

3. Equity share with different right.

Demerits of equity shares:

1. In case of loss equity share holders are not paid any dividend.

2. Equity dividend is not deductible in computing taxable income of the company.

3. Fresh issue dilutes the E.P.S of existing shareholders.

4. New issue may dilute the ownership and control of the existing shareholders.

5. Flotation cost is higher than other securities.

2.7 Preference shares:

Preference shares are those, which enjoy the preferential right as to payment of dividend and repayment of capital at the time of winding up of the company over the equity shares.

Features:

i. Fixed rate of dividend

ii. Preferential right as to payment of dividend and repayment of capital at the time of liquidation.

iii. It can cumulative rights over dividend.

Kinds of preference shares:

1. Cumulative preference shares:- This type of preference share carry the right of cumulative dividends if the company fails to pay the dividend on a particular year.

2. Non cumulative preference shares:- This kind of shares does not enjoy the right to receive the arrears of dividend in a particular year.

3. Participating preference shares:- The holder of these shares are entitled to a share in the excess profit remaining after paying dividend to the equity share holder up to a certain limit.

4. Non participating:- The holder of these share are not entitled to a share in the excess profit of the company if any.

5. Convertible preference share:- These share holder enjoy the right to convert their shares into equity shares within a certain period.

6. Non convertible preference share:- These shareholders do not carry the right of conversion into equity shares.

7. Redeemable preference share:- These shares can be redeemed after a fixed period of time, on desired by the company.

8. Irredeemable preference share:- Shares which can’t be redeemed during the life time of the company.

9. Partly convertible:- As per the agreement certain portion of the share can be converted into equity share.

10. Guaranteed preference share:- Guaranteed shares are those share that are guaranteed to receive fixed rate of dividend for a fixed period of time.

Advantages of preference shares:

1. Fixed rate of dividend.

2. Preferential right as to payment of dividend and repayment of capital at the time of liquidation.

3. Cumulative preference shares can enjoy the arrear of dividend.

4. Redeemable preference shares are redeemed after a certain period.

5. Preference shares can be converted into equity shares.

Disadvantages of preference share:

1. Preference shareholders have no voting rights.

2. No bonus or right shares are issued to preference share holder.

3. Preference shareholders are paid a pre fixed rate of dividend even when company earns maximum profit.

4. It is an obligation to pay dividend on preference shares.

5. In the long run preference share may not be the part of companies share capital if company perform well.

1.8 Difference between preference shares and equity shares:

SL. No.	Subjects	Preference share	Equity shares
1	Dividend	Rate of dividend is pre fixed.	Rate of dividend on equity share is not pre fixed.
2	Voting right	Preference shares do not have any voting right.	Equity share holders enjoy voting right.
3	Convertibility	Preference shares may be converted into equity shares.	Equity shares are not convertible.
4	Redemption	Redeemable preference shares are redeemed after certain time.	Equity shares can't be redeemed during the life time of the company.
5	Arrears of dividend	Preference shareholders enjoy the arrears of dividend if company fails to pay the dividend in any year.	Equity share holders have no such facilities.

1.9 Book Building:

Meaning of Book Building:

Two of the most popular means to raise money are Initial Public Offer (IPO) and Follow on Public Offer (FPO).During the IPO or FPO, the company offers its shares to the public either at fixed price or offers a price range, so that the investors can decide on the right price. The method of offering shares by providing a price range is called book building method. This method provides an opportunity to the market to discover price for the securities which are on offer.

Book Building may be defined as a process used by companies raising capital through Public Offerings-both Initial Public Offers (IPOs) and Follow-on Public Offers (FPOs) to aid price and demand discovery. It is a mechanism where, during the period for which the book for the offer is open, the bids are collected from investors at various prices, which are within the price band specified by the issuer. The process is directed towards both the institutional investors as well as the retail investors. The issue price is determined after the bid closure based on the demand generated in the process.

Book Building vs. Fixed Price Method:

The main difference between the book building method and the fixed price method is that in the former, the issue price to not decided initially. The investors have to bid for the shares within the price range given. The issue price is fixed on the basis of demand and supply of the shares.

On the other hand, in the fixed price method, the price is decided right at the start. Investors cannot choose the price. They have to buy the shares at the price decided by the company. In the book building method, the demand is known every day during the offer period, but in fixed price method, the demand is known only after the issue closes.

Book Building in India:

The introduction of book-building in India was done in 1995 following the recommendations of an expert committee appointed by SEBI under Y.H. Malegam. The committee recommended and SEBI accepted in November 1995 that the book-building route should be open to issuer companies, subject to certain terms and conditions. In January 2000, SEBI came out with a compendium of guidelines, circulars and instructions to merchant bankers relating to issue of capital, including those on the book-building mechanism.

Book Building Process:

The principal intermediaries involved in a book building process are the companies, Book Running Lead Manager (BRLM) and syndicate members are the intermediaries registered with SEBI and eligible to act as underwriters. Syndicate members are appointed by the BRLM. The book building process is undertaken basically to determine investor appetite for a share at a particular price. It is undertaken before making a public offer and it helps determine the issue price and the number of shares to be issued.

The following are the important points in book building process:

1. The Issuer who is planning an offer nominates lead merchant banker(s) as 'book runners'.

2. The Issuer specifies the number of securities to be issued and the price band for the bids.

3. The Issuer also appoints syndicate members with whom orders are to be placed by the investors.

4. The syndicate members put the orders into an 'electronic book'. This process is called 'bidding' and is similar to open auction.

5. The book normally remains open for a period of 5 days.

6. Bids have to be entered within the specified price band.

7. Bids can be revised by the bidders before the book closes.

8. On the close of the book building period, the book runners evaluate the bids on the basis of the demand at various price levels.

9. The book runners and the Issuer decide the final price at which the securities shall be issued.

10. Generally, the number of shares is fixed; the issue size gets frozen based on the final price per share.

11. Allocation of securities is made to the successful bidders. The rest bidders get refund orders.

How is the Price Fixed?

All the applications received till the last dates are analyzed and a final offer price, known as the cut off price is arrived at. The final price is the equilibrium price or the highest price at which all the shares on offer can be sold smoothly. If the price quoted by an investor is less than the final price, he will not get allotment.

If price quoted by an investor is higher than the final price, the amount in excess of the final price is refunded if he gets allotment. If the allotment is not made, full money is refunded within 15 days after the final allotment is made. If the investor does not get money or allotment in a month's time, he can demand interest at 15 per cent per annum on the money due.

Book Building vs. Reserve Book Building:

While book building is used to raise capital for the company's business operations, reverse book building is used for buyback of shares from the market. Reverse book building is also a price discovery method, in which the bids are taken from the current investors and the final price is decided on the last day of the offer. Normally the price fixed in reverse book building exceeds the market price.

2.10 Green shoe option

In case the issue has been oversubscribed, the company has to exercise a green shoe option to stabilize the post-listing price. When a particular issue is oversubscribed the appetite of investors for the stock has not been satisfied and once it gets listed they tend to pick up the stock from the secondary market.

Since the demand is greater than supply the prices tend to rise way beyond what the fundamentals of the stock would justify. So in order to stabilise the post-issue price of the stock, the issuer has to issue more shares in case of oversubscription.

These shares are taken from the pre-issue shareholders or promoters and are issued to the investors who have come in through the public offer on a prorata basis. The green shoe option can be a maximum of 15% of the public offer.

2.11 Dematerialization:

Demat stands for dematerialisation. Dematerialisation is the process of converting physical financial instruments such as share certificates, mutual fund investments, and bonds into electronic form. An Investor who needs to dematerialise his shares needs to open a demat account with Depository Participant. This physical shares are then surrendered by the investor and in return he gets electronic shares in his demat account.

A demat account is similar to a bank account. When you receive your bank statement, you will see 2 columns – deposits and withdrawals of money and balance money in the account on the last day of the statement. Similarly, a demat statement will show the investments you have bought, sold and the balance investments held on the last day of the statement.

It offers flexibility along with security and convenience. Holding share certificates in physical format carried risks like certificate forgeries, loss of important share certificates, and consequent delays in certificate transfers. Dematerialization eliminates these hassles by allowing customers to convert their physical certificates into electronic format. Shares in the electronic format are held in a Demat account.

Process of dematerialization

- Dematerialization starts with opening a Demat account. For demat account opening, you need to shortlist a Depository Participant (DP) that offers Demat services.

- To convert the physical shares into electronic/demat form, A Dematerialization Request Form (DRF), which is available with the Depository Participant (DP), has to be filled in and deposited along with share certificates. On each share certificate,' Surrendered for Dematerialization' needs to be mentioned.

- The DP needs to process this request along with the share certificates to the company and simultaneously to registrars and transfer agents through the depository

- Once the request is approved, the share certificates in the physical form will be destroyed and a confirmation of dematerialization will be sent to the depository

- The depository will then confirm the dematerialization of shares to the DP. Once this is done, a credit in the holding of shares will reflect in the investor's account electronically.

- This cycle takes about 15 to 30 days after the submission of dematerialization request

- Dematerialization is possible only with a Demat account, Learn about how to open a demat account to understand dematerialization.

Causes of dematerialization:

- Handling of paperwork related to shares in physical format often led to errors and unforeseen mishaps in the past.

- Tracking records and share documents with respect to transfer and upkeep transactions was difficult

- The authorities in charge of updating these documents could not keep up with the increasing volume of share papers, which, if left unchecked, could cripple the financial base of the Indian share market and associated businesses.

Benefits of dematerialization

1. Itallows you to conveniently manage your shares and transactions from anywhere

2. Stamp duty is not levied on your electronic securities

3. When you open a demat account, it provides paperless transactions of securities.

4. Nominal holding charges are levied. Holding your investments in demat form is easy and convenient.

5. You don't have to face the problem of losing investment certificates or receiving forged certificates.

6. Transferring securities becomes easy.

7. You incur lower costs associated with transactions when compared to physical buying and selling of securities.

8. You receive bonus shares and share splits automatically.

2.12 Employees stock option plan:

An Employee Stock Option Plan (ESOP) is a benefit plan for employees which makes them owners of stocks in the company. ESOPs have several features which make them unique compared to other employee benefit plans. Most companies, both at home and abroad, are utilising this scheme as an essential tool to reward and retain their employees. Currently, this form of restructuring is most prevalent in IT companies where manpower is the main asset.

in Abroad, ESOP (where the 'O' often stands for ownership) is seen when employees buy over the stock of an owner or promoter who is relinquishing charge. In India, ESOP is used largely to motivate employees to put in their best and in turn, help the company enjoy lower employee turnover and retain its talent pool. These two uses probably account for over two-thirds of all ESOPs now in existence, and their numbers are expected to increase with time.

Benefits of ESOP's The major benefits of awarding Employee Stock Options are mentioned below:

Lock-in Period: ESOP's come with a lock-in period known as vesting period and employees can exercise the options only after this period. If the employee leaves the

organisation before completing the specified period – these ESOP's get lapsed and the employee will not get any benefit.

A 'Sense of Ownership' for the employees: When the employees are given shares of the same company in which they are working, it gives them a sense of feeling that now they are not employees of this organisation but are the owners. As they are now they owners, they also have a share in the profits of the company. In fact, since employees directly benefit from the increase in the share price, they focus on overall value creation for the company.

Kind instead of Cash: ESOP's are a way of awarding the employees in kind instead of cash. In the initial days of ESOP's in India, small organisations who were cash strapped used to give ESOP's to their employees to increase the overall pay package. In this manner, they were able to compensate the employees in kind without affecting their cash reserves.

2.13 Bonus Shares:

Meaning of Bonus Shares:

Sometimes a company cannot pay dividend in cash due to shortage of liquid funds, viz., cash, in spite of earning a large amount of profit for a particular period. Under the circumstances, the company issues new shares to the existing shareholders in lieu of paying dividend in cash. These shares are known as 'Bonus Shares'. Such bonus shares are to be offered to the existing shareholders in proportion to the shareholdings and dividend rights. Generally, the company issues bonus shares out of profits and/ or reserve to the existing shareholders. Since the profit/reserve is being capitalized, it is also called capitalisation of profit/reserve. As the company cannot receive cash from the shareholders for the purpose of issuing bonus shares, a sum equal to the total value of bonus issue is to be adjusted against profit/reserve and transferred to Equity Share Capital Account.

Advantages of Issuing Bonus Shares:

A. From the company's view point:

(a) By issuing bonus shares shareholders are to be satisfied when the company cannot pay dividend in cash due to shortage of liquid funds, i.e., profit can be distributed without distributing the liquid resources, viz., cash.

(b) By issuing bonus shares shareholders are to be satisfied particularly when the company does not prefer to pay dividend in cash for the purpose of either its extension or its working capital or any other specific purposes.

(c) Sometimes a company is bound to reduce its reserve for the interest of its own. It may so happen that the amount of earning profit exceeds the amount of total paid up capital of the company which, in other words, encourages the competitors and creates unhealthy relationship between workers and the company.

B. From the shareholder's view point:

(a) Shareholders need not pay tax on the bonus shares but they are to pay them on the dividend so received in cash.

(b) Shareholders, if they so desire, can convert the shares into cash by disposing of the same at a higher price.

(c) If partly paid shares are converted into fully paid by issuing bonus, the shareholders need not pay a further sum for the purpose. On the other hand, their shares become fully paid up.

Disadvantages of issuing Bonus Shares:

(a) If the rate of dividend fluctuates, i.e., cannot be maintained, the market value of shares may go down.

(b) If the rate of profit is not increased, the rate of dividend may be decreased.

(c) It encourages speculation which is not desirable.

Conditions of issuing bonus shares are:

1. There should be a provision in the Articles of Association regarding bonus issue.

2. If the subscribed capital and paid up capital exceeds the amount of authorised capital by the subsequent issue of bonus shares, a resolution should be passed at the general body meeting to increase the amount of authorised capital, if necessary.

3. A resolution passed at the general body meeting for bonus issue should be furnished before an application is made to the controller of capital issue.

4. Free reserves created out of real profits and share premium collected in cash may be utilised for the purpose of issuing bonus shares.

5. Reserve created by the revaluation of fixed assets is not permitted to be utilised for the purpose.

6. Development Rebate Reserve or Investment Allowance Reserve may be considered as free reserve and hence, may be capitalized.

7. The residual reserves after bonus issue should be at least 40% of the increased paid-up capital.

8. Capital Redemption Reserve, if any, for the computation of the said 40% of the residual reserve, is not to be taken into consideration.

9. Contingent liabilities which may have a bearing on net profits shall be turned into consideration for the calculation of minimum residual reserve of 40%.

10. 30% of the average profits (before tax but after providing preference divi-dend) for the previous 3 years should at least yield a dividend of 10% on the expanded equity capital.

11. Declaration of bonus issue in lieu of dividend is not permitted.

12. Further application for issue of bonus shares may be made only after 36 months from the date of an earlier bonus issue.

13. Unless the partly paid shares are made fully paid, bonus issues are not permitted.

14. If it is found that the company has defaulted the payment of statutory dues of the employees, e.g., contribution of P.F., bonus shares, in this case, is not permitted.

15. Capital Reserve which is created out of revaluation of assets without accrual of cash resources will neither be allowed to be capitalized (nor will it be allowed to be taken into consideration) for the computation of the said residual reserve of 40%.

16. At any one time, total amount of bonus issue out of free reserves shall not exceed the total amount of paid-up equity capital.

17. If the application is made both for the purpose of issuing bonus shares and right shares at the same time, permission should be given first f'- bonus issue and later for right issue.

18. An auditor's certificate show

ISSUE OF BONOUS SHARES

A company may issue bonus shares out of free reserves accumulated out of genuine profits or share premium collected. Reserves created by revaluation of fixed assets are not available for issue of bonus shares.

The bonus may be applied to convert partly paid shares into fully paid shares or may be issued as fully paid up bonus shares. The accounting entries in each of these cases would be as follows:

(A) For converting partly paid shares into fully paid shares

(i) Equity share final call a/c Dr.

To equity capital a/c

(Being call money due on… shares)

(ii) P&L a/c Dr.

Securities Premium a/c Dr

Reserve a/c Dr.

To bonus to shareholders a/c

(Being bonus declared)

(iii) Bonus to shareholders a/c Dr.

To equity share final call a/c

(Conversion of partly paid equity shares into fully paid equity shares)

(B) For fully paid bonus shares

(i) P&L a/c Dr

Securities Premium a/c Dr

Reserve a/c Dr.

To bonus to shareholders a/c

(ii) Bonus to shareholders a/c Dr.

To equity share capital a/c

(Being bonus utilized to issue fully paid up bonus sharesuld be furnished stating that proper depreciation has been provided as per Income-tax Act.

1.14 Methods of issue of shares:

A company may issue its share in three ways.

1. Shares issued at par: Generally shares are issued at its face value or par value which is written on the face of the security.

Ex. A share of Rs. 100 issued at Rs. 100

2. Shares issued at premium: Due to right growth and demand in the market some time company issue its share at a price above the face value. It is said share issued at premium.

Ex. A share of Rs. 100 issued at Rs. 110.

3. Share issued at discount: Shares are said to be issued at discount when it is issued at a price lower than the face value of it.

Ex. Share of Rs. 100 issued at Rs. 90

2.15 Issue of sweat equity shares:

Sweat equity shares are issued by a company to its employees or directors at a discount or for consideration other than each, For providing knowledge how intellectual property right or value additions. Sweat equity shares are not a special class of shares, it is a kind of equity shares.

Conditions for issue:

1) At least one year has elapsed at the date of the issue after the company obtained the certificate of commencement of business.

2) The issue must be authorised by a special resolution passed by the company in the annual general meeting.

3) The resolution must specify the number of shares, current market price consideration and the classes of directors or employees to whom it will be issued.

Accounting entries:

Shares may be issued by a company for two different considerations

1) For cash

2) For consideration other than cash

1. For Cash:

Companies generally issue shares for cash. The procedure involved is as follows.

a) Applications

b) Allotment

c) Call

2. Other than Cash :

Such shares may be issued t the venders, under wriler and promoters of the company or as sweat equity shaares.

a) Issue of shares to the venders

b) Issue of shares to the promoters

c) Issue f sweat equity shares

Over subscription

Shares are said to be over subscribed when the number of shares applied is more than the number of shares offered.

Ex. Company can offered 10,000 shares to the public but the public applied for 12,000 shares.

In case of over subscription company can return the application money to the applicant whose application is rejected or Adjust the same if it is partially accepted.

Under subscription:

Shares are said to be under subscribed when the number of shares applied for is less than the number of share offered.

Ex. Company can offered 10,000 shares to the public but the public applied for 8,000 shares only.

In case of under subscription all applications are accepted in full. So the question of returning the money does not arise at all.

Calls in arrear:

Calls-in-arrear refer to the amount called by the company which cannot yet been paid by the shareholders till the last day of payment.

The amount of calls-in-arrears is shown by way of document from the called up.

Capital on the balance sheet. Interest @5% p.a can be charged on calls in arrears.

Calls in advance:

Calls-in-advance refer to the amount paid by shareholders in excess of the amount due from them. The balance in calls in advance account is shown in the balance sheet as a separate item under share capital.

Interest @6% p.a. can be paid on this account.

Accounting entries:

a) When calls in advance is received

Bank account ..... Dr

To Calls in advance account

b) When a call is made by the board of directors

Calls in advance A/C ..... Dr

To Relevant call A/C

Issue of shares at premium:

Shares are sad to be issued at a premium when they are issued at a price higher than the face value. The excess price is called share premium.

Ex.A share of Rs. 100 is issued at Rs. 115.

All entries are same as share issued at par. Only 3rd entry will be as follows.

Share allotment A/C ..... Dr

To Share capital A/C

To Share premium A/C

Issue of share at par:

Shares are said to be issued at par when they are issued at a price equal to the face value.

Ex. A share of Rs. 10 is Issued at Rs. 10

Accounting entry

1. On receipt of application money

Share application A/C ..... Dr

To Share capital A/C

2. On making application money due

Share application A/C ..... Dr

To Share capital A/C

3. On making allotment money due

Share allotment A/C ..... Dr

To Share capital A/C

4. On receipt of allotment money

Bank A/C ..... Dr

To Share allotment A/C

5. On making the calls

Share call A/C ..... Dr

To share capital A/C

6. On receipt of call

Bank A/C .....Dr.

To Share call A/C

Issue of share at discount:

Shares are said to be issued at discount when they are issued at a price lower than the face value. The price difference is called discount.

Ex. Share of Rs. 100 is issued at Rs. 90.

Accounting treatment:

All entries are same as like as issue of share at par. Since the discount is allowed on allotment, the 3rd entry will be as follows.

Share allotment A/C ..... Dr

Discount on issue of share A/C ..... Dr

To Share capital A/C

Issue of shares to underwriters

1.16 Distinction between reserve capital and capital reserve

Sl. No.		Reserve Capital	Capital Reserve
1	Meaning	It refers to that portion of uncalled share capital which the company decides to retain in the hands of share holders until liquidation.	It refers to those amount which are not
2	Creation	It is not mandatory to create reserve capital.	It is mandatory to create capital reserve.
3	Disclose	It is not disclosed in the balance sheet.	It is required to be disclose on the balance sheet.
4	Use	It can be used only at the time of winding up.	It can be used during the life time of the company.

1.17 ISSUE OF RIGHT SHARES

Section 81 of the Companies Act requires that a public limited company, whenever it proposes to increase its subscribed capital after the expiry of two years from the date of its incorporation or after the expiry of one year from the date of allotment of shares in that company, made for the first time after its formation, whichever is earlier, shall be required to offer those shares to the existing equity shareholders in the proportion of paid-up capital as nearly as possible. Such shares are known as rights shares. The price at which these shares are offered to the existing shareholders is normally below the market price of the shares. The existing shareholders thus have a specific advantage in the sense that market price of the shares offered is more than its issue

price. This specific advantage has a money value called as value of the right. The value of the right can be calculated as follows:

1. Ascertain the total market value of the shares which a shareholder is required to possess in order to get additional shares from of the fresh issue.

2. Add to the above market price, the amount to be paid to the company for additional shares of the fresh issue.

3. Find average price. This can be calculated by dividing the total prices calculated under step 2 by the total number of shares.

4. Deduct average price from market price. This difference is called value of the right.

1.18 Illustration:

Example: A company makes a rights issue of one shares of ₹ 100 at a premium of 10 percent for every three shares held by the members of the company. Shares of the company are being sold in the market @ ₹150 per cent. Find the value of the right.

Solution: Market price for every 3 shares held by the shareholders

= 3x150 = ₹450

Add: Issue price of 1 right share = ₹ 110

Total price of 4 shares = ₹ 450 + 110 = 560

Average price = 560/4 = ₹ 140

Market price = ₹ 150 per share

Value of the right = 150 - 140 = ₹10

The accounting treatment of rights share is the same as that of issue of ordinary shares and is as follows:

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.

Illustration 1 :

a.

b. X Co. Ltd. forfeited 50 shares of ₹10 each, ₹ 7 called up on which the shareholder had paid applications and allotment money @₹ 5 per share. Out of these 50 shares, 30 shares were reissued as fully paid up @₹ 8 per share.

c. X Co. Ltd. forfeited 100 shares of ₹ 10 each (₹ 6 called up) issued at a discount of 10 per cent on which the shareholder had paid ₹ 2 per share. All the shares were reissued as fully paid up @ ₹ 8 per shares.

Solution:

(a) Share capital a/c Dr. To forfeited share a/c To share allotment a/c To share first and final call a/c (Being the forfeiture of 100 shares of ₹ 10 of each fully called up for called up for Non payment of allotment money @ 3 and first and final call @ ₹ 4 per share)	1,000	 300 300 400
Bank a/c Dr. Forfeited shares Dr. To Shares capital a/c (Being the reissue of 100 forfeited shares as fully paid up @ ₹ 9)	900 100	 1000
Forfeited share a/c Dr. To capital reserve a/c (Being balance in forfeited shares a/c transferred to capital reserve a/c)	 200	 200
(b) Share capital a/c Dr. To forfeited shares a/c To shares first call a/c To discount on share a/c (Being the forfeiture of 50 shares of ₹ 100 each, ₹ 7 called for non-payment of first call @ ₹2)	 600	 200 300 100
Bank a/c Dr. Forfeited shares Dr. To share capital a/c (Being the reissue of 30 shares of ₹ 10 each @₹ 8 per share as fully paid up)	240 60	 300
Forfeited share a/c Dr. To capital reserve a/c (Being the profit on reissue of forfeited shares transferred to capital reserve a/c)	90	 90

(c) Share capital a/c Dr. To forfeited shares a/c To share allotment a/c To discount on shares a/c (Being the forfeiture of 100 shares of ₹ 10 each (₹ 6 called up) for non-payment of allotment money @ ₹ 3 per share, discount being ₹ 1 per share)	600	 200 300 100
Bank a/c Dr. Forfeited shares Dr. Discount on shares a/c Dr. To share capital a/c (Being the reissue of 100 shares of ₹ 10 each @ ₹ 8 per share as fully paid up)	800 100 100	 1000
Forfeited shares a/c Dr. To capital reserve a/c	100 100	

Illustration 2 :

Bharat Limited invited applications for 1,00,000 shares of ₹ 100 each at a price of ₹ 110, payable ₹ 40 on application (including premium ₹ 10), ₹ 45 on allotment and balance on first and final call.

Applications were received for 1,20,000 shares. Allotment was made as:

To applicants of 80,000 shares: 100%

To applicants of 40,000 shares: pro-rata to all applicants

Excess application money was adjusted against further money payable. Mr. Rahul, to whom

1,000 shares were allotted on a pro-rata basis, failed to pay the allotment and call money. Mr. Sanjay, to whom 500 shares were allotted failed to pay the call money.

Prepare the following ledger accounts in the books of Bharat Ltd.:

(i) Equity share capital account

(ii) Share allotment account

(iii) Share call account

(iv) Securities premium account

Solution :

Dr. Equity Share Capital A/c Cr

Particulars	(₹)	Particulars	(₹)
To balance c/d	1,00,00,000	By equity share application By equity share allotment By equity share call	30,00,000 45,00,000 25,00,000
	1,00,00,000		1,00,00,000

Dr. Share Allotment Account Cr

Particulars	(₹)	Particulars	(₹)
To equity share capital		By equity share application By equity share allotment By balance c/d (allotment money in share	8,00,000 36,95,000 5,000
	45,00,000		45,00,000

Dr. Share Call Account Cr

Particulars	(₹)	Particulars	(₹)
To equity share capital	25,00,000	By Bank By balance c/d (calls in arrears on 1,500 shares)	24,62,500 37,500
	25,00,000		25,00,000

Dr. Securities Premium Account Cr.

Particulars	(₹)	Particulars	(₹)
To Balance c/d	10,00,000	By equity share application	10,00,000
	10,00,000		10,00,000

Illustration 3 :

A company made an issue of 30,000 shares of 10 each, payable 3 on application. 5 on allotment and 2 on call. A total of 93,200 shares were applied for and owing to this heavy oversubscription allotments were made as follows:

Applicants for 21,500 (in respect of applications for 2,000 or more) received 10,200 shares.

Applicants for 50,000 (in respect of application for 1,000 or more but less than 2,000)received 12,600 shares.

Application for 21,100 (in respect of application for less than 1,000)Received 7,200 shares . Cash then received after satisfying amount due on application was applied towards allotment and call money and any balance was returned. All moneys due on allotment and call were realized. Give journal entries including that of cash and write up the cash account and ledger accounts relating to this issue of shares in the books of the company.

Solution : Journal Entries in the Books of Company

1. Bank a/c Dr. To share application (Application money being received)	2,79,600	 2,79,600
2. Share application a/c Dr. To share capital (see workings) To bank (see workings) To shares allotment a/c (see workings) To calls-in-advance (see workings)	2,79,600	 90,000 25,800 1,32,900
3. Share allotment a/c To share capital a/c (Money due on allotment)	1,50,000	 1,50,000
4. Bank a/c Dr. Share allotment a/c	17,100	 17,100
5. Final Call a/c Dr. Share Capital a/c	60,000	 60,000
6. Bank a/c Dr. To final Call a/c	29,100	 29,100
7. Call-in-advance a/c Dr. To final Calla/c	30,00	 30,900

Dr. **Cash Book** **Cr.**

Particulars	**(₹)**	**Particulars**	**(₹)**
To share application To share allotment To final call	2,79,600 17,100 29,100	By share application (money)	25,800 3,00,000
	3,25,800		3,25,800

Dr. **Share Application** **Cr.**

Particulars	(₹)	Particulars	(₹)
To share capital To bank To share allotment To calls-in-advance	90,000 25,800 1,32,900 30,900	By bank (93,200 x 3)	2,79,600
	2,79,600		2,79,600

Dr. **Share Allotment** **Cr.**

Particulars	(₹)	Particulars	(₹)
To closing balance	1,50,000	By share application By bank	1,32,900 17,100
	2,79,600		1,50,000

Dr. **Final Call** **Cr.**

Particulars	(₹)	Particulars	(₹)
To share capital	60,000	By Bank By Call-in-advance	29,100 30,900
	60,000		60,000

Dr. **Share Capital** **Cr.**

Particulars	(₹)	Particulars	(₹)
To closing balance	3,00,000	By share Application By share allotment By share final call	90,000 1,50,000 60,000
	3,00,000		3,00,000

Sum up: Issue of shares is a term of law and finance for the number of shares of a corporation which have been allocated (allotted) and are subsequently held by shareholders. The act of creating new issued shares is called issuance, allocation or allotment. Allotment is simply the creation of shares and their transfer to a subscriber. After allotment, a subscriber becomes a shareholder, though usually that also requires formal entry in the members register. The number of shares that can be issued is limited to the total authorized shares. Issued shares are those shares which the board of directors and/or shareholders have agreed to allocate. The issued shares of a corporation form the equity capital of the corporation, Shares are most commonly issued fully paid, in which case the liability of the shareholders is limited to the

amount paid on the shares; but they may also be issued partly paid, with unlimited liability, subject to guarantee, or some other form.

Key terms: Deferred share, Equity share, Preference share, Share capital, Book building, Green shoe option, Dematerialisation, ESOP, Bonus share, Sweat equity share, Right share, Over subscription, under subscription, At par, At a discount, At a premium, Calls in arrear, Calls in advance.

Self Assessment Questions:

1. What is equity share? State the advantages and disadvantages of it.

2. What is preference share? State the advantages and disadvantages of it?

3. What is share? What are the natures of it?

4. Distinguish between equity and preference share.

5. Distinguish between reserve capital and capital reserve.

Model Questions:

1. What is Sweat equity share? In which conditions it is issued

2. Define bonus share? State the advantages and disadvantages if it.

3. What is ESOP? Describe the benefits of it?

4. What do you mean by dematerialisation? What are the process and causes of it.

5. What is book building? What are the processes of it?

6. Write a short note on Green shoe option.

Further Readings:

1. Modern Accountancy: Hanif and Mukherjee, volume –I, Tata Mcgrewhill.

2. Higher secondary Accounting: Biswal and Sharma.

3. Financial Accounting: P.C. Tulsian, Pearson.

4. An Introduction to Accountancy: S.N. Maheshwari, S.K. Maheshwari. Vikas.

UNIT-III: FORFEITURE OF SHARES

Learning objective:

After studying this lesson, you will be able to know: Meaning of forfeiture, rules regarding forfeiture of share, procedure of forfeiture, annulment of forfeiture, procedure for forfeiture, condition for forfeiture, when how shares are forfeited, effects of forfeiture, reissue of shares, procedure for reissue, conditions for reissue, meaning of capital reserve.

Structure:

3.1 Introduction:

If a shareholder fails to make the payment of allotment or call money in time even after the reminder, then board of directors may forfeit the shares defaulters as per provision of the articles of association. Due to the forfeiture the name of the defaulted shareholders is removed from the registrar of the company and causes their claim on the paid up amount on shares.

3.2 Meaning of Forfeiture of Shares

If a shareholder, who is called upon to pay any call fails to pay the amount, even after sending several reminders, the company may forfeit his shares. Forfeiture of shares results in a permanent reduction of the share capital.

3.3 Rules regarding forfeiture of shares:

Rules relating to a valid forfeiture of shares are as follows:

1. Share can be forfeited only against the non payment of allotment or call due in respect of the shares.

2. A notice must be given at least fourteen days before to inform the member that in the event of non payment their shares will be liable to be forfeited.

3. For non compliance of the notice, the board of directors will pass a resolution of forfeiture and a notice a notice of the same will be sent to the defaulter.

3.4 Annulment of forfeiture:

If the defaulting share holders wishes to pay the dues after the forfeiture of shares, and request the company to cancel the forfeiture the board of directors can take a decision to cancel the forfeiture and calls up on the defaulters to pay off the dues with interest. On payment of the dues the name of the share holder should be re entered in the registrar of the company.

Forfeiture of fully paid up shares:

Schedule – 1 of the companies Act, 1956, Table A, do not make any provision for forfeiture of fully paid up shares. But in the case of Shyamchand vs. Calcutta stock exchange, fully paid up shares could be forfeited in case like execution of members where the articles authorises.

Points to be noted on forfeiture of shares:

1. The amount called up on the forfeited shares

2. The amount unpaid on the shares forfeited

3. The amount received on the shares forfeited

3.5 Procedures regarding forfeiture of shares:

(1) Provision in the Articles of Association: The secretary has to check if there is a provision in the Articles of Association regarding forfeiture of shares. If there is a provision in the Articles, the company can go ahead regarding forfeiture of shares. If there is no provision in the Articles, the company cannot go ahead regarding forfeiture of shares.

(2) Preparing the list of defaulters: As soon as the due date of payment of call money is over, the secretary prepares a list of defaulting members. He, then calls a meeting of the Board of Directors and places the list of defaulters for consideration and suitable decision and action by the Board.

(3) Board Meeting and Resolution by Directors: The secretary arranges the meeting of the Board Directors and in this meeting a resolution will be passed whereby the secretary will be authorized to send reminders to the defaulters. Such call reminders contain a request to pay the call amount due, within a specified period with interest. This letter also intimates the defaulters that his shares are liable for forfeiture in case the default in payment of the amount continues.

(4) Issue of Warning Letter: Even after reminders have been sent to the defaulters, no heed has been taken to pay the call money, the secretary has to issue a warning notice under the authority of the Board's resolution and the Articles. The warning notice is for asking the defaulting members to pay the dues within 14 days from the date of notice. Warning is also given that failure to pay within the stipulated time will make the shares liable for forfeiture.

(5) Board Meeting for resolution on forfeiture: If the default continues even after 14 days warning notice, the secretary has to arrange a meeting of the Board of Directors. In this meeting a resolution will be passed by the Board of Directors to forfeit the shares of the defaulting members.

(6) Notice of the forfeiture: The secretary has to send a formal notice to the defaulting members informing them about the forfeiture and asking them to surrender the forfeited shares. Such notice of forfeiture or letter of forfeiture is required to be sent by registered post to the individual share holders concerned. Usually, the fact of

forfeiture is also notified in the press and the public is cautioned against dealing in the said shares. The amount of forfeited shares is transferred to a Forfeited Shares Account in the financial books of the company.

(7) Removal of names from the register of members: Finally, the secretary has to remove the name of defaulters, from the register of members and enter the same with other particulars in the register of forfeiture of shares.

3.6 Conditions for Forfeiture of shares:

A company can forfeit its shares only when the following conditions are satisfied:

1. Authority to Forfeit: The power to forfeit must be expressly given in the Articles. Accordingly, if no power is given in the Articles, no forfeiture can be made.

2. Default in Payment of Calls: The shares can be forfeited only for the non-payment of calls and not for the default in payment of any other debts.

3. In Accordance with the Articles: Forfeiture shall be valid only when the provisions of the Articles are strictly complied with. Even a slight deviation from the provisions shall render the forfeiture invalid.

4. Bonafide and for the Benefit of the Company: The right to forfeit shares is in the nature of trust and so it can be exercised bonafide and only for the benefit of the company. The power cannot be exercised hastly or for private ends.

5. Board Resolutions: Forfeiture will be effected only by means of a Board resolution.

6. Notice to Defaulting Shareholder: Notice precedent to forfeiture must be given to the defaulting shareholder. In the matter of forfeiture of shares, technicalities must be strictly observed.

When and how the shares of the company are forfeited?

If any shareholder fails to make the payment of allotment or call money, the company may forfeit such share the effect of forfeiture is that the name of such shareholders is removed from the register of member, the allotment is cancelled and the amount paid by the shareholder is forfeited.

3.7 Effects of forfeiture:

- A person whose shares have been forfeited would cease to be a member of the company, in respect of those shares. A person whose shares have been forfeited would notwithstanding the forfeiture, remain liable to pay to the company all moneys,

which at the date of forfeiture were payable by him to the company in respect of the shares.

The liability of the defaulting member shall not cease till the company receives the full payment which is due in respect of shares. The name of the defaulting member will be placed as a past member on the list of contributories if a winding up of the company commences within one year of the date of forfeiture.

Accounting entries:

Forfeiture of share issued at par:

The journal entry will be:

Share capital A/C (Amount called up) Dr.

To Calls in arrears A/C (Unpaid amount)

To Share forfeiture A/C (Amount received)

(Being forfeiture of share due to non payment of money as per board resolution No.....dated.....)

Illustration

A share holder holds 100 shares of Rs.100 each issued at par. On which he fails to pay Rs.40 on allotment and Rs.20 on call. The company forfeited his shares. Pass necessary journal entry.

Solution:

Date	**Particulars**	**L / F**	**Dr.**	**Cr.**
	Share capital A/c Dr		10,000	
	To share allotment A/c			4,000
	To Share call A/c			2,000
	To Share forfeiture A/c			4,000
	(Being 100 shares are forfeited due to non payment of allotment and call money as per board resolution No..... dated.....)			

Forfeiture of share issued at premium:

a. When premium amount has not been paid

Share capital A/C ..... Dr. (Amount called up)

Securities premium A/C ....Dr. (Premium amount)

To Calls in arrear A/C (Unpaid amount)

To Share forfeiture A/C (Amount received)

b. When premium amount has been paid

Share capital A/C..... Dr. (Amount called up)

To calls in arrear A/C (Amount die)

To share forfeiture A/C (Amount received)

Illustration:

Balaji Ltd. Issued 10,000 shares of Rs.10 each, at a premium of Rs.1 which is payable as follows.

Rs.4 on application

Rs.3 on allotment (Including premium)

Rs.4 on final call

Mr. X holds 100 shares fails to pay allotment and call money. For this his shares are forfeited. Pass necessary journal entries.

Date	**Particulars**	**L / F**	**Dr.**	**Cr.**
	Share capital A/C..... Dr. Share premium A/C..... Dr. To share allotment A/C To share final call A/C To share forfeiture A/C (Being forfeiture of 100 shares for non payment of allotment and call money)		1,000 100	 300 400 400

Forfeiture of shares issued at discount:

If shares originally issued at discount are forfeited later on, the journal entry in such case is:

Share capital A/C Dr. (Called up amount)

To discount on issue of share A/C (Discount paid)

To calls in arrear A/C (Amount

To share forfeiture A/C (money already received)

(Being forfeiture of shares due to non payment of money as per board resolution No..... Dated.....)

Illustration:

Amar was holding 500 shares of Zip Ltd. Of Rs.20 each issued at 10% discount. He did not pay any money due on allotment @ Rs.10 and final call Rs.5. The board of directors forfeited his shares. Pass necessary journal entries to record the forfeiture of shares.

Date	Particulars	L / F	Dr.	Cr.
	Share capital A/C..... Dr. To discount on issue of share A/C To share allotment A/C To share final call A/C To share forfeiture A/C (Being the forfeiture of 500 shares of Rs. 20 each for non payment of allotment and call money as per the board resolution No..... Dated.....)		10,000	 1,000 5,000 2,500 1,500

3.8 Reissue of forfeited shares:

Shares forfeited becomes the property of the company and the directors of a company have an authority to re-issue the shares once forfeited by them in accordance with the provisions contained in Articles of Association. Table 'A' provides that "A forfeited shares may be sold or otherwise disposed off on such terms and in such manner as the Board thinks fit". They can re-issue the forfeited shares at par, at premium or at

discount. However, if the shares are re-issued at discount, the amount of the discount does not exceed the amount paid on such shares by the original shareholder but in case of shares originally issued at a discount, the maximum permissible discount will be amount paid on such shares by the original shareholder plus the amount of original discount.

When shares are forfeited, such shares become the property of the company and the directors can deal with them in any way they think best in the interests of the company. Such shares can be reissued to some other person.

3.9 Requirements of Companies Act:

The following are the requirements of the Companies Act regarding the reissue of forfeited shares:

1. The forfeited shares are generally issued at a price lesser than their face value. But the discount so allowed to the new buyers should not exceed the amount already paid by the defaulting member.

2. A resolution sanctioning the reissue must be passed in the Board Meeting.

3. The forfeited shares are to be transferred in the name of the buyer and his name should be entered in the Register of Members.

4. A public notice in newspapers should be given stating that such and such shares have been forfeited due to the non-payment of calls.

3.10 Auditor's Duty regarding reissue of forfeited shares

The auditor's duty as to the re-issue of forfeited shares is described as follows:

1. The auditor should ascertain whether the Articles authorize the Board of Directors to reissue the forfeited shares.

2. He should examine the resolution passed by the Board of Directors at their meeting under which the forfeited shares have been re-allotted.

3. He should vouch the entries made for re-allotment in the Cash Book.

4. He should see that the balance remaining in the forfeited shares account has been transferred to the Capital Reserve Account.

5. In case the shares were reissued at a price above par value, he should see that the excess has been transferred to the Share Premium Account.

6. He should vouch the copy of the return of allotment filed with the Registrar of Joint Stock Companies.

3.11 Effects of reissue:

On reissue the transferee should be registered as the holder of the share.

- A new share certificate should be issued in the name of the transferee who shall be registered as the holder of the shares.

- The title of the transferee should not be affected by any irregularity or invalidity in the proceedings in reference to the forfeiture, sale or disposal of the share.

3.12 Procedure for reissue:

1. a notice by registered post is sent to the defaulting members demanding payment.

2. A list of persons, who have not paid the amounts due in spite of the notice, will be prepared.

3. The Board meeting will consider the proposal for forfeiture and will direct the secretary by resolution to issue notice to the member (as per draft approved by the Board) requiring him to pay the money due on the shares.

4. The notice will further state that in case of non-payment on or before the date mentioned therein, the share is liable to be forfeited without further notice.

5. The resolution will authorise the Secretary to take further action to forfeit the shares in case the conditions of the notice are not complied with.

6. Where the money due is not received on or before the due date specified in the notice, the director or secretary, authorised by the Board, will make a declaration, which will be duly verified, that the share in the company has been forfeited on the date stated in the declaration.

7. A notice will be published in the newspaper.

8. Stock exchange will be advised of the forfeiture in the case of listed shares, immediately after the Board meeting.

9. The forfeited shares may then be disposed by sale or in any other manner as directed by the Board.

10. Short particulars of reissued shares will be advised to the stock exchange concerned.

11. Before selling the forfeited shares, keep ready a duly verified declaration in writing signed by the director, manager or secretary of the company stating that the shares of the company have been forfeited on a particular date.

12. The aforesaid declaration will serve as conclusive evidence against all persons claiming title to shares forfeited and sold to others.

13. To give effect to the sale of forfeited shares, the Board will authorise some person, preferably the director or Secretary, to transfer the shares sold to the purchaser thereof and to make a declaration in connection therewith.

14. Show full consideration either by receipt or by adjustment, for the sale of forfeited share and execute the transfer of those shares in favour of the person to whom shares are sold or disposed of.

15. The defaulting members will be asked to return the share certificates.

16. If they fail to do so fresh certificates will be issued.

17. Public and stock exchange will be advised not to deal with the old certificates.

18. On registration of the transfer in the books of the company, the purchaser will be recorded as the owner of the shares in question.

19. Any surplus arising out of sale after adjusting the amount due to the company in respect of the shares will be refunded to the member concerned.

3.13 Maximum permissible discount rate:

Maximum permissible discount at the time of reissue of forfeited shares is ascertained in different situations in the following manner:

Shares originally issued at par: When the shares are originally issued at par, the maximum permissible discount for reissue of shares is equal to the amount forfeited on such shares

Shares originally issued at premium: In case of shares originally issued at premium, there can be two situations: (a) premium has not been received on the forfeited shares, and (b) premium has been received on such shares. The amount forfeited is the amount that has been received including the amount of premium if it has been received and the maximum discount that can be allowed on reissue of such shares is the amount so forfeited.

Shares originally issued at discount: In this case the actual amount received becomes the forfeited amount. But the maximum permissible discount on reissue of shares will

be equal to the amount forfeited plus the amount of discount initially allowed on these shares at the time of their original issue as per the provision of companies Act 1956; forfeited shares can be reissued by the company at any price.

Capital reserve: After the reissue of forfeited shares, the credit balance left in the share forfeiture a/c is a capital gain to the company and must be transferred to "capital reserve a/c". Such gain is also known as profit on reissue of forfeited shares. It should be clearly understood that if the forfeited shares are not reissued, only that proportion of shares forfeiture account, which belong to the reissued number of shares, should be transferred to capital reserve account

The journal entry on the reissue of forfeited shares is:

Shares reissued at par

Bank A/C..... Dr. (Amount actually received on reissue)

To share capital A/C (Face value of the share)

(Being reissue of forfeited shares @ Rs..... each)

Share reissued at discount

Bank A/C ..... Dr.

Share forfeiture A/C..... Dr.

To share capital A/C

Share reissued at premium:

1. Bank A/C .....Dr.

Toshare capital A/C

Toshare premium A/C

(Being reissue of forfeited share @ Rs..... each)

2. Share forfeiture A/C..... Dr.

To ..... capital reserve A/C

(Being balance of share forfeiture A/C transferred to capital reserve A/C)

Illustration :

Vinayak Ltd. Decided to reissue the 200 shares of Rs.10 each held by Rajesh for non payment of call money of Rs.2 each to Priyanka at a discount of Rs.2 per share. Pass the necessary journal entries on reissue of shares.

Date	Particulars	L / F	Dr.	Cr.
	(1)Share capital A/C..... Dr To calls in arrear A/C To share forfeiture A/C (Being the forfeiture of 200 shares for non payment of call money as per the board resolution No..... Dated .....)		2,000	 400 1,600
	(2)Bank A/C..... Dr. Share forfeiture A/C..... Dr. To share capital A/C (Being forfeited shares are now reissued at discount)		1,600	400 2,000
	(3)Share forfeiture A/C .....Dr. To capital reserve A/C (Being the balances of the share forfeiture A/C transferred to capital reserve A/C)		1,200	1,200

When all the forfeited shares are not reissued:

XYZ Co. Ltd. 200 share of Rs.100 each held by Ravi for non payment of final call of Rs.30 per share. Out of these 150 shares are reissued to Kishore at a discount of Rs.10 per share. Pass the journal entries.

Date	Particulars	L / F	Dr.	Cr.
	Share capital A/C..... Dr. To share forfeiture A/C To calls in arrear A/C (Being 200 shares ware forfeited due to non payment of the final call money of Rs.3 per share as per board resolution No..... Dated....)		20,000	 14,000 6,000
	Bank A/C..... Dr. share forfeiture A/C Dr To share capital A/C (Being out of 200 forfeited shares		13,500 1,500	 15,000

	150 shares are reissued) Share forfeiture A/C..... Dr. To capital reserve A/C (Being the balance of share forfeiture A/C transferred to capital reserve A/C)		9,000	9,000

Illustration: A limited company has an authorised capital of rs 2, 50,000 in rs 10 shares. Of these, 4,000 shares were issued as fully paid in payment of building purchased, 8,000 shares were subscribed for by the public, and during the first year rs 5 per share was called up, payable rs 2 on application, Re. 1 on allotment, Re. 1 on first call and Re. 1 on second call. The amounts received in respect of these shares were as follows:

On 6,000 shares — full amount

On 1,250 shares — rs 4 per share

On 500 shares — rs 3 per share

on 250 shares — rs 2 per share

The directors forfeited the 750 shares on which less than ₹ 4 per share had been paid.

		(₹)	(₹)
1.	Buildings a/c Dr. To vendor a/c	40,000	40,000
2.	Vendor a/c Dr. To share capital a/c	40,000	40,000
3.	Bank a/c Dr. To share application a/c	16,000	16,000
4.	Share application a/c Dr. To share capital a/c	16,000	16,000
5.	Share allotment a/c Dr. To share capital	8,000	8,000
6.	Bank a/c Dr. To share allotment a/c (Allotment money on 250 shares not received)	7,750	7,750
7.	Share first call a/c Dr. To share capital a/c	8,000	8,000
8.	Bank a/c Dr. To share first call a/c	7,250	7,250
9.	Share second call a/c Dr. To share capital a/c	8,000	8,000

Give journal entries recording the above transactions and set out the capital as it would appear in the company's balance sheet at the end of the first year.

Solution :

Journal Entries in the Books of Company

Balance Sheet

Liability	**₹**	**Assets**	**₹**
Authorised capital:	2,50,000	Buildings	40,000
25,000 shares of ₹ 10 each		Bank	37,000
Issued capital:	1,20,000		
12,000 shares of ₹ 10 each			
Subscribed capital:	40,000		
4,000 shares of ₹ 10 each fully paid up			
7,250 shares of ₹ 10 each, ₹ 5 called up			
36,250			
Less: Calls unpaid by other than directors 1,250			
35,000 Add			
:Share forfeited amount	37,000		
2,000			
4,000 shares of ₹ 10 each fully paid up are issued to vendors for consideration other than cash			
	77,000		77,000

Illustration:

The directors of a company with a subscribed capital of 20,000 equity shares ofrs 25 each and 20,000 preference shares of rs 25 each, on both of whichrs 20 per share were called up, forfeited 200 equity shares held by A on which he had failed to pay first and second calls of rs 5 per share each. They also forfeited 400 preference shares of B who failed to pay rs 5 per share on allotment, rs 5 per share on first call and rs 5 per share on second call. The directors further reissued the forfeited shares of A atrs 15 per share and those of B at rs 17.50 per share, all of which were taken up and paid for by C.

Pass the necessary journal entries to record the above transactions in the books of the company.

Particulars		₹	₹
1.	Bank a/c Dr	2,00,000	
	To equity share application		1,00,000
	To preference share application		1,00,000
2.	Equity share application a/c Dr.	1,00,000	
	Preference share application a/c Dr.	1,00,000	
	To equity share capital a/c		1,00,000
	To preference share capital a/c		1,00,000
3.	Equity share allotment a/c Dr.	1,00,000	
	Preference share allotment a/c Dr.	1,00,000	
	To equity share capital a/c		1,00,000
	To preference share capital		1,00,000
4.	Bank a/c Dr.	1,98,000	
	To equity share allotment a/c		1,00,000
	To preference share allotment a/c		98,000
(All money due on allotment, except on 400 preference shares, received)			
5.	Equity share first call a/c Dr.	1,00,000	
	Preference share first call a/c Dr.	1,00,000	
	To equity share capital a/c		1,00,000
	To preference share capital a/c		1,00,000
6.	Bank a/c Dr.	1,97,000	
	To equity share first call a/c		99,000
	To preference share first call a/c		98,000
(All money due on first call, except on 200 equity shares and 100 preference shares, received)			
7.	Equity share second call a/c Dr.	1,00,000	
	Preference share second call a/c Dr.	1,00,000	1,00,000
	To equity share capital		1,00,000.
	To preference share capital		
8.	Bank a/c Dr.	1,97,000	
	To equity share second call a/c		99,000
	To Preference share second call a/c		98,000
(All money due on second call, except on 200 equity shares and 400 preference shares, received)			
9.	Equity share capital a/c Dr.	4,000	
	To equity share first call a/c		1,000
	To equity share second call a/c		1,000
	To equity share forfeiture a/c		2,000
(Forfeiture of 200 equity shares on which first and second calls were unpaid)			
10.	Preference share capital a/c Dr.	8,000	
	To preference share allotment a/c		2,000
	To preference share first call a/c		2,000
	To preference share second call a/c		2,000
	To preference share forfeiture a/c		2,000

(Forfeiture of 400 preference shares on which allotment, first and second calls were unpaid)		
11. Bank (200 x Z 15) a/c Dr. Equity share forfeiture a/c Dr. To equity share capital a/c (Reissue of 200 equity shares at Z 15 per share as ! 20 called up)	3,000 1,000	 4,000
12. Bank (400 x Z 17.50) a/c Dr. Preference share forfeiture a/c Dr. To preference share capital a/c (Reissue of 400 preference shares at Z 17.50 per share as Z 20 called up)	7,000 1,000	 8,000
13. Equity share forfeiture a/c Dr. Preference share forfeiture a/c Dr. To capital reserve a/c (Transfer of balance in forfeiture account to capital reserve)	1,000 1,000	 2,000

(b) X co. Ltd. Forfeited 50 shares 0f 10 each, 7 called up on which the share holder had paid application and allotment money @5 per share. Out of these 50 shares, 30 shares were reissued as fully paid up @8 per share.

(c) X co. Ltd. Forfeited 100 shares of 10 each (Z 6 called up) issued at a discount of 10 percent on which the share holder had paid 2 per share. All the shares were reissued as fully paid.

Solution:

(a) Share Capital a/c .....Dr. To forfeited share a/c To share allotment a/c To share first and final call a/c (Being the forfeiture of 100 share of Z 10 of each fully called up for non payment of allotment money @ 3 and first and final call @ Z 4 Per share)	1,000 900 100	 300 300 400 1,000
Bank a/c .....Dr.	200	200
Forfeited share a/c .....Dr. To Share capital a/c	 350	

(Being the reissue of 100 forfeited shares as fully paid up @Z 9)		250 100
Forfeited share a/c .....Dr. To capital reserve a/c (Being balance in forfeited share a/c transferred to capital reserve a/c)	240 60	 300
(b) Share capital a/c .....Dr. To forfeited share a/c To share first call a/c (Being the forfeiture of 50 shares of Z 10 each, Z 7 called for non payment of first call @ Z 2)	90 600	90 200 300 100
Bank a/c .....Dr. Forfeited share a/c .....Dr. To share capital a/c (Being the reissue of 30 shares of Z 10 each @ T 8 per share as fully paid up)	800 100 100	 1,000
Forfeited share a/c .....Dr. To capital reserve a/c (Being the profit on reissue of forfeited shares transferred to capital reserve a/c)	100	100
(c) Share capital a/c .....Dr. To forfeited share a/c To share allotment a/c To discount on shares a/c (Being the forfeiture of 100 shares of Z 10 each (Z 6 called up) for non-payment of allotment money @ Z 3 per share, discount being Re.1 per share)		
Bank a/c .....Dr.		

Forfeited share a/c .....Dr. Discount on shares a/c .....Dr. To share capital a/c (Being the reissue of 100 shares of Z 10 each @ Z 8 per share as fully paid up) Forfeited share a/c .....Dr. To capital reserve a/c		

Sum up:

Share forfeiture is the process by which the directors of a company cancel the power of a shareholder if he does not pay his call money when the company demands for it. The company will give 14 days' notice; after 14 days if the shareholder does not pay then company will forfeit his shares and strike his name from the register of shareholders. The company will not repay the funds received from the shareholder. In order to do a share forfeiture the Articles of Association of the company should contain a provision for that.

Keywords: Forfeiture, Reissue, Capital Reserve, Annulments, Permissible limit of discount, Calls in arrear, Share Premium, Defaulting share holder.

Self Assessment Questions:

Journal entries for forfeiture and reissue of shares in the following cases:

1.(a) Real Estate Developers Ltd. forfeited 500 shares of Rs. 10 each held by Amarjeet Singh which were issued at a premium of Rs. 3 per share to be paid along with allotment money. He paid only application money of Rs 3 per share. 200 of these shares were reissued at Rs. 10 per shares

(b) Royal Enterprises Ltd. forfeited 200 shares of Rs. 10 each issued at a discount of 10%, on which only Rs.4 per share has been paid. Out of these, 100 shares have been reissued at Rs 7 per share.

2. Make journal entries (a) P Ltd. issued 400 shares of Rs. 10 each to Suresh on which he has paid Rs. 3 per share on application but failed to pay allotment money of Rs 3 per share and first call money of Rs 2 per share. His shares were forfeited before making the final call. These shares were later on reissued at Rs 8 per share fully paid up.

(b) A company issued 10000 shares of Rs 100 each at a premium of Rs 20 per share, payable as Rs 20 on application, Rs 60 including premium on allotment, Rs 20 each on two calls. Final call was not made. Pinky holding 200 shares did not pay allotment money and on her non payment of first call, her shares were forfeited by the board of the directors of the company. 150 of these shares were reissued at Rs 120 per share fully paid up.

3. Joy Entertain Ltd. issued 100000 shares of Rs 10 each at a premium of Rs 2 per share. The amount was payable as : Rs 3 per share on application Rs 5 (including premium) on allotment Rs 2 per share on first call and Rs 2 per share on final call MODULE - 5 Accounting for Shares and Debentures Notes 311 Reissue of Forfeited Shares ACCOUNTANCY Application were received for 150000 shares. All applications were accepted and allotment was made on prorata basis Sushil who was allotted 1000 shares fail to pay allotment money. On his subsequent failure of first call his shares were forfeited. Gomang who had applied for 750 shares failed to pay the two calls. His shares too were forfeited. All the shares of Sushil and 200 shares of Gomang were reissued at a discount of Rs 2 per share. Make journal entries in the books of the company and open necessary ledger accounts.

4. 21st Century Cotton Mills Ltd was registered with a capital of Rs 1000000 divided into 1 lakh shares of Rs 10 each. 50000 shares were offered to public for subscription at a discount of Rs 1 per share. The amount was payable as Rs 5 per share on application and allotment and Rs 4 per share on call. Applications were received for 48000 shares. Call was made and money was duly received except on 1000 shares. These shares were forfeited. 800 of forfeited shares were reissued at Rs 12 per share. Make journal entries in the books of the company. Prepare the Balance sheet also.

Model questions:

1. State the meaning and rules of forfeiture.

2. What do you mean by annulment of forfeiture? Describe the procedures of forfeiture.

3. Write in details the conditions of forfeiture.

4. What is reissue? What are the requirements of the companies act regarding reissue of shares?

5. Discuss the auditors duty regarding reissue of shares

6. Highlights the procedures and effects of reissue.

7. Write a short note on capital reserve

8. State the maximum permissible limit of discount on different conditions of reissue.

Further readings:

1. Modern Accountancy: Hanif and Mukherjee, volume –I, Tata Mcgrewhill.

2. Higher secondary Accounting: Biswal and Sharma.

3. Financial Accounting: P.C. Tulsian, Pearson.

4. An Introduction to Accountancy: S.N. Maheshwari, S.K. Maheshwari. Vikas.

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