Centre for Distance and Online Education

Punjabi University, Patiala

Class : B.COM Part-II **Semester:3**
Paper : B.C.304(Corporate Accounting- I) **Unit: I**
Medium : English

Lesson No. **(Updated on : 27 June 2023)**

Department website : www.pbidde.org

BC 304: CORPORATE ACCOUNTING -I

Time allowed : 3 hours | Max Marks: 100
Pass Marks : 35% | Internal Assessment: 30
Periods per week : 6 | External Assessment:70

Note : Simple Calculator(not scientific) is allowed

INSTRUCTIONS FOR THE PAPER SETTER/ EXAMINERS

The question paper covering the entire course shall be divided into three sections as follows.

SECTION-A

It will consist of essay type and numerical questions. Four questions, (two theory and two numericals), shall be set by the examiner from Unit-I of the syllabus and the candidate shall be required to attempt two. Each question shall carry 10 marks; total weight of the section shall be 20 marks.

SECTION-B

It will consist of essay type and numerical questions. Four questions, (two theory and two numerical), shall be set by the examiner from Unit-II of the syllabus and the candidate shall be required to attempt two. Each question shall carry 10 marks; total weight of the section shall be 20 marks.

SECTION-C

It will consist of 12 very short answer questions (six theory and six numericals) from entire syllabus. Students are required to attempt 10 questions up to five lines in length. Each question shall carry 3 marks; total weight of the section shall be 30 marks

UNIT - I

Corporate Accounting as per the Companies Act 2013: Issue, forfeiture and re-issue of shares; Redemption of preference shares; Issue and redemption of debentures; Issue of bonus shares and right shares; Underwriting of shares and debentures; Accounts of underwriters.

UNIT - II

Final Accounts including computation of managerial remuneration and disposal of profit; Profit prior to and after incorporation; consolidated balance sheet of holding companies with one subsidiary only.

Course outcome: The students will be well versed with the issue and redemption of shares and debentures, forfeiture of shares etc. They will be able to prepare final accounts in simple as well as consolidated form .

Relevant Accounting Standards must be discussed in the class.

Suggested Readings:

1. S.P.Jain: Corporate Accounting
2. C.M.Juneja: Corporate Accounting
3. VK Goyal: Corporate Accounting
4. Nirmal Gupta: Corporate Accounting
5. Raj Kumar Sah. Corporate Accounting

LESSON NO. 1.1 AUTHOR : PROF. DEVINDER KUMAR

COMPANY ACCOUNTS - ISSUE OF SHARE CAPITAL

Structure of the Lesson :

1.1.0 OBJECTIVES

The main objective of this Lesson is to provide detail about :

1. Issue of share capital;
2. Reissue and Forfeiture of share capital;
3. Pro-Rata Allotment of shares; and
4. Surrender of shares.

1.1.1 INTRODUCTION

To overcome the major limitations of sole proprietorship and partnership concerns, one of the most convenient form of organisation that grew with expansion of business requiring huge funds is the joint stock company form of Organisation. In India, joint stock companies are governed by provisions of the companies Act, 2013.

A limited company is a body corporate, that is an aggregation of persons and individual, arising by statute or Royal Charter, having the status of a separate being or person, the liability of whose members is limited according to circumstances.

1.1.2 MEANING OF COMPANY

Under section 2(20)(i) of the Companies Act, 2013. A company means of a company formed and registered under this Act or an existing company. Most of the companies may have a share capital with liability of the share holder limited to the amount remaining unpaid on the shares for which they have subscribed. A few companies may not have share capital, the liability being limited to the amount, members agree in the form of a guarantee. But such companies are very rare, i.e. non-profitable concerns, Chambers of Commerce, Institutions, or Clubs, etc.

1.1.3 CHARACTERISTICS OF A COMPANY

1. A company is a voluntary association of persons, nobody can compel any person to form a company.
2. A company has separate legal entity i.e. it can hold, purchase and sell properties, can open bank accounts in its own name and can enter into contract.
3. A company has common seal, being an artificial person.
4. A company has perpetual succession. Its continuity is not affected by the change in the membership.
5. Most of the companies are limited companies. In such cases the liabilities of members are limited to the amount he has agreed to pay to the company.

1.1.4 BOOKS OF ACCOUNTS

The Provisions of maintaining books of accounts are contained in Section 128 of the Companies Act 2013 as follow :

(a) All sums of money received and expanded by the company and the matters in respect of which the receipt and expenditure take place.
(b) All sales and purchases of goods by the company.
(c) The assests and liabilities of the company.
(d) In the case of company pertaining to any class of companies engaged in production, processing, manufacturing or mining activities, such particulars relating to utilisation of material or labour or to other items of cost as may be prescribed if such class of companies is required by the Central Government to include such particulars in the books of account.
(e) Books of accounts must give a true and fair view of the state affaris of the company or its branches
(f) Books of accounts must be kept on accrual basis and according to the double entry system of accounting.

1.1.5 SHARE CAPITAL

The information relating to the share capital of a company is to be given in the Balance Sheet under the broad heads like Authorised Capital, Issued

Capital and subscribed Capital, etc. under the provision of Schedule VI of the Companies Act, 2013. The said terms are described as under :

(i) Authorised Capital : It is maximum amount of share *capital* which a company is authorised to raise. This amount is stated in Memorandum of Association and is also *described as Registered* capital or *Nominal* capital.

(ii) Issued Capital : It is defined as the 'normal' amount of that part of authorised capital which is offered to public for *subscription* by the company and includes the shares taken up by the subscribers of the *Memorandum of Association.*

(iii) Subscribed Capital : Subscribed Capital is that part of the issued capital for which applications are received from the public.

(iv) Called up Capital : It is that *portion* of the subscribed *capital* which has been called up the *company*.

(v) Paid up Capital : It is that part of the called up share *capital for* which payment has been received by the company.

(vi) Uncalled Capital : It is that part of the *Subscribed* share capital on *which* no calls have yet been made by the *company.*

(vii) Unissued Capital : It is that part of the Authorised share capital which has not been offered for subscription to the public or to vendors of property acquired by the company.

(viii) Reserve Capital : It is that portion of the subscribed share capital not already called up in respect of which the company has by a special resolution determined it that it shall not be capable of being called up, except in the events of for the purpose of the winding up of the *company.*

STOCK

As per companies Act, 2013 (Section 61), When all the shares of a *company* have been fully paid up, they may be *converted* into stock if so authorised by the Articles of *association,* it is another types of unit of capital of company (Section 43).

1.1.6 TYPES OF SHARES

There are two types of shares :

(A) Preference Shares (B) Equity Shares

(A) Preference Shares :

The law defines preference share *capital* as of the share *capital* of company which enjoys preferential right as to :

(i) The payment of dividend at a fixed rate during the life of the company.

(ii) The repayment of capital on winding up of the company.

(B) Equity Shares :

The equity share capital is a share *capital* other than the *preference* share capital i.e. the dividends in respect of the said capital can be paid only after paying the preference dividend. As regards return of capital, Equity shareholder is paid only when the preference share capital is paid out fully. *However,* the Equity Share capital *carries* voting rights, whereas preference shares does not have such a right except in *certain* circumstances as laid down in the Act.

Classes of Preference Shares

i) Cumulative Preference Shares :

Holders of this class of shares are entitled to dividend of previous years also if not paid. If in any year dividend on the said shares can not be paid, the same shall be payable out of the profits to the subsequent years.

ii) Non-Cumulative Preference Shares :

In this case *holders* of the shares do not have the right to claim unpaid dividends of the past years. The right to receive dividend for a particular year lapse immediately if the profit of the years is not sufficient to pay the same.

iii) Redeemable Preference Shares :

They are such shares which would be repaid on or after a certain date in accordance with the terms of issue and as per the provision laid down in the companies Act, 2013.

iv) Convertible Preference Shares :

They have a right to be converted into Equity shares.

1.1.7 ISSUE OF SHARES

Shares are units of ownership of a Limited Company. It must raise the necessary capital before it begins the operations.

These are to be subscribed by the promoters, their friends, relations or by means of a public offer. The shares may be issued either at par or at a premium or discount. The amount of subscription may be paid in instalments or the entire amount at one time.

1.1.7.1 Entries of Issue of Shares

(a) If the shares are issued on one class at par, the entire amount being payable at once, the entries will be as follows :

(i) Sundry Members A/C ---------- Dr.

To Share Capital A/C

(ii) Cash/Bank A/C---------- Dr.

To Sundry Member A/C

If the amount is payable in instalment :

(i) For amount received on Application

Cash/Bank A/C -------------Dr.

To Share Application A/C

(ii) On allotment of share (For the value of application money received in respect of share allotted).

Share Application A/C ----------Dr.

To Share Capital A/C

(iii) For amount due on allotment

Share Allotment A/C ---------- Dr.

To Share Capital A/C

(iv) For money received on allotment

Cash/Bank A/C -----------Dr.

To Share Allotment A/C

(v) For excess money received on application returned to share holders :

Share Application A/C---------- Dr.

To Cash/Bank A/C

(vi) For adjusting the excess money on application towards amount due on allotment.

Share Application A/C---------- Dr.

To Share Allotment A/C

(v) When Shares are over subscribed some applicants are allotted lesser number of shares than they applied for

Share Application A/C---------- Dr.

To Share allotment account

To Calls-in-advance account

To Bank account

(Being excess application money adjusted against allotment and surplus transferred to calls in-advance account.)

(vi) When allotment money is demanded, the allotment money becomes due to the company

Share allotment A/C ----------Dr.

To Share Capital A/c

(vii) When allotment money is received

Bank A/C ------------ Dr.

To share allotment A/C

(viii) When some members fail to make the payment of allotment money

Calls in-arrears A/C ---------------Dr.

To share allotment account

(ix) When call money is demanded

Share first call A/C------------ Dr.

To share capital A/C

(x) When call money is received

Bank A/C ----------Dr.

To share first call A/C

(xi) When a part of call money is not received

Calls in arrears A/C ----------- Dr.

To Share first call A/C

(xii) When calls-in-advance money is adjusted

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

To Share Calls A/C

1.1.7.2 Issue of Shares to Vendors

Sometimes the company issue fully paid shares to the vendors from whom it buys it assets. These particulars should be given in the Balance Sheet and such shares must be distinguished from the one issued for cash.

The entries for that are as under :

(i) For purchase of assets i.e. machine, building etc.

Assets A/C ---------- Dr.

To Vendors A/C

(ii) For issue of shares.

Vendors A/C -----------Dr.

To Share Capital A/C

1.1.7.3 Issue of Shares at Discount

Under the Companies Act, 2013, a company shall not issue shares at *a discount* except as provided in Section 54.

A company may issue shares at a discount in the company of a class already issued. If the following conditions are fulfilled :

(i) The issue of share at a discount is authorised by a resolution passed by the company is generally meeting and sanctioned by the Central Government.

(ii) The resolution specifies the maximum rate of the discount at which the shares are to be issued. The maximum rate of discount allowable is 10% unless Central government is of the opinion that a higher percentage in special circumstances is necessary.

(iii) Atleast one year must have elapsed since the Company was entitled to commence business such shares if sanctioned by the Central government must be issued within two months or such extended time as the Central government may allow :

e.g. A company issued 10,000 shares of Rs. 100 each at a discount of 10%. Entries :

		Dr.	Cr.
(a)	Cash/Bank A/C----------Dr.	90,000	
	To Application & Allotment A/C		90,000
	(Being Application and allotment moneys issued vide resolution of)		
(b)	Share Application Allotment A/C----------Dr.	90,000	
	Discount on Shares A/C----------Dr.	10,000	
	To Share Capital A/C.		1,00,000

(Being issue of Shares at a discount of
10% vide resolution date)

1.1.7.4 Issue of Shares at Premium

A company due to its attractiveness of its shares may be able to issue shares at a premium. In other words it will issue the shares at a price which is above par. The premium received on shares shall be credited to a separate account called Securities Premium Account.

Securities Premium Account cannot be treated as free reserves, as they are in the nature of capital reserves. The utilization of Securities Premium Account may be made as follows :

(a) In paying up unissued share of the company to be issued to the members of the company as fully paid bonus shares.

(b) In writing off the preliminary expenses of the company.

(c) In writing off the expenses of or the commission paid or discount allowed on, issue of shares or debentures of the company, or

(d) In providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company.
These provisions are contained in Section 52(2) of the Companies Act,2013.

(e) For buying back of shares.
The following journal Entries are passed at the time of issue of shares at premium.

(i) Application/Allotment A/C----------Dr. (full amount)
To Share Capital A/C (with the amount of Face value)
To Securities Premium A/C (Amount of Share Premium)

(ii) Cash A/C---------- Dr.
To Application/Allotment A/C.

(Being receipt of cash on A/C of Application or allotment of Shares).

When both Preferences and Equity Shares are Issued

When a company issues both preference and equity shares then it is desirable that the entries for the application money, allotment money and calls money should be separately passed for each type of share capital. The words 'Equity' or 'Preference' must invariably be used in all the circumstances.

1.1.7.5 Calls in Arrears and Calls in Advance

If any amount has been called by the company either as allotment or call money and a shareholder has not paid that money, such amount is known as calls in arrears. On such calls, if the company's directors want and there is a provision in the Articles of Association, the company can charge interest @ 10% for the period for which such amount remained as arrear from the shareholders. Similar, if any call has been made but while paying that call, some shareholders have paid the amount of the rest of calls also, than such amount will be called as calls in advance and will be credited to a separate account known as calls in Advance account by passing the following entry-

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

To Calls in Advance A/C

Calls in Advance Account is shown on the liabilities side of the balance sheet separately from the paid up capital. Generally interest is paid on such calls as per the provisions of the Articles of Association but such rate should not exceed 12% p.a. Calls in advance are not entitled to any dividend declared by the company.

Reserves not Available for Issue of Bonus Shares :

Following reserves do not available for issue of bonus shares :-

1. Capital Reserve arising due to revaluation of assets.
2. Securities Premium arising on issue of shares on amalgamation or takeover.
3. Investment allowance reserve and development rebate reserve before expiry of 4 years of creation.
4. Balance in debenture redemption reserve account before redemption.
5. Surplus arising from a change in the method of charging depriciation.

1.1.7.6 Forfeiture of Shares

When a shareholder of a company fails to pay any call, the company, if empowered by its articles, may forfeit the shares. If a shareholder does not pay any call on the day fixed for payment and fails to pay it even in extra time given to him, then the Board of Directors will pass resolution to the effect that such share shall be forefeited. When such shares are forfeited the shareholder's name is removed from the register of members and amount already paid by him on the shares is forfeited by the company and it becomes the property of the company. The following journal entry is passed at the time of forefeiture of shares :

Share Capital A/C----------Dr.	(With the called-up amount)
Securities Premium A/C----------Dr.	(If not received)
To Unpaid Call A/C	(With the Unpaid amount)
To Discount on issue A/C	(If shares are issued at discount) To
Shares Forefeited A/C	(With the amount already received)

NOTE : If shares are issued at a premium which has been received, the amount may remain in Securities premium account if it is realised. If not received the amount of premium should be written back by debiting the Securities Premium A/C. If the shares were issued at discount, the discount on shares account is credited, at the time of forefeiture for the amount of discount allowed.

1.1.7.7 Reissue of Forfeited Shares

Forfeited shares may be reissued by the company as and when the company finds it suitable and convenient. However, the price charged on the reissue of shares must not be less than the amount that was in arrear when shares are forfeited. The discount allowed has to be debited to the shares forfeited account.

The following journal entry is to be passed at the time of reissued of shares :-

Bank A/C----------Dr.	(Actual amount received)
Discount on the issue of with Shares A/C --------- Dr.	(If the shares were issued at discount the amount of discount of reissue)
Share Forfeited A/C ----- Dr.	(Total discount allowed on reissue less original discount).
To Share Capital A/C	(with the face value of shares)
To Securities Premium A/C	(If the shares are reissued at premium).

The amount standing to the credit of share forfeited account, in respect of forfeited shares not yet re-issued, should be shown in the Balance Sheet by way of addition to paid-up capital under a separate head.

After reissue of all the Forfeited Shares if there is no balance in the shares Forfeited account, then there will be a capital profit. But where there is profit on the reissue of all Forfeited shares, i.e. shares Forfeited account is showing credit balance after reissue of all Forfeited shares, such profit should be treated as capital profit and the balance transferred to capital reserve account by passing the following entry :

Share forfeited A/C----------- Dr.

To Capital Reserve A/C

Capital Reserve will be shown on liabilities side of the Balance Sheet and can be used for writing off capital losses.

1.1.8 PRO-RATA ALLOTMENT

'Pro-rata allotment' means allotment is in proportion of shares applied for - Adjustment of excess money towards the amount due on the allotment and calls

Sometimes a company may not allot all the shares for which applications have been received, because of over-subscription, the allotment is either made of less number of shares or on pro-rata basis. For example, if the company offered Rs. 1,50,000 share of Rs. 10 each but applications for 20,000 shares were received by the company. The Directors sent letters of regret to application of 5,000 shares and applicants for 15,000 shares were allotted 10,000 shares on pro-rata basis.

In such a case, application money of 5,000 shares will be adjusted either on allotment and on calls, if there is still surplus money after adjusting the allotment and call money due from shareholders, if will be paid in cash.

PRO-RATA ALLOTMENT AND FORFEITURE OF SHARE

In case of *pro-rata* allotment of shares, the students may face difficulty to find the amount not received on a particular call, if such shares have been forfeited. It will be better to find the number of shares applied for in such a case on the following basis :-

$$\frac{\text{Total Shares applied for}}{\text{Total Shares allotted}} \times \text{Shares alloted to defaulting shareholders}$$

It is important here to mention that the question of *pro-rata* allotment arises only in case if there is over subscription. In such a situation company can not satisfy all the applicants, thus the company may either :

(i) Reject the excess applications in full;

(ii) Allot proportionately to all the applications; and

(iii) Reject some applications and allotment may be made proportionately to the rest applicants.

'Pro-rata allotment' means allotment is in proportion of shares applied for.

Accounting Entries

(a) For rejected application

Share Application A/C ---------- Dr.

To Bank Account

(Being excess application money refunded)

(b) For pro-rata allotment

Share Application account ------- Dr.

To Share Allotment Account

(Being excess application money adjusted with allotment money)

1.1.9 EXAMPLE :

ABC Limited, issued prospectus inviting applications for 20,000 shares of Rs. 10 each at a premium of Rs. 2 per share on application, Rs. 5 on allotment (including premium), Rs. 3 on first call, Rs. 2 on second call.

Applications were received for 30,000 shares and allotment made pro-rata to the applicants of 24000 shares, money overpaid on application was employed on accounts of sums due on allotment.

Mr. x to whom 400 shares were allotted, failed to pay the allotment money and on his subsequent failure to pay the first call. His shares were Forfeited. Mr. Y, the holder of 600 shares failed to pay both calls and his shares were Forefeited after the second call. 800 shares out of 1100 forfeited shares were reissued at Rs. 9 per share fully paid up. The whole of Mr. X share being included.

Pass the necessary journal enteries.

Solution

Books of ABC Limited

Journal Entries	Rs.	Rs.
Bank A/C------- Dr. To Share Application A/C (Being application money received on 30,000 shares @ Rs. 2 per share)	60,000	60,000
Share Application A/C ------- Dr. To Share Capital A/C To Bank A/C (Being transfer of application money on 20,000 Shares @ Rs. 2 Share Capital A/C and refunded application money to applicants of 6,000 shares @ Rs. per share)	52,000	40,000 12,000
Share Application A/C ------- Dr. To Share Capital A/C To Securities Premium A/C (Being allotment money due on 20,000 Shares @ Rs. 5 per share including premium of Rs. 2 per share)	1,00,000	60,000 40,000
Bank A/C ------- Dr. Share Application A/C ------- Dr. To Share Allotment A/C (Being receipt of allotment money and surplus money on application adjusted to Shares Allotment A/C).	90,160 8,000	98,140
Shares First Call --------Dr. To Share Capital A/C (Being First call due on 20,000 shares @ Rs. 3 per share).	60,000	60,000
Bank A/C -------- Dr. To Share Capital A/C (Being receipt of first Call money on 19000 shares @ Rs. 3 per share 20,000 - (600 + 400).	57,000	57,000
Share Capital A/C -------- Dr. Securities Premium A/C --------- Dr.	3200 800	

To Share Allotment A/C To Share First Call A/C To Share Forfeited A/C (Being forfeiture of 400 shares held by Mr. X for non- payment of allotment money and first call money)		1840 1200 960
Share Second & Final Call A/C ---------- Dr. To Share Capital A/C (Being Second and Final Call due on 19000 Shares @ Rs. 2 per share)	38,000	38,000
Bank A/C -------- Dr. To Share Second & Final Call A/C (Being receipt of Second and Final Call due on 19000 shares @ Rs. 2 per share)	38,000	38,000
Share Capital A/C --------- Dr. To Share First Call A/C To Share Second & Final Call A/C To Share Forfeited A/C (Being forfeiture of 600 shares held by Mr. Y fornon-payment of First Call @ Rs. 3 and Final Call@ Rs. 2 per share)	6,000	1800 1200 3000
Bank A/C -------- Dr. Share Forfeited A/C ---------- Dr. To Share Capital A/C To Capital Reserve A/C (2) (Being 800 shares out of 1000 forfeited shares reissued @ Rs. 9 at discount of Rs. 1 per share and the balance of share forfeited A/C on 800 shares transferred to Capital Reserve A/C)	7,200 2,960	8,000 2,160

WORKING NOTE :

1) CALCULATION OF AMOUNT RECEIVED ON ALLOTMENT :

Amount due on allotment on 20,000 shares @ Rs. 5	Rs.
Less : Excess application money : of 4,000 if shares	1,00,000
adjusted on allotment (4000 × 2)	8,000
	92,000

Less : Amount not received on 400 shares :
If allotment 20,000 shares, applied for 24,000 shares
and allotted 400 shares applied 480 $\left(\frac{\text{i.e. } 24000 \times 400}{20,000}\right)$

Surplus money of application 80 × 2 = Rs. 160
Amount of allotted due on 400 shares

400 × Rs. 5 =	Rs. 2,000	
	Less Rs. 160	1,840
		90,160

2) Calculation of Amount Transferred to Capital Reserve :

		Rs.
Total money received on 800 re-issued forfeited shares Rs. 960 + 2,000	2,960	
Less : Discount allowed on reissue of 800 forfeited shares		800
		2,160

Example :

X. Co. Ltd. invited for 20,000 equity shares of Rs. 10 each at a premium of Rs. 2 per share, payable Rs. 3 on application, Rs. 7 on allotment including premium and the balance on first all final call.

Applications for 25,000 shares were received. It was decided :

a) to refuse allotment to applicants for 1,000 shares.
b) to allot in full to applicants for 4,000 shares.
c) to allot the balance of the available shares on pro-rata among the other applicants, and
d) to utilise excess application money in part payment of allotment money.

Mr. X holding 200 shares to whom shares had been allotted on pro-rata basis failed to pay the amount due on call only. These shares were forfeited.

160 forfeited shares of Mr. X and 40 forfeited shares of Mr. Y were re-issued at a discount of Rs. 1 per share to Mr. Z.

Show the necessary journal entries including cash in the books of X Co. Ltd.

JOURNAL

Solution :

Date	Particular	L.F.	Debit Amount	Credit Amount
			Rs.	Rs.
	Bank Account ---Dr.		75,000	
	To Share Application Account			75,000
	(Being the receipt of application money on 25,000 share @ Rs. 3 per share)			

	Share Application Account ---Dr. To Share Capital Account (Being the transfer of the application money on 20,000 shares allotted to share capital account)	60,000	 60,000
	Share Allotment Account ---Dr. To Share Capital Account To Share Premium Account (Being the allotment money due on 20,000 @ Rs. 7 per share including premium)	1,40,000	 1,00,000 40,000
	Share Application Account ---Dr. To Bank Account (Being the return of the application money on 1,000 shares rejected)	3,000	 3,000
	Share Application Account ---Dr. To Share Allotment Account (Being the transfer of excess application money on shares allotment to shares allotment account)	12,000	 12,000
	Bank Account ---Dr. To Share Allotment Account (Being the receipt of allotment money from all shareholders except X holding 200 shares to whom pro-rata allotment has been made (See note No.3)	1,26,750	 1,26,750
	Share Final call Account ---Dr. To share Capital Account (Being the final call money due on 20,000 shares @ Rs. 2 per share)	40,000	 40,000
	Bank Account ---Dr. To Share Final Call Account (Being the receipt of final call money from all except X holding 200 shares and Y holding 100 shares)	39,400	 39,400
	Share Capital Account ---Dr. Share Premium Account ---Dr. To Share Forefeited Account To Share Allotment Account To Share Final Call Account	3,000 400	 1,550 1,250 600

	(Being the forfeited of 200 shares of Mr. X due to the non-payment of allotment and call money and 100 shares of Y due to the non-payment of call money as per Board's resolution, dated.....................)		
	Bank Account ---Dr. Bank Forfeited Account ---Dr. To Share Capital Account (Being the reissue of 160 share of X and 40 shares of Y at a discount Rs. 1 per share)	1,800 200	 2,000
	Share Forfeited Account ---Dr. To Capital Reserve Account (Being the share premium of Rs. 2 due on 160 forfeited shares of X and gain on the reissue on 200 shares transferred to Shares Premium Account and Reserve Account)	720	 720

At a later date and before further calls were made, 500 of these shares were reissued as fully paid for a consideration of Rs. 8/- per share. Write up Ledger Accounts.

Note : 1. The company had received application for 25,000 shares. Since the total number of shares offered to the public were 20,000 the allotment cannot exceed 20,000 shares. There has been firm allotment to the applicants of 4,000 shares 16,000 shares have been allotted to the applicants of 20,000 shares on pro-rata basis. Since no allotment has been made to the applicants of 1,000 shares, therefore the application money to these applicants has been refunded.

2. X had paid Rs. 750 on application, which has been calculated as follows : Shares allotted 16,000 out of shares applied for 20,000
Shares allotted 200 out of shares applied for

$$\frac{20{,}000}{16{,}000} \times 200 = 250$$

Application money on 250 shares @ Rs. $3 = 250 \times 3 =$ Rs. 750

3. Amount due from X on allotment is Rs. 1,250 and not Rs. 1,400 (i.e. 200×7). It has been calculated as follows :

Total (Gross) amount due on allotment on 200 shares = 1400
Less advance from X received on application adjusted towards allotment.
Received on application 250×3 = 750

Adjusted on application (200 ×3) = 600

Advance adjusted towards allotment 150

New amount due on allotment Rs. 1400 - Rs. 150 = Rs. 1,250

Total amount received on account of allotment is

Rs. 1,40,000 - Rs. 12,000 - Rs. 1,250 = Rs. 1,26,750

1.1.10 SURRENDER OF SHARES

After the allotment of shares, sometimes a shareholder is not able to pay further calls and return his shares to the company for cancellation. Such voluntary return of shares to the company by the shareholders himself is called surrender of shares. Surrender of shares has no separate accounting treatment but it will be like that of Forfeiture of shares. Thus, the same entries (as are passed in case of forfeiture of shares) will be passed in case of Surrender of Shares.

1.1.11 PRIVATE PLACEMENT OF SHARES [SECTION 42 (1)]

Private placement of shares implies issue and allotment of shares to a selected group of persons and not to the general public. For such a placement, a company must pass a special resolution to this effect. Where no special resolution is passed, but the number of votes cast in favour of such company exceeds the number of votes cast against the proposal, the board of directors of such company can make an application to the central government for obtaining consent by stating that the proposal is most beneficial to the company.

According entries for private placement of securities are to be the same as are passed at the time of application and allotment as also the accounting entries passed for the issue of shares for a consideration other than cash.

1.1.12 Self Check Exercises

Ques1: What is Authorized Capital?

Ques2: What is issued capital?

Ques3: What do you understand by the term calls in arrears and calls in advance?

1.1.13 Summary

The capital of the company is divided into units called shares. Company issues the shares to the public and generate capital for the company. There are different types of share capital such as authorized capital, issued capital, subscribed capital, called up capital, paid up capital, uncalled capital, unissued capital. There are two types of shares namely equity shares and preference shares. As per Companies Act, 2013, a company shall not issue share at a discount but can issue share at par and premium.

1.1.14 Glossary

1. Authorized Capital: It is maximum amount of share capital stated in Memorandum of Association, authorize the company to raise during the life time of the company.
2. Reserve Capital: It is that part of subscribed share capital not already called up but it would be called for the purpose of winding of the company, as in this respect, company has passed special resolution.
3. Forfeiture of share: When a shareholder fails to pay any call, the company as per

article of association may forfeit the share.

4. Surrender of share: When a shareholder returns his share voluntarily to the company for cancellation due to unable to pay further calls called surrender of shares.

1.1.15 Short Question

Ques1: What is the difference between Reserve Capital and Capital Reserve?

Ques2: Explain the conditions where premium received on shares can be utilized?

Ques3: Explain the difference between equity shares and preference shares?

Ques4: Explain the types of preference shares?

1.1.16 Long Questions

Ques. 1. Write short notes on :

1. Forfeited Shares
2. Surrender of shares
3. Calls in Advance.

Ques. 2. What do you mean by Pro-rata allotment ?

Ques. 3. Explain briefly the provisions of Companies Act regarding

(1) Issue of shares at discount

(2) Issue of shares at premium

Ques.4. What is Forfeiture of Shares? When can shares be forfeited and how?

Ques.5. Young Farmers Limited issued 2,00,00 Shares of 10 each. Terms of payment being Rs. 3 on application, Rs. 2 on allotment and Rs.

4 on 'First and Final Call'. The company received application for 2,80,000 shares, pro-rata allotment was made on the application for 2,50,000 shares. Give journal entries assuming that an applicant who was allotted 1000 shares did not pay "allotment" and "First and Final Call" money.

Ques. 6. A Ltd. Whose authorised share capital is Rs. 10,000 in Rs. 10 shares issued the whole of its capital at a premium of Rs. 1/- per share, payable as follows : On application and allotment Rs. 6 per share (including premium), First call of Rs. 1/- per share.

The application and allotment money were received in full, but members holding 1000 shares failed to pay the call of Rs. 1/- per share, in consequences the shares were forfeited.

1.1.17 SUGGESTED READINGS

1. Corporate Accounting
By : Jain and Narang
2. Corporate Accounting
By : C. Mohan Juneja
B.K. Sachdeva
Inderjit Singh
Rakesh Katyal

LESSON NO. 1.2 AUTHOR : PROF. DEVINDER KUMAR

REDEMPTION OF PREFERENCE SHARES

Structure of the Lesson :

1.2.0 OBJECTIVES

The main objective of this lesson is to introduce the students with the lastest provisions of section 55 of the Companies Act, 2013. These provisions are about redemption of Preference shares, such as, capital redemption reserve account's treatment, Process of Fresh issue, and accounting entries to redeem the share capital.

1.2.1 INTRODUCTION

A company is not allowed to return to its shareholders the share money without the permission of the court as per of the companies Act. But in case, the refund is made to the redeemable preference shareholders, then such permission is not required. However u/s 55 of the Companies Act the company limited by the shares may if authorised by its articles, issue preference share which are at the option of the company liable to be redeemed with in a period not exceeding 20 years from the date of issue. But company may issue preference shares for a period exceeding twenty years for infrastructure projects.

1.2.2 PROVISIONS ABOUT REDEMPTION OF PREFERENCE SHARES

(a) No such shares shall be redeemed except out of profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of the redemption.

(b) No such shares shall be redeemed unless they are fully paid.

(c) The premium, if any payable on redemption shall have been provided for out of the profits of the company or out of the company's securities premium account before the shares are redeemed.

(d) Where any such shares are redeemed otherwise than out of the proceeds of a fresh issue, they shall be redeemed out of a profit which would otherwise have been available for dividend, be transferred to a reserve fund to be called the "Capital Redemption Reserve Fund", a sum equal to the nominal amount of shares redeemed, and the provisions of the act relating to the reduction of the share capital of a company shall, except as provided in this section apply as if the Capital redemption reserve account were paid up share capital of the company.

If those shares are redeemed out of the proceeds of new issue, no stamp duty shall be payable on the new issue if the preference shares are redeemned within one month of the new issue.

However, where a company is not in a position to redeem any such shares within the required period and to pay the dividend due thereon, it may, issue further redeemable preference shares (make a fresh issue) equal to the amount due including the dividend thereon in respect of the unredeemed preference shares. By the issue of such further shares the unredeemed preference shares shall be deemed to have been redeemed.

Where a company has issued redeemable preference shares the Balance Sheet must show separately the amount thereof, the term of redemption or conversion and the earlier date of redemption or conversion.

If a company does not have sufficient accumulated profits and does not issue any shares for the specific purpuse of redemption of preference shares, the redemption will be illegal. Further, the issue of debentures need not be considered for this purpose, if the preference shares are to be redeemed at a premium. The premium may be debited to the profit & Loss Account or Securities Premium Account.

The premium received on the issue of shares may not be considered for the redemption of preference shares when only the face value will be utilised. However, the said premium may be utilised for providing premium payable on the redemption of preference shares etc.

If the redeemable preference shares are redeemed partly out of the profit of the company which would otherwise be available for dividend and partly out of the proceeds of fresh issue for shares, the Capital Redemption Reserve Account and the new Share Capital (Equity or Preference) taken together will replace the Redeemable Preference Share Capital redeemed.

1.2.3 CAPITAL REDEMPTION RESERVE ACCOUNT

The companies Act permits the redemption of shares from out of the profits, which are otherwise available for dividend. In case the redemption is out of profits, the company is expected to transfer an equal amount to an account called 'Capital Redemption Reserve Account' out of divisible profits.

Table-I is showing the profits available for redemption and not available for redemption.

Profits available for redemption redemption	Profits not available for
1. Reserves	1. Security Premium Account
2. General Reserve	2. Share forfeited Account
3. Reserve Fund	3. Profit prior to incorporation
4. Dividend equalisation fund	4. Capital reserve
5. Insurance fund	5. Development rebate reserve
6. Workmen's compensation fund	
7. Workmen's accident fund	
8. Voluntary debenture redemption account	
9. Debenture sinking fund	
10. Profit and Loss Account (cr.)	

There is much scope for confusion as to what should constitute the "proceeds of fresh issue" in various circumstances like, issue of shares.

(i) at par,

(ii) at a premium

1.2.4 PROCEEDS OF FRESH ISSUE

The word 'proceeds' used in the present context implies the amount received excluding the amount of share premium, if the shares are issued at a premium but the net amount received if shares are issued either at par or at discount.

This point is particulary important to determine the amount not covered by fresh issue for transfer to Capital Redemption Reserve Account.

For this, the following principles should be followed :

1.2.4.1 When fresh issue of shares is made at par :- In such a case, the nominal value of the shares issued will constitute the proceeds and the same should be considered for determining the amount to be credited to Capital Redemption Reserve Account.

1.2.4.2 When fresh issue of shares is made at a premium :- In such a case, the confusion may arise as to whether the nominal value of the shares issued should constitute the 'proceeds' or both the nominal value shares issued and the premium money received on those shares should constitute the 'proceeds'.

A critical analysis of the provisions of the Companies Act, clearly state that where a company issues shares at a premium, a sum equal to the aggregate amount of the premium received be credited to a separate account called 'Securities Premium Account' and the provisions relating to the reduction of capital shall apply if the securities premium Amount is utilised otherwise than for the purposes specified there in. Thus, it is clear that the premium received on issue of share should be disregarded and only the nominal value of the shares issued should be considered for determining the amount to be credited to Capital Redemption Reserve Account.

1.2.5 ACCOUNTING ENTRIES

The following steps for solving problem is suggested :

(1) If there is a fresh issue of share capital then make journal entry for it. This issue can be made either at par or at premium or at discount. Entries for the issue will be same as in usual way.

(a) Bank A/C.............Dr. (Where shares issue at par)
To share Capital A/C

(b) Bank A/C.............Dr. (Where shares are issued at premium) To
Share Capital A/C
To Securities Premium A/C

(2) Second step is to make entry for redemption of preference shares. This redemption can be done either at par or at premium. If redemption takes place at premium, premium is a loss and loss should be debited. Journal entry :

(a) Redeemable Preference Share Capital A/C........Dr.
(value) Premium on Redemption A/C........Dr.
(Premium) To Preference Shareholder A/C (Total amount payable)

(b) Preference Shareholders A/C .... Dr.
To Bank A/C (Payable to preference shareholders)

(c) If the redemption is at par, the journal entry is :

Redeemable Preference Share Capital A/C........Dr. (Value)
To Bank A/C

(3) Third step is to transfer premium on redemption account. Premium on the redemption of preferences shares can be transferred either to profit and loss account or any reserve account or Securities premium account. Although there is no restriction on transferring this account to any particular account it is desirable to set it off against securities premium account which can be used only for limited purposes. Journal entry for this :

Securities Premium A/C .... Dr.
Or
Profit & Loss A/C ....Dr.
Or
General Reserve A/C .... Dr.
To Premium on Redemption of Preference Share Capital A/C

(4) Transfer appropriate amount from Profit and Loss Account or general reserve or any other reserve to meet the deficiency of the amount required for redemption of preference shares by passing following entry :

Profit & Loss A/C ....Dr.
Or
General Reserve A/C .... Dr.
Or
Any other Revenue Profit A/C.............Dr.
To Capital Redemption Reserve A/C

(5) If liquid assets are not available for making payment to preference shareholders on redemption then either current assets may be by the company or bank overdraft may be arranged. The entry will be :

Bank A/C .... Dr.
Or
Profit & Loss A/C........Dr. (If loss on sale of assets)
To Current Assets A/C
(Note : If profit on sale then reverse entry)

(6) If Bonus shares are issued out of capital redemption reserve account, the following journal entries are made :

(i) When decision is taken to issue Bonus Shares
capital Redemption Reserve A/C ....Dr.
To Bonus to Shareholders A/C

(ii) When bonus shares are issued
Bonus to Shareholders A/C ....Dr.
To Share Capital A/C

(7) If shares are redeemed by converting into some other type of shares, then the entry will be :

Preference Share Capital A/C.............Dr.

To New Share Capital A/C

In this case no amount is needed to be transferred to capital redemption reserve account.

1.2.6 EXAMPLE :

A company has 4,000 6% redeemable preference shares of Rs. 10 each fully paid. The company decided to redeem the shares on December 31, 2007 at a premium of 5 percent. The company makes the following issues :

(a) 1,000 equity shares of Rs. 10 each at a premium of 10%

(b) 1,000 9% debentures of Rs. 10 each.

The issue was fully subscribed and whole the amount was received. The redemption was duly carried out and the company has sufficient profits. Give Journal entries.

SOLUTION :

	JOURNAL ENTRIES	Dr. Rs.	Cr. Rs.
2007 Dec. 31	Bank A/C................Dr. To Equity Share Capital A/C To Securities premium A/C (Being the issue and allotment of 1000 Shares of Rs. 10 each at a premium of Rs. 1)	11,000	 10,000 1,000
Dec. 31	Bank A/C................Dr. To 9% Debentures A/C (Being issue of 1000, 9% debentures of Rs. of 10 each)	10,000	 10,000
Dec. 31	Profit and Loss A/C .... Dr. To Premium on Redemption of Preference Share A/C (Being provision of premium of 5% payable on redemption of 4,000 redeemable preference shares of Rs. 10 each (4000 × Rs. 0.5)	2,000	 2,000
Dec. 31	Profit and Loss A/C .... Dr. To capital Redemption Reserve A/C (Being amount transferred to Capital Redemption Reserves A/C, the amount uncovered by the face value of the shares issued)	30,000	 30,000

	6% Redeemable Preference Shares Capital Account........................Dr.	40,000	
	Premium on Redemption of Preference Shares A/C..................Dr.	2,000	
	To Bank A/C		42,000
	(Being repayment of the 4,000 redeemable preference shares of Rs. 10 each at a premium of Rs. 0.5 per share)		

Example : The 3,000 6% Redeemable Preference Share of Rs. 100 each fully paid of X Ltd. were due for redemption on 30.6.2008 at a premium of 5%. The company made an issue of 2,000 Equity Shares of Rs. 100 each at a premium of 20% on the above mentioned date. The issue was immediately subscribed and paid for expense of issue of the shares came to Rs. 10,000. The General Reserve and the Profit and Loss Account had balance of Rs. 3,50,000 and Rs. 60,000 respectively on 30.6.2008. The redemption was carried out, holders of 500 shares not being traceable. A bonus issue of Rs. 30,00,000 in the form of fully paid equity shares was made.

Show the journal entries for issue of shares and redemption of shares assuming the revenue Reserve or Surplus is to be used to minimum extent possible.

SOLUTION : BOOK OF X LTD.

	Journal Entries	Dr. Rs.	Cr. Rs.
2008 30 June	Bank A/C................Dr.	2,40,000	
	To Equity Share Capital A/C		2,00,000
	To Securities Premium A/C		40,000
	(Being 2000 equity shares of Rs. 100 each Issued at a premium of 20% for purpose of redemption of preference shares.)		
30 June	Share Issue Expenses A/C.............Dr.	10,000	
	To Bank A/C		10,000
	(Being expenses of the issue of share paid)		
30 June	6% Redeemable Preference Share Capital A/C..................Dr.	3,00,000	
	Premium on Redemption of Preferences Shares A/C....................Dr.	15,000	
	To Redeemable Preference Share A/		3,15,000

	(Being amount due to the redeemable preference shareholders on redemption in respect of capital and premium)		
30 June	Redeemable Preference Shareholder A/C ....Dr.	2,62,500	
	To Bank A/C		2,62,500
	(Being amount due on redemption paid excep 500 shares whose holders were not traceable)		
30 June	Securities remium A/C .... Dr.	25,000	
	To Premium on Redemption of Preference Share A/C		15,000
	To Share issue expenses A/C		10,000
	(Being providing of premium payable on redemption @5% on Rs. 30,00,000 and writing off share issue expenses out of share premium		
	General Reserve A/C .... Dr.	1,00,000	
	To Capital Redemption Reserve A/C		1,00,000
	(Being creation of Capital Redemption Reserve A/C out of general Reserve i.e. Rs. 1,00,000 (Rs. 3,00,000-Rs. 2,00,000)		
	Capital Redemption Reserve A/C ....Dr.	1,00,000	
	Share Premium A/C .... Dr.	15,000	
	General Reserve A/C .... Dr.	1,85,000	
	To Bonus to Shareholders A/C		3,00,000
	(Being amount of Bonus shares to be issued)		
	Bonus to Shareholders A/C .... Dr.	3,00,000	
	To Equity Share Capital A/C		3,00,000
	(Being fully paid Bonus share of Rs. 3,00,000 issued)		

1.2.7 Self Check Exercises

Ques1: What do you understand by the term Capital Redemption Reserve Account?

Ques2: Write down the profits available for redemption of preference shares?

1.2.8 SUMMARY

As per company act it is not allowed to return shares to its shareholders, while the company is in existence. But section 55 of the companies Act allows a company, if authorised by its articles to issue preference shares which at the option of the company may be redeemed, if the conditions are to be satisfied.

Redemption of redeemable preference shares shall be notified to the registrar of companies within one month of redemption. Therefore the Companies Act has laid down manifold conditions for the redemption of preference shares.

1.2.9 Glossary

1. Capital Redemption Reserve Account: The Company Act allows the redemption of shares out of profits then a company transfers the equal amount to a account called Capital Redemption Reserve Account.
2. Premium: When shares are issued at a price which is more than its face value.
3. Preference Share: Preference shares are those which are entitled to get preference over equity in respect of payment of dividend and redemption of capital in the event of winding of the company.

1.2.10 Short Question

Ques1: Explain the provisions about redemption of preference shares?

Ques2: Explain the profits which are not available for redemption of preference shares?

1.2.11 Long Questions

Q.1. What are the sources of redemption of preference shares?

Q.2. A company wishes to redeem its preference shares amounting to Rs. 1,00,000 at a premium of 5%. The company has also a balance of Rs. 1,00,000 in General Reserve. Give Journal entries to record the above.

Q.3. Explain the procedure (along with journal entries) for solving problems on Redemption of Preference Shares.

Q.4. A company has 8,000 redeemable preference shares of Rs. 10 each fully paid. The company decides to redeem the shares on 30th September 2006 at a premium of 5%. The company had sufficient profits but in order to augument liquid funds the following issues are made :

(a) 3,000 6% Debentures of Rs. 10 each at Rs. 10.60.

(b) 2,000 Equity shares of Rs. 10 each at Rs. 11.

The issues were fully subscribed and all the amount were received. The redemption was duly carried out. Give journal entries.

1.2.12 SUGGESTED READINGS

1. Corporate Accounting,

By : C. Mohan Juneja, B.K. Sachdeva, Inderjit Singh, Rakesh Katyal, Kalyani Publishers.

2. Corporate Accounting

By : S.P. Jain

K.L. Narang

Kalyani Publishers.

LESSON NO. 1.3 AUTHOR : PROF. DEVINDER KUMAR

ISSUE OF DEBENTURES

Structure of the Lesson :

1.3.0 OBJECTIVES

The main objectives of this lesson is to introduce the students with the latest provisions or treatment of issue of debentures, kinds of debentures, SEBI guidelines for issue of debentures and guidelines for the protection of interest of debentureholders.

1.3.1 INTRODUCTION

A debenture is a *document acknowledging* a loan to company and is generally executed under the seal of the company, usually containing provisions as to payment of interest and the payment of principal and giving a charge on the assets of such company and may give security for the payment over some or all of the assets and undertaking of company.

It has been defined under the Companies Act, 2013 as Debenture includes debenture stock, bonds and any other securities of a company or not.

1.3.2 BORROWING POWERS OF THE COMPANY

This is usually *provided* in the *memorandum of Association. Although* it has been held that a trading company has an implied power to borrow without restriction, such power is usually exercised by the Board unless the Articles specify otherwise and includes an implied power to give security for money borrowed. Sec. 180 restricts the *power* of the Board to borrow money where such borrowings together with existing borrowings (apart from temporary loans from bankers of the ordinary course of business) exceed the aggregate paid up Capital of this company and its free reserves.

1.3.3 KINDS OF DEBENTURES

1. From Security Point of View :

   These are of two types :

   (i) Naked Debentures :

   The naked debentures are the debentures which are not secured.

   (ii) Mortgage Debentures :

   These debentures are secured either on a particular assets called 'Fixed Charge' or on the general assets of the company called floating charge.

2. From the Priority Point of View :

   (A) First Debentures :

   First debentures are those debentures which are repaid before the payment of any other debenture.

   (B) Second Debentures :

   These debentures are paid after the payment of First debentures.

3. From Permanence Point of View :

   (a) Redeemable Debentures : Redeemable debentures are those debentures which are redeemed or the payment of which is made after a specified time.

   (b) Irredeemable Debentures : Those *debentures* which are *repayable* after a long period of time or on the winding up of the company. In other *words the debenture holders,* in this case cannot demand the payment from the company so long as it is a going concern.

4. From Recording Point of View :

   (a) Bearer Debentures : Which can be transferred by mere *delivery.* The company does not keep any record of such kind of debenturesholders name and addresses, payment of interest is made on production of coupons attached to the debentures.

   (b) Registered Debentures: This type of debentures are transferred only by Transfer deed. The complete particulars in regard to such debentures are entered in the register and the interest is paid only to those, whose name appears in the register.

5. From Conversion Point of View :

   (a) Convertible Debentures : The holders of such debentures are given the option to convert the debentures fully of partly into equity shares after a specified time.

(b) Non-convertible Debentures : The holders of which have no right convert them into equity shares.

1.3.4 FIXED AND FLOATING CHARGES

A fixed charge is a creation of mortgage on specific assets, which usually allow the company to certain possession of the asset changed but prevents it from parting or dealing with such assets without the permission of the debentures holders or the Trustees for debentures holders.

A floating charge is the general charge on assets or class of assets in favour of debentures holders, in such a case the company is entitled to deal with the disposal of assets in the ordinary course of business until the occurrence of events specified in debenture trust deed (i.e. winding up, non- payment of interest or principal etc.) when the charge crystalises and become fixed, then the company cann't deal with the property with the consent of the debenture holders or the trustees.

1.3.5 ADVANTAGES OF ISSUE OF DEBENTURES

1. The bear a lower rate of return by way of interest in view of the *security provides* and *resulting* lower *risk factor.*

2. Debenture holders may be repaid without recourse to the courts.

3. Debenture holders are not members of the company and have no control over the business.

4. Interest paid on debentures is an allowable *expenses for Income Tax.* Dividend on shares *are not so allowable.*

5. The statutory *restriction on issue of shares at a discount do not apply.*

1.3.6 DIFFERENCE BETWEEN DEBENTUREHOLDER AND SHAREHOLDER

DEBENTUREHOLDER	SHAREHOLDER
(a) They are loan creditors of the the company.	(a) Shareholders are proprietors of company.
(b) They are entitled to interest on any The amount lent by them.	(b) They are entitled to dividend if declared out of the profits of the company.
(c) The interest must be paid whether or not there are profits (i.e. it is a charge on the profits.	(c) Dividend is paid only when there are profits (i.e. it is anappropriation of profit).
(d) Debentures are paid back as per without terms of redemption.	(d) Shares cannot be paid back legal formalities.
(e) In case of winding up the debentures holders are paid first.	(e) Only out of the balance money left after payment of all liabilities they

	are paid.
(f) Debentures can be issued on any discount conditions.	(f) Shares can be issued at a but with certain legal formalities.

1.3.7 DISCOUNT BETWEEN DEBENTURE AND DEBENTURE-STOCK

The debenture need not be fully paid whereas the debenture stock must always be fully paid. The *debenture is transferable only in their entirely whereas the debenture* stock is transferable in *fraction also. Debentures have identity in terms of numbers assigned* to them. There is no such *identity for debenture stock.*

1.3.8 SEBI GUIDELINES FOR ISSUE OF DEBENTURES

(i) Issue of fully convertible debentures (FCDs) having a conversion period of more than 36 months will not be permissible, unless conversion is made optional with call and out option.

(ii) Compulsory credit rating will be required if conversion is made for FCDs after 18 months.

(iii) Premium amount on conversion, time of conversion, in stages, if any, shall be pre-determined and stated in the prospectus.

(iv) Issue of debentures with a maturity period 18 months or less is exempted from the requirement of appointment of debenture trustees or creating a debenture redemption reserve. In other cases, the names of the debenture trustees must be states in the prospectus.

(v) Any conversion, in part of whole of the debentures shall be optional at the hands of the debentureholder, if the conversion takes place at or after 18 months from the date of allotment, but before 36 months.

(vi) In case of NCDs/PCDs (Party Convertible Debentures) credit rating is mandatory where maturity period exceeds 18 months.

(vii) The discount on the non-convertible portions of PCDs in case they are traded and the procedure for their purchase on spot trading basis must be stated in the prospectus.

(viii) In case, the non-convertible portions of PCD/NCP (Non Convertible Debentures) are to be rolled over with or without charges in the interest rate, a compulsory option should given to those debentureholders who wish to withdraw and encash from the debenture programme. Roll-over should be done only in cases where debentureholders have sent their negative reply.

(ix) Letter of information regarding the roll over shall be vetted by SEBI with regard to the credit rating, debenture holder resolution option for conversion and such other items as SEBI may prescribe from time to time.

1.3.9 GUIDELINES FOR THE PROTECTION OF INTEREST OF DEBENTURE HOLDERS

1. A debenture redemption reserve (DRR) shall be created by all companies

raising debentures as under :

(i) A Moratorium upto the date of commercial production can be provided for creation of the DRR in respect of debentures raised for project finance.

(ii) In case of PCDs, DRR should be created in respect of non- convertible debenture issue similar to that created for fully convertible debenture issue.

(iii) DRR may be created either in equal instalments for the remaining period or higher amounts if profits allow.

(iv) Companies may distribute dividends out of general reserves in certain years if residual profits after transfer to DRR are insufficient.

(v) DRR will be treated as part of general reserve for consideration of bonus issue proposals and for price fixation related to post-tax return.

(vi) Trustees to the debenture issue shall be vested with the requisite powers for protecting the interest of debentureholders including a right to appoint a nominee director on the board of the company in constitution with institutional debentureholders.

(vii) Lead institution/investment institution will evaluate the progress in respect of debentures for project finance, expansion or diversification.

(viii) Institutional debenture holders and trustees should obtain a certificate from the companys' auditors with regard to utilisation of funds during the implementation period of projects.

1.3.10 ISSUE OF DEBENTURES

This may be studies under the following different angles :

1. From the consideration point of view.
2. From price point of view.
3. From conditions of the redemption point of view.

Regarding the first *two entries* are the same as in the case of shares and similar *procedure* of offer, application, allotment and letters of regret apply. However, it is not customary to make calls on an issue of debenture which are payable in instalments at fixed dates.

Debentures may be issued at premium, or at a discount without statutory restriction as applicable to shares issued at a discount. When debentures are issued at a premium or at a discount the full nominal amount should be credited to the debentures account, the *premium* or discount being *credited* and *debited* to a premium on issue of Debentures account or discount in issue of Debentures account as applicable. The discount should be written off out of profits and this write off may spread over the life of a debenture.

When the debentures are *repayable* by annual *drawing* the write off should be related to the amount of *debenture* outstanding in that years. Thus where an issue is repayable in ten equal instalments from the year of issue, the amount to be written off in the first year would 10/55 i.e., 10 (10+9+8+7+6+5+4+3+2+1) the next year 9/55 ths. and so on. A student may work out the general rule applicable to the proportion of *discount* to be written off each year. In such cases where debentures are repaid at a *premium.* The premium should similar be reserved on redemption and create provisions for the premium on repayment and the written off discount on issue will not be necessary.

The premium on issue of *Debentures* may be used to write off the expenses on issue of fictitious assets, or to form part of the sinking fund for Redemption of *debentures*. If not so untilised, it should be treated as a capital *reserve although it is not so provided* in the Companies Act, 1956.

It may be stated alternatively that the premium on redemption of debenture account is *personal account and has not been shown as liability until the repayment is made, Since the company* agree to pay more than the face value of debenture at the time of *redemption* it is a loss to the company.

Therefore, the sum is debited to "Loss on Issue of Debentures" account. The said account is to be written off generally every year during the life of the debentures. The balance remaining not written off generally every year during the life of the debentures. The balance remaining not written off is to be shown *on the asset side of the Balance Sheet under* the heading *Miscellaneous Expenditure.*

Like issue of debentures at par, premium or discount, the redemption of debentures can also be redeemed

(a) at par

(b) at premium

(c) at discount only when company is able to buy the debentures in the open market at a price lower than the face value of debenture.

Thus, following sets of cases can be formed :

(1) Issue at par, redeemable at par

(2) Issue at discount, redeemable at par

(3) Issue at premium, redeemable at par

(4) Issue at par, redeemable at premium

(5) Issue at discount, redeemable at premium

(6) Issue at premium, redeemable at premium.

1.3.11 ACCOUNTING ENTRIES FOR ISSUE OF DEBENTURES

1. When debentures are issued at par and redeemable at par.

(i) Cash/Bank A/C ------------ Dr.
  To Debentures A/C
  (Being debentures issued)

(ii) Debentures A/C
  To Bank A/C --------- Dr.
  (Being debentures redeemed at due date)

2. *When debentures issued at discount and redeemable at par.*

(i) Bank Cash A/C--------Dr. (For the amount received)
Discount on Issue of Debenture A/C ---------------Dr.
(For the discount allowed)
To Debentures A/C
(Being debentures issued at a discount)

(ii) Debentures A/C----------Dr.
To Bank A/C
(Being debentures redeemed)

3. *When debentures are issued at par and redeemable at premium.*

(i) Cash/Bank Account ----------------------------------- - Dr.
Loss on the issue of Debenture A/C ----------- Dr.
To Debentures A/C
To Premium on Redemption of Debentures A/C
(Being debentures issued)

(ii) Debenture Account..Dr.
Premium on Redemption of Debentures A/C ---------- Dr.
To Bank A/C
(Being debentures redeemed)

4. *When debentures are issued at premium and repayable at par :-*

(i) Bank Account.......................Dr.
To Debentures Account
To Premium on the issue of Debentures A/C
(Being debentures issued at premium)

(ii) Debenture A/C................ Dr.
To Bank A/C
(Bank debentures redeemed)

5. *When debentures are issued at discount and redeemable at premium.*

(i) Bank Account ....Dr.
Loss on Issue of Debentures A/C.................... Dr.
(With the amount of discount and premium on redemption)
To Debentures Account
(Being debenture issued)

(ii) Debentures A/C.................Dr.
Premium on the redemption of Debentures A/C................ Dr.
To Bank A/C
(Being debentures redeemed)

6. *When debentures are issued at premium and redeemable at premium.*

(i) On issue of debentures
Bank Account -----------Dr.
Loss on Issue of Debentures Account ---------- Dr.
(For Premium on redemption less premium on issue)

To Debentures Account
To Premium on Redemption of Debentures Account
To Capital Reserve Account
(If Premium on issue is more than premium on redemption)

(ii) On redemption of debentures
Debentures Account -------------- Dr.
Premium on Redemption of Debentures Account ---------- Dr.
To Bank

Notes: 1. Loss on Issue of debentures and Discount on Issue of debentures are Capital losses and will be shown on the assets side of the Balance sheet under the head "Miscellaneous Expenditure" until these are written off either against Profit and Loss Account or Securities Premium Account.

2. Premium on debentures Account is raised when debentures are issued at a premium whereas Premium on Redemption of Debentures Account is raised only if the debentures are to be redeemed at a premium.

The former represents a Capital profit and is shown on the liabilities side under the head Reserves and Surplus and the latter represents a provision of the liability which is to be paid at the time of redemption of debentures and is shown on the liabilities side of the Balance Sheet so far debentures are not redeemed.

1.3.12 ILLUSTRATION

Elbo Ltd. issued 10,000, 9% Debentures of Rs. 100 each. Give journal entries if the Debentures are (i) issued at par, (ii) issued a discount of 10%, and (iii) issued at a premium of 10%, (iv) Debentures issued at par redeemable at premium, (v) Debentures issued at discount redeemable at premium.

SOLUTION :

Journal of ELBO Ltd.

		Debit Rs.	Credit Rs.
(i)	Debentures Issued at par		
	Bank A/C...........Dr.	10,00,000	
	To 9% Debentures A/C		
	(Being issue of 10,000, 9% debentures @ Rs. 100 each)		1,00,000
(ii)	Issued at discount :		
	Bank Account..........Dr.	9,00,000	

Discount on Debentures A/C............Dr.	1,00,000	
To 9% Debentures A/C		10,00,000
(Being issue of 10,000 9% debentures @ Rs. 90 per debenture)		
(iii) Issued at a premium :		
Bank A/C .... Dr.	11,00,000	
To 9% Debenture A/C		10,00,000
To Premium on Debentures A/C		1,00,000
(Being issued 10,000 9% per debentures of Rs. 100 each at Rs. 110 per debenture.)		
(iv) Debentures Redeemable at a Premium of 5% and issued at par :		
Bank A/C ....Dr.	10,00,000	
Loss on Issue of Debentures A/C ....Dr.	50,000	
To 9% Debentures A/C		10,00,000
To Premium on Redemption of Debentures A/C		50,000
(Being issue of 10,000 9% Debenture of Rs. 100 each (redeemable at Rs. 105) issued at par)		
(v) Debentures Redeemable at a premium of 5% and issued at a discount of 10% :		
Bank A/C...............Dr.	9,90,000	
Loss on Issue of Debentures A/C ....Dr.	60,000	
To 9% Debentures A/C		10,00,000
To Premium on Redemption of Debentures A/C		50,000
(Being issue @Rs. 99 of 10,000, 9% Debentures of Rs. 100 each repayable at Rs. 105 per debenture)		

1.3.13 INTEREST ON DEBENTURES

Interest of debentures is charged to the profit and loss account. While paying the interest on debentures, it is the obligation of the company concerned to deduct the income tax before making payment of interest of debentures holders. The following journal entries are passed in this connection :

(i) When interest on debentures is due :

Interest on debentures Account.........Dr. (with gross amount)

To Income tax Account (with income tax)

To Debentureholders Account (with net amount)

(ii) When net amount due is paid :

Debentures Holders Account Dr.

To Bank Account

Interest on debentures is required to transferred to the debit side of profit and loss account and the credit balance of income tax account is shown on the liabilities side of the Balance Sheet. As and when it is paid to the Government this account is debited and bank account will be credited.

1. Own Debentures

Directors if authorised by the terms of the contract, can purchase own debentures whenever they find the market price favourable to the company. Such own purchased debentures can be either cancelled by the company or may be kept as an investment, called own debentures and may be utilised for reissue when needed later.

Purchase of own debentures were to be treated in accounts in the same way as an ordinary investment, the entry will be as given below :

Investment in own debentures A/c----------- Dr.

OR

Own debentures A/c ------------------------------ Dr.

To Bank A/c

Own debentures account will be shown on the assets side of the Balance sheet. Debentures will continue to be shown on the liabilities side of the Balance sheet. Here, it is assumed that the debentures are purchased immediately after the payment of interest.

As and when the company wants to cancel investment in own debentures, the following entry is required to pass :

Debentures A/c...Dr.

Loss on Redemption of Debentures A/c (for loss) ------------ Dr.

To Debentures a/c

To Profit on Redemption of Debentures a/c (for profit)

2. Interest on own Debentures

The total amount of interest due on debentures (including held by the company as own investment) is deemed to be outstanding. But payment of interest on debentures is made only to the outsiders. The portion of interest on own debentures will be credited to interest on own debentures account the following entry is made in this case :

Debentures Interest A/c (on whole debentures) ---------- Dr.

To Bank A/c (payable to outsiders)

To Interest on own debentures A/c (due to the company)

When there is no sinking fund, the debit balance of debentures interest is shown on the debit side of profit and loss accounts and credit balance of interest on own debentures amount is credited to profit and loss account.

When sinking fund exists, the interest on own debentures is transferred to sinking fund instead of profit and loss account.

1.3.14 Self Check Exercises

Ques1. What are first debentures and second debentures?

Ques2: What are naked debentures?

Ques3: What are mortgage debentures?

1.3.15 SUMMARY

A Company usually needs a large number of debentureholders to raise funds without increasing its Share capital. To fulfill its requirement the company generally invites the public by open declaration to lend money for a fixed period at a declared rate to be paid on such money. The companies Act, 1956 and SEBI have issued various guidelines for the issue of debentures and to protect the interest of debentureholders as discussed in this lesson.

The journal entries to be passed at the time of issue and redemption of debentures is also given in this lesson.

1.3.16 Glossary

1. Naked Debentures: Those debentures which are not secured.
2. Mortgage Debenture: Those debentures which are secured.
3. Bearer Debenture: When debentures can be transferred by mere delivery.

1.3.17 Short Questions

Ques1: Write a short note on interest on own debenture?
Ques2: What do you understand by the term debenture stock?
Ques3: What is the difference between debenture holder and shareholder?
Ques4: What is the difference between bearer debenture and registered debenture?

1.3.18 Long Questions

Q.1. Give the different considerations for which debentures may be issued.

Q.2. Write short notes on :
(a) Debentures as Collateral Security.
(b) Own Debentures.

Q.3. What is the difference between Debentureholder and Shareholder ?

Q.4. Write in detail the various types of Debentures ?

Q.5. What is a Debenture? What entries will you pass at the time of issue of Debentures in all cases ?

Q.6.(a) On first January, 2007 a limited company issued debentures of the face value of Rs. 1,00,000 at discount of 6%. The debentures were repayable by annual drawing of 20,000 made on 31st December each year. The Directors decided to write off the discount on issue over the period of the debentures in such a way as to change each year with an amount proportionate to debentures outstanding in that year.

(b) R. Ltd. issue debentures at 94% for Rs. 1,00,000 on Ist April, 2006, repayable by five equal annual drawings of Rs. 20,000 each. The company closes its accounts on calendar basis.
Indicate the amount of discount to be written off every accounting year assuming that the company decides to write off the debentures account during the life of debentures.

1.3.19 SUGGESTED READINGS

1. Corporate Accounting By : C. Mohan Juneja, B.K. Sachdeva, Inderjit

Singh, Rakesh Katyal, Kalyani Publishers.

2. Corporate Accounting By : S.P. Jain, K.L. Narang Kalyani Publishers.

LESSON NO. 1.4 AUTHOR : PROF. DEVINDER KUMAR

REDEMPTION OF DEBENTURES

Structure of the Lesson :

1.4.0 OBJECTIVES

The main objective of this lesson is to give the detailed accounting treatment regarding the redemption of debentures. To achieve this objective the whole redemption procedure has been discussed in this lesson under various methods like,

(1) redemption out of profit;
(2) redemption out of capital;
(3) redemption out of provisions made for this purpose; and
(4) by converting them into shares or new debentures.

1.4.1 INTRODUCTION

Redemption of debentures refer to the discharge of liability on account of debentures. The following three problems require attention when a company wants to redeem the debentures :

(a) Time of redemption of debentures : Generally debentures are redeemed at the expiry of their period by making the payment of the amount promise for. But sometimes company may reserve the right in the articles of association to redeem the debentures even before the date of redemption either by instalments or by purchasing them in the open market.

(b) Amount to be paid on redemption : If the debentures are redeemed on the expiry of the period or only during a lot, then the amount to be paid can be either at premium or at par as promised by the company. If the debentures are redeemed by purchasing them in the open market, then the amount to be paid depends on the market price i.e. either at a par or at a discount or at a premium. Generally the companies purchase their own debentures when the debentures are quoted below face value.

(c) Sources of finance : The major sources where from the debentures can be redeemed may be :

(i) Out of profits
(ii) Out of capital
(iii) Out of provisions made for redemption and
(iv) Converting them into shares or new debentures.

The prospectus of every public company inviting application for debentures always contains terms and conditions of redemption or repayment of the debentures. There are three ways of redeeming the debentures :

(a) By payment to the debentures holders at specified date or without a period specified according to the terms of issue.
(b) By purchase of debentures in the open market and cancellation of the same.
(c) By payment of certain portion in each year.

1.4.2 ACCOUNTING ENTRIES

The basic entry to make, when debentures are redeemed is to debit debentures account and to credit Bank Account. But actually sometimes the amount paid on redemption may be more than the face value or less than the face value of debentures, so at that time the above simple entry will not serve the purpose. Above entry is only passed at the time when debentures are redeemed at par. The various entries are as follows :

1. When debentures are issued at par and redeemable at par :
   (a) Bank a/c ---Dr.
   To Debenture a/c
   (b) Debenture a/c ---Dr.
   To Bank a/c
2. When debentures are issued at discount and redeemable at par :
   (a) Bank a/c ---Dr.
   To Debenture application and allotment a/c
   (b) Debenture application and allotment a/c ---Dr.
   Discount on issue of debentures a/c ---Dr.
   To Debentures a/c
3. When debentures are issued at premium and redeemable at par :
   (a) Bank a/c ---Dr.

To Debenture application and allotment a/c

(b) Debenture application and allotment a/c ---Dr.

To Debentures account

To premium on issue of debentures a/c

4. When debentures issued at par and redeemable at premium :

(a) Bank a/c ---Dr.

To Debenture application and allotment a/c

(b) Debenture application and allotment a/c ---Dr.

Loss on issue of debentures a/c ---Dr.

To Debentures a/c

To premium on redemption of debentures a/c

5. When debentures issued at discount redeemable at premium :

(a) Bank a/c ---Dr.

To Debenture application and allotment a/c

(b) Debenture application and allotment a/c ---Dr.

Loss on issue of debentures a/c ---Dr.

To Debentures a/c

To premium on redemption of debentures a/c

NOTE :

The profit on redemption of debentures is a capital profit and is utilized for writing off discount on issue of debentures, by payment to the debenture holder at a specified date or within a specified period according to the terms of issue.

Sinking Fund Method :

In order to redeem the debentures at a specified date, the company has to raise sufficient money and the method of raising of funds for redemption is known as "Sinking Fund Method".

Under this method an amount is set aside out of the profit each year and an adequate amount invested in securities so calculated that by the time of redemption sufficient amount would have accumulated at expected interest rates to repay the debentures. The appropriations are to ensure that amount in question is not available for distribution.

I. In the first year

The accounting entries are as under :

(i) For setting aside the amount from profits

Profit & Loss Appropriation A/c........Dr.

To Sinking Fund A/c

(ii) For investing the amount set aside Sinking

Fund Investment A/C................................ Dr.

To Cash/Bank A/C

with the amount of annual instalment

II. In the Second and Subsequent Year :

(i) For the interest received on investment
Cash/Bank A/C ....Dr.
To interest on Sinking Fund Investment a/c

(ii) For transferring the interest received
Interest in Sinking Fund Investment A/c ....Dr.
To Sinking Fund A/C

(iii) For setting aside the amount out of the profits
Profit & Loss Appropriation Account ....Dr.
To Sinking Fund A/C

(iv) For investing the amount set aside including the interest earned.
Sinking Fund Investment A/C..................Dr.
To Sinking Fund A/c

III. In the year of redemption :

(i) For the amount due on redemption.
Debentures A/C ....Dr.
To Debentures Holders A/C

(ii) For receiving the interest and setting aside of funds out of profit accounting entries i, ii, iii in II as given above are to be repeated. However the amount set aside need not be invested outside. Therefore the entry iv and II, is not required.

(iii) For realising the sale proceed for investment at profit Cash/Bank
A/C..........Dr. (with amount realised)
To Sinking Fund Investment A/C (with book value of investment sold)
To Sinking Fund A/C (with amount of profit)

(iv) For loss on sale of investment the reverse entry to the above is passed.
Bank A/c ---Dr.
Sinking Fund A/C ---Dr.
To Sinking Fund Investment A/C

(v) For transferring the balance in sinking fund Account
Sinking Fund A/C ....Dr.
To General Reserve A/C

(vi) For payment to Debenture holders
Debenture Holder A/C ....Dr.
To Cash/Bank A/C.

1.4.3 ALTERNATIVE ACCOUNTING ENTRIES

A. Entries on creation of fund each year :

(i) For the annual amount set aside from profit

Profit & Loss Appropriating A/C ....Dr.

To Debentures Redemption Fund A/C

(ii) For amount of investment (Made out of annual investment and interest)

Debentures Redemption Fund Investment A/C ....Dr.

To Cash A/C

(iii) For the amount of interest received each year

Cash Account.....................Dr.

To Debentures Redemption Fund A/C

B. On Redemption of Debentures :

(i) For the Sale Proceeds of Investment A/C

Cash A/C .... Dr.

To Debentures Redemption Fund Investment A/C

(ii) For the amount of profit on realisation or the amount of loss on realisation on investment.

(a) In case of Profit :

Bank A/C ------- Dr.

To Sinking fund Investment a/c

To Sinking fund a/c

(b) In case of loss :

Bank A/C ---------------- Dr.

Sinking fund a/c -------- Dr.

To Sinking fund Investment a/c

(iii) For the amount paid for debenture redeemed or purchased.

Debentures Account .... Dr.

To Cash Account.............Dr.

(iv) (a) For Profit on Redemption

Debenture A/C................... Dr.

To Debenture Redemption A/C

(b) For Loss on redemption (This arises where debentures are purchased in the open market or at fixed prices)

Debenture Redemption.............. Dr.

To Debenture A/C

(v) For the balance after redemption on all debentures :

Debenture Redemption A/C.................... Dr.

To General Reserve A/C

(vi) Where discount is written off over a period with the balance amount discount not yet writing off or where discount is written off at the time of redemption with the full discount.

General Reserve A/C .... Dr.

To Discount on Debentures A/C.

The Debenture Redemption Fund after redemption of the Debentures is no longer represented by earmarked investment but by the general assets of the business. The purpose of which it was created having been fulfilled, represents only general appropriations out of profits and the balance is properly transferred to General Reserve.

1.4.4 EXAMPLE

1. The balance sheet of X Ltd. as on 31st December 2007 was as follows :

	Rs.
6% Debentures	10,000
Sinking Fund	4,250

Sinking Fund Investment : Rs. 1,000 own debentures purchased at 98.

Rs. 3,500 4% stock purchased at Rs. 3,270.

On the above date the company redeemed all the debentures. For this purpose it realised 4% stock at par. It utilised Rs. 1,500 for redemption out of current year's profits. Journalise the transactions in the books of the company.

Solution :

JOURNAL

Date	Particulars	L.F.	Debit Amount	Credit Amount
2007 Dec. 31	Bank a/c ---Dr. To sinking fund Investment (4% stock) a/c (Being the sale of sinking fund investment for redemption of debentures)		3,500	 3,500
	Sinking fund Investment (4% stock) a/c ---Dr. To sinking fund a/c (Being the profit on the sale of investment transferred)		230	 230
	6% Debentures a/c ---Dr. To own debentures a/c To profit on redemption of debenture a/c (Being the cancellation of own debentures)		1,000	 980 20
	Profit on redemption of debentures a/c ---Dr. To sinking fund a/c (Being the profit on redemption of debentures transferred to sinking fund account)		20	 20
	6% Debentures a/c ---Dr. To Bank a/c		9,000	 9,000

	(Being the redemption of outstanding debentures)			
	Profit and loss appropriation a/c ---Dr. To Debenture redemption reserve a/c (Being transfer of Rs. 1,500 from the profit)		1,500	 1,500
	Debenture redemption reserve a/c ---Dr. To General reserve a/c (Being debenture redemption reserve account transferred)		1,500	 1,500
	Sinking fund a/c ---Dr. To General reserve a/c To capital reserve a/c (Being the transfer of balance in sinking fund to general and capital reserve)		4,500	 4,250 250

1.4.5 PURCHASING OF DEBENTURES IN OPEN MARKET AND CANCELLATION OF THE SAME

The Director of a company, if authorised by the terms of contract can purchase debentures when they find that the market price is favourable to the company. The debentures so purchased may be either cancelled or kept as an investment to be utilized for re-issue in future, if needed. On purchase of debentures, the following entry is to be passed.

For the purchase value of debentures :

Own Debenture A/C.................Dr.

To Bank A/C

The Own Debenture Account will appear as an asset under the head "Investment on the asset side of the balance sheet and debentures are continued to be shown on the liability side at the figure appearing in the books when the said purchased debentures are cancelled, the following entries, are to be passed :

Debentures Account ....Dr. (with the paid up value) To

own Debenture A/c (with the purchase cost)

The difference between the two value represents the profit or loss on cancellation and is therefore credited/debited as the case may be to Debenture Redemption Reserve Account or Debenture Sinking Fund Account or General Reserve Account.

The Debentures may be purchased as sinking fund investment. In which case, it is necessary, to see that the debenture interest on the debenture purchased is credited to the fund account and reinvested in the same manner as an outside investment. At the time of realisation of Sinking Fund Investment the difference between the purchase price and nominal value of the debenture purchased will be transferred to the debenture redemption reserve account.

1.4.6 REDEMPTION BY ANNUAL DRAWING OUT OF PROFIT

Where the debentures are redeemed by annual drawing at a fixed price as prescribed in the terms of debenture. In the case of drawing of lots, only the particular debentures which, are to be redeemed are decided by lots, but the amount payable already decided by the terms of debentures where these are redeemed by annual drawings by purchasing in the open market the accounting entry will be to Debit Debenture Account and Credit Cash/Bank by the yearly drawings. If there be any profit or loss on redemption of the debentures the same should be transferred from Profit and Loss Account to General Reserve.

1.4.7 DEBENTURE REDEMPTION FUND POLICY

Instead of purchasing investment, it is possible that the company may purchase an insurance policy which will enable the company to have the required sum on the required date. Every year, on payment of the premium, the Insurance Policy Account will be debited and cash credited. Also a Debenture Redemption Fund Account should be credited and Profit and Loss Appropriation Account debited with a figure equal to the premium payable. No interest will be received and hence no entry will be required for this on the date of redemption. When the policy will be realised cash account is debited and policy account is credited. The Credit Balance in the policy Account will be transferred to the Debenture Redemption Fund Account. The Debentures will be paid off and the balance in the Debenture Redemption Fund Account will be transferred to the General Reserve.

1.4.8 EX-INTEREST AND CUM-INTEREST QUOTATIONS

When debentures are purchased in the open market on a date other than the date of declaration of interest, the difference must be made between the capital expenditure and revenue portion of the price paid for the debenture. Amount paid towards the cost of debentures constitutes the capital portion. Amount paid towards interest from the last date of interest payment to the debenture depends on the quotation. If the quotation is cum-interest, the price quoted includes the interest for expired period. On the other hand in the case of ex-interest quotation, the latter does not include the interest and therefore the buyer has to pay in addition, the interest for the expired period.

At the time of recording the purchase of Own Debentures, only the price paid for them (Capital Portion) must be debited to the account. Amount paid by way of interest (revenue portion) must be debited to interest account.

So if same quotation is ex-interest, the buyer has to pay higher amount than under cum-interest. At the time Own-debentures are cancelled, it naturally follows that profit on cancellation will be more in the case of cum- interest rather than ex-interest quotation.

1.4.9 CONVERSION OF DEBENTURES INTO SHARES

One of the issue of the debentures may be that the debentures holders will have the option to convert the debentures into shares-Equity or Preference at the stipulated rate within a stipulated period. In such a case the proceeds of the issue of debentures should be considered while determining the number of shares to be issued. The issue price of the share and the amount actually received from the debenture holder should be the same.

The new shares or debentures can be issued either at par or at a premium or at a discount. The following entry will be made :-

Old Debentures Account ---Dr.
Discount on issue of shares Account ---Dr.
To New share capital Account
To premium on the issue of shares Account
To Debenture Account

1.4.10 EXAMPLE-II

For example 8% debentures are issued at a discount of 5% and the debentures holders have the option of converting the debentures into 9% preference shares at a premium of 10% and holders of Rs. 22,000 debenture wish to exercise the option in that case the face value of the preference shares to be issued will be Rs. 19,000 calculated as below :

Rs.

Face Value of Debenture22000 Less discount allowed on issue @5% 1100 Amount Actually received 20900 Issued price of Preference Shares 100

Assuming Face Value Rs. 100
and issue price is 100+10 as
Premium at the rate 10%

Number of Shares issued : $\dfrac{20,900}{100} = 209$

Face value of the Preference Shares $\dfrac{20,900}{110} = 190 \times 100 = 19,000$

Actual proceeds of the issue of debentures must be considered as otherwise there is danger of violating section 79 of the companies Act- conversion of debentures issued at a discount into shares considering only the nominal value, would amount to issuing the shares at discount.

Conversion of debentures into shares at the time of redemption of debentures is due can be on the basis of terms mutually agreed at the time even debentures originally issued at discount can be converted into shares on the basis of par values. Provision of section 79 can not be considered to have been violated in such case.

1.4.11 Self Check Exercises

Ques1: What do you understand by the term redemption of debentures?

Ques2: Write down the sources of finance for the redemption of debentures?

Ques3: What do you understand by the term sinking fund?

1.4.12 SUMMARY

Redemption of debentures refers to the discharge of liability on account of debentures. When a company wants to redeem the debentures, the following three problems, that is, time of redemption of debentures, Amount to be paid on redemption and sources of finance require, attention as discussed in this lesson.

The major sources wherefrom the debentures can be redeemed may be (a) out of profits, (b) out of capital, (c) by converting them into shares or new debentures, and (d) out of provisions made for redemption.

1.4.13 Glossary

1. Redemption of Debenture: Discharge of liabilities on account of debentures.
2. Sinking Fund Method: For the redemption of debentures at a particular date, company needs to raise sufficient amount of money and the method of raising of fund for redemption is called Sinking Fund Method.

1.4.14 Short Questions

Ques1: Explain the term Debenture Redemption Fund Policy?

Ques2: Explain the redemption of debenture by annual drawing out of profit?

Ques3: What is the difference between ex-interest and cum interest?

1.4.15 Long Questions

Q.1 Discuss various methods of Redemption of Debentures.

Q.2 Write short notes on :

(a) Ex-interest and Cum-interest

(b) Own Debentures

(c) Sinking Fund

Q.3. Paul Ltd. issued Rs. 5,00,000, 12% debentures of Rs. 1,000 each at par and repayable at par at the end of fourth years. As per the trust deed, a sinking fund was to be created for the purpose of accumulating sufficient fund for the purpose. Investments were made yielding 4% interest received at the end of each year. Sinking fund table shows that 0.23549 of annually at 4% amounts to Re. 1 in 4 years. Give Journal entries and ledger accounts for 4 years if company sold investments for Rs. 3,76,000 and closed its accounts on 31st December every year.

Q.4. The Debenture Redemption Fund Account of a limited company stood at Rs. 1,60,000 represented by Rs. 2,00,000 (nominal) investments. The debentures stood at Rs. 5,00,000 and the company sold Rs. 24,000 investments at Rs. 85 for the purpose of redeeming Rs. 20,000 debentures at 102. Show- ledger accounts ignoring interest etc.

1.4.16 SUGGESTED READINGS

(1) Advanced Accounting (Part-2)

By : Ashok Sehgal

Deepak Sehgal

Taxmann's Publication

(2) Corporate Accounting

By : Jain and Narang

LESSON NO. 1.5 AUTHOR : PROF. DEVINDER KUMAR

ISSUE OF BONUS AND RIGHT SHARES

Structure of the Lesson :

1.5.0 OBJECTIVES

The main objective of this lesson is to introduce the students with the valuation methods of right shares and Bonus shares. Further SEBI guidelines for issue of bonus shares, Resourses, advantages and disadvantages of Bonus shares and Accounting treatment for bonus and Right shares are also discussed in this lesson.

1.5.1 INTRODUCTION

Under Section 62 of the Companies Act 2013, every public Limited Company, Wherever it proposes to increases 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 the allotment of shares in the company, made for the first time after its formation which is earlier, shall be required to offer those shares to the existing shareholders of equity shares in the proportion of paid up capital as early as possible. If the Board of Directors, decide to increase the subscribed capital of the company by the allotment of further shares, then

(i) The further shares shall be offered to the existing shareholders on that date in proportion to their equity holding on that date.

(ii) The above offer shall be made through a notice which will specify that number of shares offered and time limit which should be less than 15 days from the date of offer. If within that time the offer is not accepted by the shareholders, the offer will be deemed to have been declined.

(iii) Unless the Articles of Association of the Company otherwise specify, the offer shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him in favour of any other person.

(iv) After the expiry of the time specified in the notice referred to above, on receipt of easier intimation from the person to whom such notice is given that he declined to accept the shares offered, the Board of Directors may proceed to dispose to such shared offered, the Board of Directors may proceed to dispose of such shares offer in such manner as they consider most beneficial to the company.

As per section 62 (IA) the new shares may be offered to outsiders if;

(i) A special resolution is passed by the company to that effect or,

(ii) An ordinary resolution is passed to that effect and approval of the Central Government is obtained on the *ground that* such an offer to the outsiders is most beneficial to the company. This is specific advantage of this legal right to the existing shareholders specially when the *market* price of the share is more than the issue price.

1.5.2 VALUATION OF RIGHT

Generally, a *company offers* rights *issue at a price which is lower than the* market price of the shares so that existing shareholders may get the *monetary benefit of being* in association with the company for a long time, sometime there is need to calculate the money value of this advantage or otherwise called the value of right, in order to calculate the value of this right the following procedure may be allotted
:

(a) Calculate the total market value of shares which a shareholder is required to keep in order to exercise the right of getting shares from the fresh issue at a concessional price.

(b) Add to the above price the amount required to be paid to the company for the fresh share.

(c) Find out the average price. This can be done by dividing the total price of shares by total number of shares.

(d) Compare the average price with the market price and find out the difference. The difference is called the value of right $V = \frac{M - S}{N + 1}$

Example : A company has decided to increase its existing share Capital by making rights issue to the existing shareholders in the proportion of one new share for every two shares held. You are required to calculate the value of the right if the market value of share at the time of announcement of right issue is Rs. 240. The company has decided to give one share of Rs. 100 each at a premium of Rs. 20 each.

		Rs.
Solution :	Market value of 2 shares already held by a shareholder 2 × 240	480
Add :	the price required to be paid for acquiring more share	120
	Total price of 3 shares	600

Average price of one share = Rs. 600/3 = Rs. 200

Value of right = Market value – Average price

= Rs. (240-200) = Rs. 40

An alternative formula is : New Share/Total Share × cum right price - new issue price = 1/3 × (240-120) = Rs.40

Proof : Suppose a person wants to hold three shares in the company. He can buy two existing shares @Rs. 240 each and then he can get one additional share from the company for Rs. 120, he will spend Rs. 600 in all for three shares, i.e. Rs. 200 per share.

Alternatively, the right attached to each existing share enable one to buy 1/2 new share, for buying one new share, two rights are required and for buying the shares one needs six rights which will cost Rs. 240 in all, one must pay Rs. 360 to the company for the three additional shares making a total of Rs. 600 in all or Rs. 200 per share.

1.5.3 ADVANTAGES OF RIGHT ISSUE

The following are the advantages of Rights of Issue :

1. The extra expenses are to be incurred otherwise if shares are offered to the public.
2. There is more certain of the shares being sold to the existing shareholders.
3. It improve the image of the company and stimulates enthusiastic responses from shareholders and the investment market.

1.5.4 BONUS SHARES (SECTION 63) COMPANY ACT, 2013

A company may not be in a position sometimes to pay cash dividends inspite of adequate profits because of paucity of liquid resources with the company. Moreover it may not want to part with cash in order to meet some capital expenditure plans. Further all prudent companies build up reserves for the purpose of expansion or for building up financial strength. However, to satisfy *shareholders and to portray a realistic relationship* between capital and profit earned, the company may issue shares without payment being required, to the existing equity shareholders. Such shares are known as bonus shares.

The accumulated profit of company thus ploughed back into the business for a part of capital employed and a stage may be reached where it becomes necessary to incorporate such accumulations in share capital.

(a) To recognise its use as such and impossibility of its return as dividends to shareholders.

(b) To bring share capital in line with its assets employed so that dividends are expressed in relation to capital instead of its terms of a historical figure.

(c) There are tax advantages which have been considerably reduced in recent times.

The capitalisation of profit on such occasions may be made by issuing fully paid bonus shares to the members or for paying out amount for the time being unpaid on shares already held by members.

1.5.5 SEBI (SECURITIES AND EXCHANGE BOARD OF INDIA) GUIDELINES FOR ISSUE OF BONUS SHARES

The company shall, while issuing bonus shares, ensure the following :

1. There should be a provision in the Articles of Association of the company for capitalisation of reserves etc. If not, the company should produce a Resolution passed at the general meeting making provision in the Articles of Association for Capitalisation.
2. Consequent to the issue of bonus if the subscribed and paid up capital is more than the authorised capital a resolution passed at the general body meeting in respect of increase in the authorised capital is necessary.
3. The company should furnish a resolution passed at the general body meeting for bonus issue before an application is made to the Controller of Issue. In the general body resolution the management intention regarding the rate of dividend to be declared in the year immediatedly after the bonus issue should be indicated.
4. The bonus issue is permitted to be made out of free reservers build out of the genuine *profits or securities premium* collected in cash only.
5. Reserves created by revaluation of *fixed assets are not permitted to be* capitalised.
6. Bonus issues are not permitted unless the partly paid shares if existing are made fully paid up.
7. No bonus issues are permitted if there is sufficient reasons to believe that the company has defaulted in respect of the payment of statutory dues of the employees such as contribution of provident funds, gratuity and bonus etc.

8. Declaration on bonus issue in lieu of dividend is not allowed.

Bonus shares are generally issued in the following circumstances :

(i) When the company's case resources are not adequate for the cash dividend.

(ii) When in company wants to increase cash resources for expansion or other purposes like repayment of liability.

(iii) When the company, having built up large reserves, wishes to show to the outsiders (and also the shareholders) the correct earning capacity.

1.5.6 RESOURCES FOR ISSUE OF THE BONUS SHARES

(a) Balance of profits and loss account.

(b) General reserves or any other accumulated balance out of profits.

(c) Balance in the sinking fund for Redemption of Debentures after the debentures have been redeemed.

(d) Realised capital profits and reserves.

(e) Capital Redemption Reserves Account (created out of profit for the redemption of redeemed preference shares).

(f) Premium received on issue of shares.

Bonus shares can be issued in the form of fully paid shares at par, or at a premium. But the bonus can also be distributed by way of making partly paid shares, fully paid that is to say, the bonus can be applied towards the call that may be due on the share.

Sometimes, when bonus shares are distributed the shareholders may not gain at all. This is because of the fact that the market value of the shares depends upon the dividend received. If the company issues bonus shares, the profits (which do not increase) will have to be distributed over a large number of share, thus reducing the dividend per share. This will result in fall in the value of the shares in the market. Thus the shareholders will have a large number of shares but the total value of this holding will not increase because each share now is of a smaller value. Hence the shareholder makes no entry in his books on receipt of bonus shares. However, the shareholders will benefit in the form of capital appreciation if there is no increase in the amount of dividend received by him.

1.5.7 ACCOUNTING ENTRIES FOR BONUS ISSUE

There are two ways of capitalisation of profits :

(i) by utilising the amount in paying up any amount for the time being unpaid on any shares held by members.

(ii) for paying up in full unissued shares of the company to be allotted and distributed, created as fully paid up, to the members. The accounting enteries in both cases are different.

(iii) Journal Entries will be as follows :

(a) Profit and Loss Appropriation Account

or

Any other Reserve A/C ....Dr.

To Bonus to Shareholders A/C

(b) Share call Account.................Dr.

To Share Capital Account.

(c) Bonus to Shareholders A/C ....Dr.

To Share Call A/C

(iv) Journal entries for issuing fully paid-up bonus shares.

(a) Profit and Loss Appropriation.

or

Reserve Account ....Dr.

To Bonus to Shareholders Account.

(b) Bonus to Shareholders Account...................Dr.

To Share Capital A/C

1.5.8 ILLUSTRATION-I

The Balance Sheet of X Ltd. on December 31, 2007 was as follows :

	Rs.		Rs.
Share Capital :			
1,000 Shares of Rs. 100 each	1,00,000	Sundry Assets	2,37,500
Security Premium	25,000		
Reserve Fund	50,000		
P & L Account	40,000		
Sundry Creditors	22,500		
	------------		------------
	2,37,500		2,37,500

The Company decided to issue bonus share at the rate of three shares for every four shares held and decided, for this purpose, to utilise the securities premium account, Rs. 30,000 out of reserve fund and the Balance out of Profit and Loss Account, Give Journal entries to give effect to the above and give the amended Balance Sheet.

Solution :

JOURNAL

Date	Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
2007	Securities Premium A/C ....Dr.	25,000	
31 Dec.	Reserve Fund A/C.......................Dr.	30,000	
	Profit and Loss A/C ....Dr.	20,000	

	To Bonus to Shareholders A/C (Being the amount of bonus shares numbering 750, i.e. = 1000×3/4 = to be distributed among the shareholders as per resolution no..........................)		75,000
	Bonus to shareholders A/C............. Dr. To Share Capital A/C (Being the allotment to bonus shares as per resolution no...........................)	75,000	75,000

BALANCE SHEET OF X LTD. AS ON 31 DECEMBER, 2006

Share Capital :	Rs.		Rs.
1750 Shares of Rs. 100 each fully paid : (of the above, 750 shares were issued as bonus shares out of securities premium A/C 25,000, Reserve Fund Rs. 30,000 and P&L A/C Rs. 20,000)	1,75,000	Sundry Assets	2,37,500
Reserve Fund	20,000		
Profit and Loss Account	20,000		
Sundry Creditors	22,500		
	2,37,500		2,37,500

1.5.9 ADVANTAGES OF ISSUING BONUS SHARES

1. It enables a company to make use of its profits on a permanent basis and increase credit worthiness of the company.
2. Abnormally high rate of dividend can be reduced by issuing bonus shares which enables company to restrict entry of new entrepreneurs into the business and there by reduces competition.
3. It is the cheapest method of raising additional capital for expansion of the business.

1.5.10 DISADVANTAGES OF ISSUE OF BONUS SHARES

1. The fall in the future rate of dividend results in the fall of the market price of share considerably. This may cause unhappiness among the shareholder.
2. The reserves of the company after the bonus issue decline and leave less

security to investors.

1.5.11 DIFFERENCE BETWEEN BONUS SHARES AND RIGHT SHARES

1. Bonus shares are issued to the existing shareholders free of cost whereas existing shareholder have to pay for taking right shares.
2. An existing shareholder may renounce the right shares partly or totally in favour of some other person whereas no such facility is available is case of bonus shares.
3. Bonus shares are always fully paid because as per companies Act only fully paid bonus shares can be issued. Right shares can be fully paid or partly paid.
4. Issue of right shares is regulated by section 81 of the companies act whereas issue of bonus shares is according to the provisions of the Articles of Association and SEBI guidelines.
5. Issue of right shares increases working capital of the company and they are issued for cash. Issue of bonus shares does not increase cash as they are issued free of cost.
6. Issue of right shares is subject to minimum subscription whereas there is no requirement of minimum subscription in case of bonus shares.

1.5.12 Self Check Exercises

Ques1: What are bonus shares?
Ques2: What are right shares?
Ques3: Write down the resources for the issue of bonus shares?

1.5.13 SUMMARY

The issue of shares by an existing company to the existing shareholders is known as rights issue. Usually a company offers rights issue at a price which is lower than the market price of the shares to give monetary benefit to shareholders being associated with the company for a long time. In the same way Bonus is paid to the shareholders which may be cash bonus or capital bonus. The various Companies Act provisions as well as SEBI guidelines are issued by the authorities to regulate the procedure of Bonus and Rights issues.

1.5.14 Glossary

1. Bonus Shares: When a company issue shares without receiving the payment from the existing equity shareholders.
2. Right Shares: When a company provides the right to existing equity shareholders to get a share at a price which is lower than market price of the share.

1.5.15 Short Questions

Ques1: Explain the advantages of right issue?
Ques2: Explain the advantages and disadvantages for the issue of bonus shares?
Ques3: What is the difference between right share and bonus share?

1.5.16 Long Questions

Q.1. What is the meaning of Bonus Share ? Give various sources out of which these shares are issued ?

Q.2. Explain the provision of the companies Act regarding Rights issue in case of a public company. How the Value of Rights is computed ?

Q.3. The nominal value of Equity Share of a company is Rs. 10 and the current market price is Rs. 40. The Company issues Right Shares @ 1 Equity Share for every 2 existing shares hold, the right shares being issued at a premium of 10%. From the above, calculate the value of the right.

1.5.17 SUGGESTED READINGS

Advanced Accounting
By : Ashok Sehgal
Deepak Sehgal
Taxmann's Publications

LESSON NO. 1.6 AUTHOR : PROF. DEVINDER KUMAR

UNDERWRITING OF SHARES AND DEBENTURES

Structure of the Lesson :

1.6.0 OBJECTIVES

The focus of this lesson is to give the information to the readers about :

1. Underwriting agreement under the law;
2. Accounting treatment for underwriting;
3. Calculation of liability of underwriting; and
4. Underwriting commission.

1.6.1 INTRODUCTION

Underwriting means undertaking a responsibility or giving a guarantee that the shares or debentures offered to the public will be subscribed for or underwriting of shares is an insurance against under-subscription. An underwriter is a guarantor. He guarantees the sale of shares or debentures, within a certain period. There are firms which undertake this sort of work and are very useful to companies which want to raise funds by issue of shares or debentures. If the shares or debentures are not taken up by the public wholly, the underwriters will have to take and pay for them. His liability is limited to the short subscription. Thus underwriting is an insurance against short subscription. For this service, they charge commission which is generally calculated at a specified rate on the issue price of the shares or debentures underwritten. Even if the public takes up all the shares or debentures offered and the underwriters are not called upon to take up any share, commission will be payable on the whole of the shares or debentures underwritten. A company cannot pay any commission on issue of shares unless it is permitted by its Articles.

1.6.2 DISCLOSURE OF UNDERWRITING AGREEMENT UNDER THE LAW

The provisions of the Companies Act, 2013 in this respect are as follows :

(1) Disclosure in the Prospectus : Clause 11 of schedule II part I dealing with the matters to be specified in prospectus requires that where any issue of shares or debentures is underwritten, the names of the underwriters and the opinion of the Directors that the resources of the underwriters are sufficient to discharge their obligations should be specified in prospectus.

According to section 40(6) of the companies Act 2013, the number of shares or debentures which underwriters have agreed to subscribe and also the amount or rate of commission payable to them should be disclosed in the prospectus or statement in lieu of the prospectus, as the case may be.

(2) Disclosure in the Statutory Report : Section 165 (3) (f) of the companies Act requires that the statutory report shall set out to the extent, if any, to which each underwriting contracts, if any, has not been carried out and the reasons therefore.

(3) Commission and brokerage : All sum payable by way of commission, brokerage etc. must be disclosed in the Balance Sheet vide Schedule VI Under the leading "Miscellaneous Expenditures".

1.6.3 UNDERWRITING COMMISSION

Provisions relating to underwriting Commission have been laid down in section 40(6) of the Companies Act, 2013. It authorises the payment of Commission on fulfilment of the following conditions :

(i) The payment of commission is possible only when it is authorised by the articles.

(ii) The commission paid or agreed to be paid does not exceed,

  (a) In case of shares, five percent of the price at which the shares are issued or the amount or rate authorised by the articles, whichever is less; and

(b) In the case of debentures, two and a half percent of the price at which the debentures are issued or the amount or rate authorised by the articles, whichever is less.

(iii) The Commission paid or agreed to be paid is disclosed in the prospectus or statement in lieu of prospectus, as the case may be.

(iv) Commission can not be paid to any person on share or debentures which are not offered to the public subscription.

1.6.4 SUB-UNDERWRITERS

In addition to the underwriters, there may be several underwriters working under him. These will be called sub-underwriters. They are responsible only to the underwriters and generally have no direct contract with the company. For subscriptions procured by the sub-underwriters, the underwriter receives a small commission, called overall commission.

1.6.5 APPORTIONMENT OF LIABILITY

When the whole issue is underwritten by the underwriter (s) it is called full underwriting. When a part of the whole issue is underwritten by the underwriters then for the balance of shares, the company itself becomes the underwriter.

1.6.5.1 Two or more Underwriting :

When a number of underwriters jointly underwrite the shares of a company the exact number of shares to be taken by each in case of short subscription is a matter of importance to the company as well as to each underwriter. The Gross liability of each underwriter is found out by applying the ratio in which the shares have been underwritten to the total number of shares issued and underwritten.

1.6.5.2 Firm Underwriting :

When an underwriter agrees to buy or subscribe a certain number of shares or debentures irrespective of the result of the issue prospectus, it is the case of firm underwriting. Under 'firm' Underwriters stipulate that they be allotted a given number of shares. Such agreement gets priority over the general public in relation to allotment of shares in the event of over subscription.

1.6.6 BROKERAGE

Brokerage is different from undertaking. Brokerage, as against underwriting is merely the act of procuring subscriptions for shares or debentures without any responsibility. A broker receives commission on the shares subscribed through him but is under no obligation to take up any shares that may remain unsold. Brokerage at the normal rates can be paid in addition to the underwriting commission if any. Brokerage can be paid to the brokers and who deal in shares or debentures and whose business includes the procuring of subscribers for shares or debentures.

(a) Brokerage is fixed at 1.5 percent in respect of all types of public issue of industrial securities whether the issue is underwritten or not.

(b) The mailing cost and other out of pocket expenses for canvasing the public etc. will be borne by the brokers. A clause to this effect must be given in the agreement.

(c) The listed companies are allowed to pay brokerage in case of private placement of capital at the maximum rate of 0 . 5 percent.

(d) No brokerage will be paid in respect of promoters quota.

(e) No brokerage will be paid when the applications are made by the institutions/banks against their underwriting commitments.

1.6.7 FEES OF THE MANAGERS TO THE ISSUES

Though the companies have the liberty to appoint one or more agencies as managers to the issue but the aggregate amount as fees to such persons shall not exceed the following limits :

(i)	For issue upto Rs. 5 crores	0.5 percent
(ii)	For issue over Rs. 5 crores	0.2 percent

Such fees shall not be paid in respect of the following :

(a) Amounts agreed to be taken by the financial institutions as investors/ underwriters;

(b) Promoters quota of capital; and

(c) Amounts subscribed on right basis.

1.6.8 MARKED AND UNMARKED APPLICATIONS

Underwriters or brokers issue application forms for shares or debentures to public, *Such application forms are stamped with the name of the underwriters or brokers.* Such applications are known as Marked Applications. Those applications which do not bear the stamp of the underwriter or the broker are known as unmarked applications.

1.6.9 ACCOUNTING ENTRIES FOR UNDERWRITING

Journal entries in the books of the Insured Company will be as follows :

(1) Commission or brokerage due to Underwriters/Brokers :

Underwriting Commission/Brokerage A/C --Dr.

To underwriters/brokers A/C

(2) Payment made for commission/brokerage :

Underwriters/Brokers A/C --Dr.

To Bank A/C

(3) Liability for shortfall in public subscription.

Underwriter A/C --Dr.

Share Capital/Debentures A/C

(4) Receipt of money for shares/debentures taken up by underwriters :

Bank A/C --Dr.

To Underwriters A/C

1.6.10 CALCULATION OF LIABILITY OF UNDERWRITER

If an underwriter underwriters the whole issue, the shares or debentures left unsubscribed by the public will have to be taken up by the underwriter.

Where the issue is underwritten by two or more underwriters in an agreed ratio the procedure to calculate their liabilities will be as follows :

1. First, of all calculate the gross liability of each underwriter in the agreed ratio.
2. Second, deduct the marked applications from the grossliability.
3. Third, give credit to unmarked application in the ratio of gross liability. This is done by way of deduction from the balance after step 2.
4. Fourth, if some figure is in minus then transfer that figure to other underwriter's accounts in the ratio of gross liability. This gives the liability of underwriters in account of shortfall in the public subscription.

Determining the liability of the underwriters under different types of underwriting agreements :

The liability of the underwriter or underwriters would be determined in the following ways :

1.6.10.1 Complete Underwriting : Calculation of Liability :

(a) If the whole of the issue of shares or debentures is underwritten only by one underwriter : In such a case, the underwriter will be liable to take up all the share or debentures that have not been subscribed for by the public.

Liability = Shares or debentures offered - Total applications received

(b) If the whole of the issue of shares or debentures in underwritten by a number of underwriters in an agreed ratio : In such a case, the liability of the respective underwriters can be determined in either of the following two ways :

(i) The gross liability of each underwriter according to the agreed ratio should be reduced first by the marked applications and then credit may be given into the company by way of deduction from the balance left in the ratio of their gross liability. Thus, the liability of each underwriter in such case will be as follows :

Gross Liability according to the agreed ratio		xxx
Less : Marked applications	xx	
Balanced left		xxxx
Less : Unmarked application in the ratio of gross liability	xxx	
Net Liability	xxxx	

(ii) The gross liability of each underwriter according to the agreed ratio should be reduced first by the marked applications and then credit may be given in respect of unmarked applications sent directly to company by way of deduction from the balance left in the ratio of gross liability as reduced by marked applications.

Thus, the liability of each underwriter in such a case will be as follows :

Gross Liability according to the agreed ratio		xxxx
Less : Marked applications		xxx
Balance left		xxx
Less : Unmarked application in the ratio of balance left (i.e. gross liability as reduced by marked applications)	xxx	
Net Liability	xxxx	

1.6.10.2 Partial Underwriting : Calculation of Liability :

Partial underwriting means that only a part of the issue is underwritten. In such a case for the balance not underwritten, the company itself becomes the underwriter. Again as in the case of complete undertaking, partial underwriting may be done by one underwriter, or more than one underwriter.

(i) When the partial underwriting is done by one person only :

The net liability of the underwriter will be equal to his gross liability minus the marked application received to his credit. All the unmarked applications are treated as marked in favour of the company and the underwriter does not get any credit for them.

(ii) When the partial underwriting is done by more than one person :

The calculation of liability of underwriter is just same as in the (i) above. In this case also the company is deemed to be the underwriter for the balance not underwritten and get the credit for unmarked applications.

Example I :

X Ltd. issued 10,000 equity shares A and B, two underwriters, underwrite 4000 and 6000 shares. Applications for 8,000 shares were received in all, out of which applications for 3,500 shares had the stamp of A and those for 4,000 shares that of B. Show the liability of the underwriters.

Solution :

Liabilities of A and B for the 2000 unsubscribed shares (10000-8000) will be determied as follows :

	A	B
Gross Liability	4,000	6,000
Less : Marked Applications in the ratio of 4 : 6	3,500	4,000
Less : Unmarked applications 500 (i.e. 8000-3500+4000)	500	2,000
is the ratio of 4 : 6	200	300

Net Liability 300 1,700

If the marked application of the underwriter exceeds his liability, the surplus should be distributed amount other underwriters in the ratio of their gross liability or the ratio of the number of shares underwritten.

1.6.10.3 Calculation of liability for firm underwriting :

When the underwriter agrees to firm underwriting it becomes an additional liability and therefore must be added to the net liability arising under the agreement. In the calculations of net liability the shares underwritten firm are ignored.

1.6.10.4 Illustration-I

A underwrites 6,000 shares and also 500 shares as a firm underwriting, the total issue being 10,000 shares. The marked applications are 5400. He will have to take 1100 shares in all 500 underwritten firm will be calculated after taking the firm underwriting into account.

The issue of 10,00,000 shares is underwritten by two underwriters - A and B equally the commission being 5% of the issue price. Each of the underwriters 20,000 shares firm.

Subscriptions total 9,60,000 shares, the distributions of forms being :

A-5, 20,000, B-3, 60,000 and unmarked form 80,000

One of the allottees (using forms marked with the name of A) for 2,000 shares fails to pay the amount due to allotment all other money due being received in full including any due from the share developing upon the underwriters. The Commission due is paid separately.

The Shares of the failed allottee are finally Forfeited by 30.6.07 and are reallotted for payment in cash of Rs. 4 per share.

Pass the necessary journal entries.

Solution : Young Farmers Forests Limited Journal Entries

DATE	PARTICULARS	DEBIT (Rs.)	CREDIT (Rs.)
2007 Jan 31	Bank A/C..................Dr. To Share Application A/C (Being application received)	24,00,000	 24,00,000
March 31	Share Application A/C..................Dr. To Share Capital A/C (Being the transfer of application money to Share capital on 9,60,000 shares	24,00,000	 24,00,000
March 31	Share Allotment A/C................ Dr. B's A/C.................. Dr. To Share Capital A/C To Share Premium A/C (Being amounts due on allotment on	28,80,000 2,20,000	 26,00,000 5,00,000

	9,60,000 Shares allotted generally and 40,000 shares developed upon B vide Board's resolution ....)		
March 31	Bank A/C..................Dr. To Share Allotment A/C To B's A/C (Being the receipt of money due on allotment except from the allottee for 2,000 shares including premium on 9,60,000 shares)	30,94,000	 28,74,000 2,20,00
March 31	Underwritting Commission A/C ....Dr. To Bank A/C (Being payment of Commission @5% on issue price of Rs. 10.50 for 10 lakh shares)	5,25,000	 5,25,000
June 30	Share Capital A/C..............Dr. Share Premium A/C............Dr. To Share Allotment A/C To Share forfeited A/C (Being 2000 shares forfeited vide Board's resolution...........)	10,000 1,000	 6,000 5,000
June 30	Bank A/C...............Dr. Shares Forfeited A/C ....Dr. To Share Capital A/C (Being re-issued 200 shares)	8,000 2,000	 10,000
	Shares Forfeited A/C ....Dr. To Capital Reserve A/C (Being transfer of profit on forfeiture to Capital Reserve)	3,000	 3,000

Working Notes :

1. It has been presumed that shares subscribed 9,60,000 include firm underwriting.
2. Calculation of Liability of Underwriters :

Particulars	A (Rs.)	B (Rs.)
Gross Liability	5,00,000	5,00,000
Less : Firm underwriting	20,000	20,000
	4,80,000	4,80,000
Less : Unmarked Forms	40,000	40,000

Less : Marked Forms (Excluding Firm Underwriting)	4,40,000	4,40,000
	5,00,000	3,40,000
Benefit of A's surplus to B	60,000	1,00,000
	60,000	60,000
Add : Firm Underwriting	—	40,000
	20,000	20,000
Number of share to be taken as per guarantee	20,000	60,000

1.6.11 ACCOUNTS OF UNDERWRITERS

It has already been stated that underwriters ensure the company that in case the shares and debentures offered to the public to the extent, the balance of shares and debentures will be taken up (on the same term as the public) by the underwriters. For this responsibility, they are paid a commission (on all shares and debentures underwritten which cannot exceed 5% of the issue price of shares and 2½% of the issue price of debentures.

An underwriter may reduce his liability by entering into a contract with sub underwriter who will assume a part of the responsibility for a commission. The sub underwriter has nothing to do with the company. He will charge his commission from the main underwriter. He will have to take the shares or debentures as may fall in his share from him.

The underwriter will maintain an account known as underwriter account. The amount paid for taking up the shares or debentures will be debited to his account. The commission received from the company will be credited to this account. In case the underwriting has a sub-underwriter, the commission due to him will be debited and the amount of shares or debentures transferred to him will be credited. The underwriter will try to sell the shares or debentures sold will be valued at cost or market price whichever is lower and carried forward to the next period. The balancing figure will be profit or loss and will be transferred to profit and loss account.

1.6.12 ILLUSTRATIONS II

A enters into a contract with B Ltd., to underwrite its 5,000 shares of Rs. 10 each in consideration of 5% commission. He also enters into an agreement with C to sub-underwrite 1,000 shares of B Ltd. at a commission of 3%. The public subscribes for 2,000 shares only and subsequently the shares were taken up by A who sold his shares @ Rs. 9 per share. The shares taken by

C were sold Rs. 10 per share. Expenses of underwriting amounts to Rs. 600. Prepare Underwriting account in the books of A.

Books of A
Underwriting Account

Dr. Cr.

Particulars	No. of Shares	Amount	Particulars	No. of Shares	Amount
To Bank (Expenses)	–	600	By Bank (Commission @ 5% on 5,000 shares of Rs. 10 each		2,500
To Bank (Shares taken up)	3,000	30,000			
To Bank (Commission 3% on 1,000 shares)	–	300	By Bank Transfer to 600 shares of Rs, 10 each to C as per sub-under writing agreement i.e., 20% of 3,000)	600	6,000
			By Bank (Sale of 2,400 shares @ Rs. 9 per share)	2,400	21,600
			By Profit & Loss Account (Loss on under-writing	–	800
	3,000	30,900		3,000	30,900

III : X Ltd. issued 2,00,000 equity shares of Rs. 10 each, The issue was underwritten by A for a commission of 5%. A arranges with B for sub- underwriting to the extent of 30% of shares for a commission of 4%. The shares were to be paid for as :

Rs. 3 on application Rs.
4 on allotment and
Rs. 3 on first and final call

The public applied for 1,60,000 shares. Both A and B fulfilled their obligations. After the call, A sold 18,000 shares at Rs. 9. At the close of the period, the market value of the shares was Rs. 9.50. Expenses were Rs. 12,000. Prepare the underwriting account in the books of A.

In the Books of A

Underwriting Account

Dr. Particulars	No. of Shares	Amount Rs.	Particulars	No. of Shares	Amount Rs. Cr.
To Bank (Expenses)	–	12,000	By Bank (Commission @ 5% on 20,00,000	—	1,00,000
To Bank (Application Money)	40,000	1,20,000	By Bank (Rs. 7 per share on shares transferred to B)	12,000	84,000
To Bank (allotment money)		1,60,000	By Bank (Sale)	18,000	1,62,000
To Bank (Commission to B) 4% on Rs. 6,00,000 (i.e. 30% of Rs. 20,00,000		24,000	By Balance c/d (Rs. 77,142 cost price)	10,000	77,142
To Bank (call on 28,000 shares)		84,000			
To profit & loss A/c (Profit)		23,142			
	40,000	4,23,142		40,000	4,23,142

Working note :

	Rs.	Rs.
Total Amount paid (including Commission to B)		4,00,000
Less : Commission received	1,00,000	
Amount receivable from B	84,000	
		1,84,000
Cost of 28,000 shares		2,16,000
Cost per share	$\frac{2,16,000}{28,000} = 7.7,142$	

IV : X Ltd. which carries on the business of underwriting shares, underwrite 15,000 shares of Rs. 10 each in a new issue made by A Co. Ltd. The agreed commission was 5% payable as to 70% in fully paid shares and the balance in cash. In addition to underwriting these shares X Co. Ltd. made 'Firm Application' in the ordinary course for an other 2,500 shares.

The issue was not fully subscribed by the public and the underwriter was obliged to take up 30% of the shares underwritten. The shares in A Co. Ltd., were subsequently quoted at a discount of 12%.

Prepare the underwriting of shares in A Co. Ltd., Account in the books of X Co.

Books of X co. Ltd.

(UNDERWRITING OF SHARES IN A CO, LTD. ACCOUNT)

Dr. Cr.

Particulars	No. of Shares	Amount Rs.	Particulars	No. of Shares	Amount Rs.
To Cash	2,500	25,000	By Cash A/c	—	2,250
To Cash (I)	2,000	20,000	By Balancing c/d	5,025	42,750
To shares A/c (Received as Commission (2)	525	—			
	5,025	45,000		5,025	45,000

Working Notes :

1. Total share to be acquired under the contract = 30% of 15,000 i.e. 4,500

Less : Shares already taken up under firm underwriting 2,500

More shares to be subscribed 2,000

Rs.

2. Total commission is 5% of Rs. 1,50,000 7,500

Less : 30% received in cash 2,250

Balance to be received in fully paid up 225 shares for which No payment is to be made, so 525 shares have to receive as a commission 5,250

3. As the book value of Rs. 8.50 per share (i.e. Rs. 42,750/5,025) is less than the market value of Rs. 8.80 (i.e. Rs. 10 Less 12%), so shares have been carried down at the book value.

1.6.13 Self Check Exercises

Ques1: What do you mean by underwriting commission?

Ques2: What do you mean by firm underwriting?

Ques3: What do you mean by the term two or more underwriting?

1.6.14 SUMMARY

The minimum subscription is the least amount which, in the opinion of directors (promoters) must be raised by issue of shares. To cover this minimum amount, companies usually get the issue underwritten by a person or group of persons to ensure that issue is fully subscribed. If whole issue is underwritten by the underwriter(s) it is called full underwriting, but if a part of the whole issue is underwritten by the underwriter(s), it is called partial underwriting. To record this whole system underwriter's Accounts are required to maintained as discussed in this lesson.

1.6.15 Glossary

1. Underwriting: Underwriting means undertaking a responsibility that debentures or shares offered to public will be subscribed.
2. Brokerage: Brokerage is procurement of subscriptions for shares or debentures without taking any responsibility.
3. Sub underwriters: When several underwriters work under a underwriter, then these several underwriters are called sub underwriters.

1.6.16 Short Questions

Q.1. What is maximum rate of commission on underwritting of shares or debentures to be paid by the company ?

Q.2. What is Underwriting Account ?

Q.3. Give a specimen of Underwriting account with various entries on the debit and credit of the account ?

Q.4. Who is sub underwriter ?

Q.5. What do you mean by Accounts of Underwriter ?

1.6.17 Long Questions :

Q.1. X Co. Ltd. which carries on the business of underwriting shares, underwrote 15,000 shares of Rs. 10 each in a new issue made by A Co. Ltd. The agreed commission was 5% payable as to 70% in fully paid shares and the balance in cash. In addition to underwriting these shares

X Co. Ltd. Made "Firm Application" in the ordinary course for another 2,500 shares.

Q.2. A company issued 4,000 shares of Rs. 10 each and entered into an underwriting agreement with B who agreed to underwrite the whole issue at a commission of 4% and entered into sub-underwriting agreement with C For 5% of the issue at a commission of 3%. The public applied only for 75% of issue. Hence the balance was taken up by the underwriters. B sold the shares held by him @Rs. 8 per share. Pass journal entries and prepare accounts in the books of B.

Q.3. It has been arranged that X Ltd. would issue 80,00,000 shares of Rs. 10 each; Re. 1 payable on application. Rs. 4 an allotment and Rs. 5 as a final call. Arrangements made for A Ltd. to underwrite the whole issue at a commission of 2½% and to apply firm for 20,00,000 shares. A Ltd. arranged with B Ltd. to sub-underwrite 10,00,000 of these shares being offered to the public for a commission of 2%.

Q.4. Write Short Notes On :

(a) Firm Underwriting

(b) Underwriting of Shares and Debentures.

(c) Marked and Unmarked Application.

1.6.18 SUGGESTED READINGS

a. Advanced Accounting

By : Jain and Narang

2. Advanced Accounting Part-II

By : Ashok Sehgal

Deepak Sehgal

Taxmann's Publication.

Mandatory Student Feedback Form

https://forms.gle/KS5CLhvpwrpgjwN98

Note: Students, kindly click this google form link, and fill this feedback form once.