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CBSE

CLASS 12TH

THE CENTRAL BOARD OF SECONDARY EDUCATION

PART – II

ACCOUNTANCY – II

SIERRA INNOVATIONS

ACCOUNTANCY – 2

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Chapter-6 Accounting for Share Capital

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Features of a Company

A company may be viewed as an association of person who contribute money or money's worth to a common inventory and use it for a common purpose. It is an artificial person having corporate legal entity distinct from its members (shareholders) and has a common seal used for its signature. Thus, it has certain special features which distinguish it from the other forms of organisation. These are as follows:

• **Body Corporate:** A company is formed according to the provisions of Law enforced from time to time. Generally, in India, the companies are **formed and registered under Companies Law** except in the case of Banking and Insurance companies for which a separate Law is provided for.

• **Separate Legal Entity:** A company has a separate legal entity which is **distinct and separate from its members.** It can hold and deal with any type of property. It can enter into contracts and even open a bank account in its own name.

• **Limited Liability:** The liability of the members of the company is **limited to the extent of unpaid amount of the shares held by them**. In the case of the companies limited by guarantee, the liability of its members is limited to the extent of the guarantee given by them in the event of the company being wound up.

• **Perpetual Succession**: The company being an artificial person created by law **continues to exist irrespective of the changes in its membership.** A company can be terminated only through law. The death or insanity or insolvency of any member of the company in no way affects the existence of the company. **Members may come and go but the company continues.**

• **Common Seal:** The company being an artificial person, cannot sign its name by itself. Therefore, every company is required to have **its own seal which acts as official signatures of the company.** Any document which does not carry the common seal of the company is not binding on the company.

• **Transferability of Shares:** The shares of a public limited company are freely transferable. The permission of the company or the consent of any member of the company is not necessary for the transfer of shares. But the Articles of the company can prescribe the manner in which the transfer of shares will be made.

• **May Sue or be Sued:** A company being a legal person can enter into contracts and can enforce the contractual rights against others. It can sue and be sued in its name if there is a breach of contract by the company.

Kinds of Companies

Companies can be classified either on the **basis of the liability of its members or on the basis of the number of members.**

On the basis of liability of its members the companies can be classified into the following three categories:

i) **Companies Limited by Shares:** In this case, the liability of its members is limited to the extent of the nominal value of shares held by them. If a member has paid the full amount of the shares, there is no liability on his part whatsoever may be for the debts of the company. He need not pay a single paise from his private property. However, if there is any liability involved, it can be enforced during the existence of the company as well as during the winding up.

ii) **Companies Limited by Guarantee:** In this case, the liability of its members is limited to the amount they undertake to contribute in the event of the company being wound up. Thus, the liability of the members will arise only in the event of its winding up.

iii) **Unlimited Companies:** When there is no limit on the liability of its members, the company is called an unlimited company. When the company's property is not sufficient to pay off its debts, the private property of its members can be used for the purpose. In other words, the creditors can claim their dues from its members. Such companies are not found in India even though permitted by the Companies Act.

On the basis of the number of members, companies can be divided into three categories as follows:

(i) Public Company: A public company means a company which

(a) is not a private company

(b) is a company which is not a subsidiary of a private company.

(ii) Private Company: A private company is one which by its articles of association:

(a) Restricts the right to transfer its shares;

(b) A private company must have at least 2 persons, except in case of one-person company

(c) Limits the number of its members to 200 (excluding its employees)

(iii) One Person Company (OPC): Sec. 2 (62) of the companies Act, 2013, defines OPC as a "company which has only one person as a member". Rule 3 of the Companies (Incorporation) Rules, 2014 provides that:

(a) Only a natural person being an Indian citizen and resident in India can form one-person company

(b) It cannot carry out non-banking financial investment activities.

(c) Its paid up share capital is not more than Rs. 50 Lakhs

(d) Its average annual turnover of three years does not exceed Rs. 2 Crores.

<u>**Share Capital of a Company**</u>

A company, being an artificial person, cannot generate its own capital which has necessarily to be collected from several persons. **These persons are known as shareholders and the amount contributed by them is called share capital.** Since the number of shareholders is very large, a separate capital account cannot be opened for each one of them. Hence, innumerable streams of capital contribution merge their identities in a common capital account called as 'Share Capital Account'.

Categories of Share Capital

From accounting point of view the share capital of the company can be classified as follows:

• **Authorised Capital: Authorised capital is the amount of share capital which a company is authorised to issue by its Memorandum of Association.** The company cannot raise more than the amount of capital as specified in the Memorandum of Association. **It is also called Nominal or Registered capital.** The authorised capital can be increased or decreased as per the procedure laid down in the Companies Act. It should be noted that the company need not issue the entire authorised capital for public subscription at a time. Depending upon its requirement, it may issue share capital but, in any case, it should not be more than the amount of authorised capital.

• **Issued Capital: It is that part of the authorised capital which is actually issued to the public for subscription** including the shares allotted to vendors and the signatories to the company's memorandum. The authorised capital which is not offered for public subscription is known as 'unissued capital'. Unissued capital may be offered for public subscription at a later date.

• **Subscribed Capital: It is that part of the issued capital which has been actually subscribed by the public**. When the shares offered for public subscription are **subscribed fully by the public the issued capital and subscribed capital would be the same.** It may be noted that ultimately, the subscribed capital may be equal to or less than issued capital. In case the number of shares subscribed is less than what is offered, the company allots only the number of shares for which subscription has been received. In case it is higher than what is offered, the allotment will be equal to the offer. In other words, the fact of over subscription is not reflected in the books.

• **Called up Capital: It is that part of the subscribed capital which has been called up on the shares, i.e., what the company has asked the shareholders to pay.** The company may decide to call the entire amount or part of the face value of the shares. For example, if the face value (also called nominal value) of a share allotted is Rs. 10 and the company has called up only Rs. 7 per share, in that scenario, the called-up capital is Rs. 7 per share. The remaining Rs. 3 may be collected from its shareholders as and when needed.

• **Paid up Capital:** It is that portion of the called-up capital which has been actually received from the shareholders. When the shareholders have paid all the called amount, the called-up capital is the same to the paid-up capital. If any of the shareholders has **not paid amount on calls, such an amount may be called as 'calls-in-arrears'.** Therefore, paid up capital is equal to the called-up capital minus call in arrears.

• **Uncalled Capital: That portion of the subscribed capital which has not yet been called up.** As stated earlier, the company may collect this amount any time when it needs further funds.

- **Reserve Capital: A company may reserve a portion of its uncalled capital to be called only in the event of winding up of the company.** Such uncalled amount is called 'Reserve Capital' of the company. It is available only for the creditors on winding up of the company.

Nature and Classes of Shares

Shares refer to the units into which the total share capital of a company is divided. Thus, **a share is a fractional part of the share capital and forms the basis of ownership interest in a company**. The persons who contribute money through shares are called shareholders. The amount of authorised capital, together with the number of shares in which it is divided, is stated in the Memorandum of Association but the classes of shares in which the company's capital is to be divided, along with their respective rights and obligations, are prescribed by the Articles of Association of the company. As per The Companies Act, a company can issue two types of shares **(1) preference shares, and (2) equity shares (also called ordinary shares).**

Preference Shares

According to Section 43 of The Companies Act, 2013, a preference share is one, which fulfils the following conditions:

(a) That it carries a **preferential right to dividend to be paid either as a fixed amount payable to preference shareholders or an amount calculated by a fixed rate of the nominal value of each share before any dividend is paid to the equity shareholders.**

(b) That with respect to capital it carries or will carry, on the winding up of the company, the preferential right to the repayment of capital before anything is paid to equity shareholders. However, notwithstanding the above two conditions, a holder of the preference share may have a right to participate fully or to a limited extent in the surpluses of the company as specified in the Memorandum or Articles of the company. Thus, the **preference shares can be participating and nonparticipating.** Similarly, these shares can be cumulative or non-cumulative, and redeemable or irredeemable.

Equity Shares

According to Section 43 of The Companies Act, 2013, an equity share is a share which is not a preference share. In other words, shares which do not enjoy any preferential right in the payment of dividend or repayment of capital, are termed as equity/ordinary shares. The equity shareholders are entitled to share the distributable profits of the company after satisfying the dividend rights of the preference shareholders. The dividend on equity shares is not fixed and it may vary from year to year depending upon the amount of profits available for distribution. The equity share capital may be (i) with voting rights; or (ii) with differential rights as to voting, dividend or otherwise in accordance with such rules and subject to such conditions as may be prescribed in the Articles of Association of the company.

Issue of Shares

A salient characteristic of the capital of a company is that the amount on its shares can be gradually collected in easy instalments spread over a period of time depending upon its growing financial requirement. The **first instalment is collected along with application and is thus, known as application money, the second on allotment (termed as allotment money), and the remaining instalments are termed as first call, second call and so on.** The word final is suffixed to the last instalment. However, this in no way which prevents a company from calling the full amount on shares right at the time of application. The **important steps in the procedure of share issue are:**

• **Issue of Prospectus**: The company first issues the prospectus to the public. Prospectus is an invitation to the public that a new company has come into existence and it needs funds for doing business. It contains complete information about the company and the manner in which the money is to be collected from the prospective investors.

• **Receipt of Applications:** When prospectus is issued to the public, prospective investors intending to subscribe the share capital of the company would make an application along with the application money and deposit the same with a scheduled bank as specified in the prospectus. The company has to get **minimum subscription within 120 days from the date of the issue of the prospectus.** It is to be noted that 'minimum subscription' of capital cannot be less than 90% of the issued amount according to SEBI. If the company fails to receive the same within the said period, the company cannot proceed for the allotment of shares and application money should be returned within 130 days of the date of issue of prospectus.

• **Allotment of Shares:** If minimum subscription has been received, the company may proceed for the allotment of shares after fulfilling certain other legal formalities. Letters of allotment are sent to those whom the shares have been allotted, and letters of regret to those to whom no allotment has been made. When allotment is made, it results in a valid contract between the company and the applicants who now became the shareholders of the company.

Shares of a company are issued either at par or at a premium. Shares are to be **issued at par when their issue price is exactly equal to their nominal value** according to the terms and conditions of issue. When the **shares of a company are issued more than its nominal value (face value), the excess amount is called premium**. Irrespective of the fact that shares are issued at par or at a premium, the share capital of a company, may be collected in instalments payable at different stages.

Accounting Treatment

On application: The amount of money paid with various instalment represents the contribution to share capital and should ultimately be credited to share capital. However, for the sake of convenience, initially individual accounts are opened for each instalment. All money received along with application is deposited with a scheduled bank in a separate account opened for the purpose.

The journal entry is as follows:

Bank A/c Dr.

To Share Application A/c

(Amount received on application for — shares @ Rs. ______ per share)

On allotment: When minimum subscription has been received and certain legal formalities on the allotment of shares have been duly compiled with, the directors of the company proceed to make the allotment of shares. The allotment of shares implies a contract between the company and the applicants who now become the allottees and assume the status of shareholders or members.

The journal entries with regard to allotment of shares are as follows:

1. For Transfer of Application Money

Share Application A/c Dr.

To Share Capital A/c

(Application money on _____ Shares allotted/ transferred to Share Capital)

2. For Money Refunded on Rejected Application

Share Application A/c Dr.

To Bank A/c

(Application money returned on rejected application for ___shares)

3. For Amount Due on Allotment

Share Allotment A/c Dr.

To Share Capital A/c

4. For Adjustment of Excess Application Money

Share Application A/c Dr.

To Share Allotment A/c

(Application Money on __Shares @ Rs__per shares adjusted to the amount due on allotment).

5. For Receipt of Allotment Money

Bank A/c Dr.

To Share Allotment A/c

(Allotment money received on ___Shares @ Rs. — per share Combined Account)

Note: The journal entries (2) and (4) can also be combined as follows: Share Application A/c

To Share Allotment A/c

To Bank A/c

(Excess application money adjusted to share allotment and balance refunded)

Sometimes a combined account for share application and share allotment called **'Share Application and Allotment Account'** is opened in the books of a company. The combined account is based on the reasoning that allotment without application is impossible while application without allotment is meaningless. These two stages of share capital are closely inter-related. When a combined account is maintained, journal entries are recorded in the following manner:

1. For Receipt of Application and Allotment

Bank A/c Dr.

To Share Application and Allotment A/c

(Money received on applications for shares @ Rs. _____ per share).

2. For Transfer of Application Money and Allotment Amount Due Share Application and Allotment A/c Dr.

To Share Capital A/c

(Transfer of application money to Share Capital Account for amount due or allotment of — Share @ Rs. _____ per share)

3. For Money Refunded on Rejected Applications

Share Application and Allotment A/c Dr.

To Bank A/c

(Application money returned on rejected application for ___ shares)

4. On Receipt of Allotment Amount

Bank A/c Dr.

To Share Application and Allotment A/c

(Balance of Allotment Money Received)

On Calls: Calls play a vital role in making shares fully paid-up and for realising the full amount of shares from the shareholders. In the event of shares not being fully called up till the completion of allotment, the directors have the authority to ask for the remaining amount on shares as and when they decide about the same. It is also possible that the timing of the payment of calls by the shareholders is determined at the time of share issue itself and given in the prospectus. Two points are important regarding the calls on shares. First, **the amount on any call should not exceed 25% of the face value of shares.** Second, there must be an **interval of at least one month between the making of two calls unless otherwise provided by the articles of association of the company.** When a call is made and the amount of the same is received, the journal entries are as given below:

1. **For Call Amount Due**

Share Call A/c Dr.

To Share Capital A/c

(Call money due on ___Shares @ Rs. ____ per share)

2. **For Receipt of Call Amount**

Bank A/c Dr.

To Share Call A/c

(Call money received)

The word/words First, Second, or Third must be added between the words "Share" and 'Call' in the Share Call account depending upon the identity of the call made. Another point to be noted is that the words 'and Final' will also be added to the last call, say, if second call is the last call it will be termed as 'Second and Final Call'.

Calls in Arrears

It may happen that shareholders do not pay the call amount on due date. When any shareholder **fails to pay the amount due on allotment or on any of the calls, such amount is known as 'Calls in Arrears'/ 'Unpaid Calls'.** Calls in Arrears represent the debit balance of all the calls account. Such amount shall appear as 'Note to Accounts However, where a company maintains 'Calls in Arrears' Account, it needs to pass the following additional journal entry:

Calls in Arrears A/c Dr.

To Share First Call Account A/c

To Share Second and Final Call Account A/c

(Calls in arrears brought into account)

The Articles of Association of a company may empower the directors to charge interest at a stipulated rate on calls in arrears. If the articles are silent in this regard, the rule contained in Table F shall be applicable which states that the interest at a rate not exceeding 10% p.a. shall have to be paid on all unpaid amounts on shares for the period intervening between the day fixed for payment and the time of actual payment thereof.

On receipt of the call amount together with interest, the amount of interest shall be credited to interest account while call money shall be credited to the respective call account or to calls in arrears account. When the shareholder makes the payment of calls in arrears together with interest, the entry will be as follows:

Bank A/c Dr.

To Calls in Arrears A/c

To Interest on Calls in Arrears A/c

(Calls in arrears received with interest)

Note: If nothing is specified, there is no need to take the interest on calls in arrears account and record the above entry.

Calls in Advance

Sometimes shareholders pay a part or the whole of the amount of the calls not yet made. The amount so received from the shareholders is known as **"Calls in Advance". The amount received in advance is a liability of the company and should be credited to 'Call in Advance Account."** The amount received will be adjusted towards the payment of calls as and when they become due. The following journal entry is recorded for the amount of calls received in advance.

Bank A/c Dr.

To Calls in Advance A/c

(Amount received on call in advance)

On the due date of the calls, the amount of 'Calls in Advance' is adjusted by the following entry:

Calls in Advance A/c Dr.

To Particular Call A/c

(Calls in advance adjusted with the call money due)

The balance in 'Calls in Advance' account is shown as a separate item under the title Equity and Liabilities in the company's balance sheet under the head **'current liabilities', as sub-head 'others current liabilities.** It is not added to the amount of paid-up capital. As 'Calls in Advance' is a liability of the company, it is under obligation, if provided by the Articles, to pay interest on such amount from the date of its receipt up to the date when appropriate call is due for payment. A stipulation is generally made in the Articles regarding the rate at which interest is payable. However, if Articles are silent on this account, Table F is applicable which provides for interest on calls in advance at a rate not exceeding 12% per annum.

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

1. **For Payment of Interest**

Interest on Calls in Advance A/c Dr.

To Bank A/c

(Interest paid on Calls in Advance)

OR

2. **(a) For Interest due**

Interest on Calls in Advance A/c Dr.

To Sundry Shareholder's A/c

(Interest paid on Calls in Advance)

(b) For Interest Paid

Sundry Shareholder's A/c Dr.

To Bank A/c

Over Subscription

There are instances when applications for **more shares of a company are received than the number offered to the public for subscription.** This usually happens in respect of shares issue of well-managed and financially strong companies and is said to be a case of 'Over Subscription'. In such a condition, three alternatives are available to the directors to deal with the situation:

(1) they can accept some applications in full and totally reject the others

(2) they can make a pro-rata allotment to all

(3) they can adopt a combination of the above two alternatives which happens to be the most common course adopted in practice.

The problem of over subscription is **resolved with the allotment of shares.** Therefore, from the accounting point of view, it is better to place the situation of over subscription within the total frame of application and allotment, i.e. receipt of application amount, amount due on allotment and its receipt from the shareholders, and the same has been observed in the pattern of entries.

First Alternative: When the directors decide to fully accept some applications and totally reject the others, the application money received on rejected applications is fully refunded. For example, a company invited applications for 20,000 shares and received the applications for 25,000 shares. The directors rejected the applications for 5,000 shares which are in excess of the required number and refunded their application money in full.

In this case, the journal entries on application and allotment will be as follows:

1. Bank A/c Dr.
   To Share Application A/c
   (Money received on application for 25,000 shares @ Rs. _ per share)
2. Share Application A/c Dr.
   To Share Capital A/c

To Bank A/c
(Transfer of application for money 20,000 for shares allotted and money refunded on applications for 5,000 shares rejected)

3. Share Allotment A/c Dr.
To Share Capital A/c
(Amount due on the allotment of 20,000 shares @ Rs. _ per share)

4. Bank A/c Dr.
To Share Allotment A/c
(Allotment money received)

Second Alternative: When the directors opt to make a **proportionate allotment to all applicants (called 'pro-rata' allotment), the excess application money received is normally adjusted towards the amount due on allotment.** In case, the excess application money received is more than the amount due on allotment of shares, **such excess amount may either be refunded or credited to calls in advance.** For example, in the event of applications for 20,000 shares being invited and those received are for 25,000 shares, it is decided to allot shares in the ratio of 4:5 to all applicants. It is a case of pro-rata allotment and the excess application money received on 5,000 shares would be adjusted towards the amount due on the allotment of 20,000 shares.

In this case, the journal entries on application and allotment will be as follows.

1. Bank A/c Dr.
To Share Application A/c
(Application money received on 25,000 shares @ Rs. _ per Share)

2. Share Application A/c Dr.

To Share Capital A/c

To Share Allotment A/c

(Transfer of application money to share capital and the excess application money on 5,000 shares credited to share allotment account)

3. Share Allotment A/c Dr.

To Share Capital A/c

(Amount due on allotment of 25,000 share @ Rs. _ per share)

4. Bank A/c Dr.

To Share Allotment A/c

(Allotment money received after adjusting the amount already received as excess application money)

Third Alternative: When the application for some shares are rejected outrightly; and pro-rata allotment is made to the remaining applicants, the money on rejected applications is refunded and the excess application money received from applicants to whom pro-rata allotment has been made is adjusted towards the amount due on the allotment of shares allotted. For example, a company invited applications for 10,000 shares and received applications for 15,000 shares. The directors decided to reject the applications for 2,500 shares outright and to make a pro-rata allotment of 10,000 shares to the applicants for the remaining 12,500 shares so that four shares are allotted for every five shares applied. In this case, the money on applications for 2,500 shares rejected would be refunded fully and that on the remaining 2,500 shares (12,500 shares – 10,000 shares) would be adjusted against the allotment amount due on 10,000 shares allotted and credited to share allotment account, the journal entries on application and allotment recorded as follows:

1. Bank A/c Dr.
   To Share Application A/c
   (Money received on application for 15,000 shares @ Rs. _ per share)
2. Share Application A/c Dr.
   To Share Capital A/c
   To Share Allotment A/c
   To Bank A/c
   (Transfer of application money to share capital, and the excess application amount of pro-rata allottees credited to share allotment and the amount on rejected applications refunded)
3. Share Allotment A/c Dr.
   To Share Capital A/c
   (Amount due on the Allotment of 10,000 shares @ Rs. _ per share)
4. Bank A/c Dr.
   To Share Allotment A/c
   (Allotment money received after adjusting the amount already received as excess application money)