

# ISSUE OF SHARES-I

## Unit Structure

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### 1.0 OBJECTIVES:

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After studying the unit the students will be able to:

- Define Company, Share Capital, Share.
- Explain the procedure for issue of shares.
- Understand the accounting entries.
- Elaborate the procedure of forfeiture.
- Know the meaning of Bonus share and Right Issue.

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### 1.1 INTRODUCTION:

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#### 1.1.1 COMPANY:

Under the companies Act, 1956 a Company means “A Company formed and registered under that Act or under any previous Companies Act.

#### 1.1.2 DISTINCTION FEATURES OF A COMPANY:

- a) Voluntary Association
- b) Independent Existence
- c) Artificial Person
- d) Compulsory Incorporation

- e) Common Seal
- f) Perpetual Succession
- g) Limited Liability
- h) Transferability of shares
- i) Separation of Ownership and Management
- j) Large Membership
- k) Ability to raise large amount of Capital

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## 1.2 SHARE CAPITAL :

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- (a) Authorised Capital:** This is the Maximum Capital which the company can raise in its life time. This is mentioned in the Memorandum of the Association of the Company. This is also called as Registered Capital or Nominal Capital.
- (b) Issued Capital:** Part of the Authorised Capital which is issued to the public for Subscription is called as Issued Capital.
- (c) Subscribed Capital:** The issued Capital may not be fully subscribed by the public Subscribed Capital is that part of issued Capital which has been taken off by the public i.e. the capital for which applications are received from the public.
- (d) Called – up Capital:** The Company may not need to receive the entire amount of capital of capital at once. It may call up only part of the subscribed capital as and when needed in installments. Called – up Capital is the part of ‘subscribed capital which the company has actually called upon the shareholders to pay. Called – up Capital includes the amount paid by the shareholder from time to time on application, on allotment, on various calls such as First Call, Second Call, Final Call etc. The remaining part of subscribe capital not yet called up is known as Uncalled Capital. The Uncalled Capital may be converted, by passing a special resolution, into Reserve Capital, Reserve Capital can be called up only in case of winding up of the company, to meet the liabilities arising then.
- (e) Paid-up Capital:** The Called-up Capital may not be fully paid. Some Shareholders may pay only part of the amount required to be paid or may not pay at all. Paid-up Capital is the part of called-up capital which is actually paid by the shareholders. The remaining part indicates the default in payment of calls by some shareholders, known as Calls in Arrears. Thus, Paid-up Capital is Called-up Capital – Calls in Arrears.

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## 1.3 SHARE:

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### 1.3.1 DEFINITION

A “share” has been defined by the Indian Companies Act, under sec.2(46) as “A share is the share in the Capital of the Company”.

### 1.3.2 TYPES OF SHARES:

A Company can issue two types of shares – Equity and Preference.

**(a) Equity Shares:** Equity shares means that part of the share capital which is not a Preference share capital. It means all such shares which are not Preference shares. Equity shares are also called as Ordinary Shares.

**(b) Preference Shares:** Preference shares are those shares which fulfill both the following two conditions:

- (i) They carry preferential share right in respect of dividend at a fixed rate,
- (ii) They also carry preferential right in regard to payment of capital on winding up of the company.

Preference shares can be further classified as follows:

**(1) Cumulative and Non – Cumulative :** If in any year the profits are insufficient to pay the preference dividend then in case of cumulative preference shares this dividend can be paid in the subsequent year before any other dividend is paid. In other words the right to receive the dividend goes on accumulating till it is paid. In case of Non – cumulative preference shares the dividend can be paid only in that year. If there are insufficient profits then such preference shareholders do not get any dividend for that year.

**(2) Participating & Non-Participating Preference Shares:** Participating preference shares are entitled to participate in the surplus profits remaining after the payment of (a) Fixed dividend to Preference shareholders and (b) Dividend to the equity shareholders. They are also entitled to participate in the surplus funds remaining at the time of winding of the company after payment of (a) Preference share capital & (b) Equity Share Capital. Non – participating preference share are not entitled to participate in the surplus profits or surplus funds left over at the time of winding off.

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## 1.4 PROCEDURE FOR ISSUE OF SHARES:

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### 1.4.1 PROCEDURE

**(a) Issue of Prospectus:** Whenever shares are to be issued to the public the company must issue a prospectus. Prospectus means an open invitation to the public to take up the shares of the company thus a private company need not issue prospectus. Even a Public Company issuing its shares privately need not issue a prospectus. However, it is required to file a "Statement in lieu of Prospectus" with the register of companies. The Prospectus contains relevant information like names of Directors, terms of issue, etc. It also states the opening date of subscription list, amount payable on application, on allotment & the earliest closing date of the subscription list.

**(b) Application of Shares:** A person intending to subscribe to the share capital of a company has to submit an application for shares in the prescribed form, to the company along with the application money before the last date of the subscription mentioned in the prospectus.

**Over Subscription:** If the no. of shares applied for is more than the no. of shares offered to the public then that is called as over Subscription.

**Under Subscription:** If the no. of shares applied for is less than the no. of shares offered to the public then it is called as Under Subscription.

**(c) Allotment of Shares:** After the last date of the receipt of applications is over, the Directors, Proceed with the allotment work. However, a company cannot allot the shares unless the minimum subscription amount mentioned in the prospectus is collected within a stipulated period.

The Directors pass resolution in the board meeting for allotment of shares indicating clearly the class & no. of shares allotted with the distinctive numbers. Then Letters of Allotment are sent to the concerned applicants. Letters of Regret are sent to those who are not allotted any shares & application money is refunded to them.

**Partial Allotment:** In partial allotment the company rejects some application totally, refunds their application money & allots the shares to the remaining applicants.

**Pro-rata Allotment:** When a company makes a pro-rata allotment, it allots shares to all applicants but allots lesser shares than applied for. E.g. If a person has applied for three hundred shares he may get two hundred shares.

- (d) **Calls on Shares:** The remaining amount of shares may be collected in installments as laid down in the prospectus. Such installments are called calls on Shares. They may be termed as “Allotment amount, First Call, Second Call, etc.”
- (e) **Calls-in-Arrears:** Some shareholders may not pay the money due from them. The outstanding amounts are transferred to an account called up as “Calls-in-Arrears” account. The Balance of calls-in-arrears account is deducted from the Called-up capital in the Balance Sheet.
- (f) **Calls-in-Advance:** According to sec.92 of the Companies Act, a Company may if so authorized by its articles, accept from a shareholder either the whole or part of the amount remaining unpaid on any shares held by them, as Calls in advance. No dividend is paid on such calls in advance. However, interest has to be paid on such calls in advance.

#### 1.4.2 TERMS OF ISSUE OF SHARES:

A limited company may issue the shares on following different terms.

- (a) Issue of Shares for Consideration other than cash or for cash or on capitalization of reserves.
- (b) Issue of Shares at par i.e. at face value or at nominal value.
- (c) Issue of Shares at a Premium i.e. at more than face value.
- (d) Issue of Shares at a Discount i.e. at less than the face value.

#### ISSUE OF SHARES AT A PREMIUM:

When the shares are issued at a price higher than the nominal value of the shares then it is called as shares issued at a premium. The amount of premium is decided by the board of Directors as per the guide lines issued by SEBI. Such share premium collected by the company is credited to a separate A/c called as “Securities Premium A/c”. Although Securities Premium is a profit to the company, it is not a revenue profit, it is treated as capital profit, which can be utilized only for the following purposes as per sec. 78 of the Companies Act –

- (a) Issue of fully paid bonus shares to the existing shareholders.
- (b) Writing off the preliminary expenses of the company.

- (c) Writing off the expenses of issue or the commission paid or discount allowed on any issue of shares / debentures.
- (d) Providing the premium payable on redemption of preference shares or debentures. The company can utilize the security Premium for any other purpose only on obtaining the sanction of the court.

### ISSUE OF SHARES AT A DISCOUNT:

The Companies Act, permits issue of shares at a discount subject to the following conditions. (sec. 79) –

- (a) The issue must be of a class of shares already issued.
- (b) Not less than 1 year has at the date of issue elapsed since the date on which the company became entitled to commence business.
- (c) The issue at a discount is authorized by a resolution passed by the company in the general meeting & sanctioned by the company law board.
- (d) The maximum rate of discount must not exceed 10% or such rate as the company law board may permit.
- (e) The shares to be issued at a discount must be issued within two months of the sanction by the company law board or within such extended time as the company law board may allow.

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## 1.5 ACCOUNTING ENTRIES:

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### 1.5.1 JOURNAL ENTRIES

	Particulars	Debit	Credit
a)	For receipt of application money Bank A/c.....Dr. To Share Application A/c	XXX	XXX
b)	On Allotment 1) Transfer of Application money to Share Capital Share Application A/c..... Dr. To Share Capital A/c	XXX	XXX
	2) Amount due to on Allotment Share Allotment A/c.....Dr. To Share Capital A/c To Securities Premium Account (if any)	XXX	XXX XXX

	3) Refund of excess Application money on rejected application Share Application A/c.....Dr. To Bank Alc	XXX	XXX
	4) Adjustment of excess application money towards allotment money due. Share Application A/c.....Dr. To Share Allotment A/c	XXX	XXX
	5) Receipt of Allotment money. Bank A/c.....Dr. To Share Allotment A/c	XXX	XXX
c)	For making First Call Share First Call A/c.....Dr. To Share Capital A/c	XXX	XXX
d)	For receipt of First Call Money Bank A/c.....Dr. To Share First Call A/c	XXX	XXX
e)	For calls in arrears Calls in Arrears A/c.....Dr. To Share First Call A/c	XXX	XXX
f)	For receipt if calls in advance Bank A/c.....Dr. To Calls in Advance A/c	XXX	XXX

### 1.5.2 ISSUE OF SHARES TO VENDORS FOR CONSIDERATION OTHER THAN CASH

A Company may take over a running business i.e. assets & liabilities of another business. The Sellers of the business are known as Vendors. The company may offer shares to the Vendors in settlement of the purchase price of the business. The buying company does not receive any cash for shares offered to them.

The following entries are passed in case of such takeover of the business:

- (a) For recording takeover of the business
- |                           |     |     |     |
|---------------------------|-----|-----|-----|
| Sundry Assets A/c         | Dr. | xxx |     |
| To Sundry liabilities A/c |     |     | xxx |
| To Vendor A/c             |     |     | xxx |
- (b) For issue of shares to Vendor
- |                                    |              |     |     |
|------------------------------------|--------------|-----|-----|
| Vendor A/c                         | Dr.          | xxx |     |
| Discount of Issue of shares A/c    | Dr. (if any) | xxx |     |
| To Share Capital A/c               |              |     | xxx |
| To Securities Premium A/c (if any) |              |     | xxx |

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## 1.6 FORFEITURE OF SHARES:

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When shares are allotted to an applicant, it becomes a contract between the shareholder & the company. The shareholder is bound to contribute to the capital and the premium if any of the company to the extent of the shares he has agreed to take. as & when the Directors make the calls. If the fails to pay the calls then his shares may be forfeiture by the directors if authorised by the Articles of Association of the company. The Forfeiture can be only for non-payment of calls on shares and not for any other reasons.

When the directors forfeiture the shares the person loses his membership in the company as well as the amount already paid by him towards the share capital and premium. His name is removed from the register of members. The directors must observe strictly all the legal formalities required by the Articles of Association before forfeiting the shares.

### 1.6.1 ACCOUNTING ENTRIES

Share Capital A/c	Dr.	xxx
(no of forfeited shares*amount called up per shares)		
Security Premium A/c	Dr.	xxx
(to the extent premium not received)		
To Calls in Arrears A/c		xxx
To Share Forfeiture A/c		xxx
(amount received towards share received)		

**Note:** Once the security premium is collected it cannot be cancelled later on. Therefore if he Forfeited shares were issued at a premium and the premium money is already received on those Forfeited shares, security premium A/c will not be cancelled or debited.

### 1.6.2 FORFEITURE OF SHARE ISSUED AT A DISCOUNT:

If the Forfeited shares are issued at a discount, the proportion amount of discount allowed on such shares should be cancelled if the discount of shares has already been debited.

### 1.6.3 RE-ISSUE OF FORFEITED SHARES:

The Directors may reissue the Forfeited shares at par, at premium or at a reissued at a discount, the maximum discount is restricted to the amount Forfeited on these shares + the original discount.

**Accounting Entries**

Bank A/c	Dr.	xxx	
Share Forfeited A/c	Dr.	xxx	
	To Share Capital A/c		xxx

Any profit on reissue of Forfeited shares represents capital profit & hence it should be transferred to capital reserve.

Share Forfeiture A/c	Dr.	xxx	
	To Capital Reserve No.		xxx

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**1.7 ISSUE OF BONUS SHARES:**


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Profit making companies may desire to convert their profit into share capital. This can be done by issue of bonus shares. Issue of Bonus shares is also called as conversion of profit into share capital or capitalisation of profits. Bonus can be of two types-

- (a) Making partly paid shares into fully paid by declaring bonus without requiring shareholders to pay for the same.
- (b) Issue of fully paid equity shares as bonus shares to the existing equity shareholders.

**1.7.1 Making partly paid shares into fully paid by declaring bonus without requiring shareholders to pay for the same.**
**Accounting Entries****(1) Making the call:**

Equity Share Call A/c	Dr.	xxx	
	To Equity Share capital A/c		xxx

**(2) Declaring the bonus:**

Capital reserve A/c	Dr.	xxx	
Investment Allowance A/c	Dr.	xxx	
Development Rebate Reserve A/c	Dr.	xxx	
General Reserve A/c	Dr.	xxx	
P & L A/c	Dr.	xxx	
	To Bonus to equity shareholders A/c		xxx

**1.7.2 Issue of fully paid equity shares as bonus shares to the existing equity shareholders.**
**Accounting Entries****(1) Declaring the Bonus:**

Capital Redemption Reserve A/c.....	Dr.	XXX
Securities Premium A/c .....	Dr.	XXX

Capital Reserve A/c.....	Dr.	XXX	
Investment Allowance A/c .....	Dr.	XXX	
Development Rebate Reserve A/c .....	Dr.	XXX	
General Reserve A/c.....	Dr.	XXX	
P&L A/c.....	Dr.	XXX	
To Bonus to Equity Shareholders A/c			XXX

**(2) Issue of Bonus Shares:**

Bonus to Equity Shareholders A/c .....	Dr.	XXX	
To Equity Share Capital A/c			XXX

**1.7.3 Adjusting Call Made Against bonus declared**

Bonus to equity shareholders A/c .....	Dr.	XXX	
To Equity Share Call A/c			XXX

**Note:** (1) Capital Reserve can be utilized for this bonus only if it is realized in cash.

(2) Capital Redemption Reserve and Securities Premium cannot be utilized for this type of bonus.

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**1.8 RIGHTS SHARES :**


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Under Sec.94 of Companies Act, A company can issue additional shares at any time by passing an ordinary resolution at its General Meeting. However, under Sec. 81 of that, such additional shares must be 1<sup>st</sup> offered to the existing equity shareholders in the proportion of the shares already held by them. Such additional shares are called "Rights Shares". Following legal provisions are pertinent in this regard.

- a) The issue should be within the limits of the authorized capital, if not so, then the authorized capital must be increased first suitably.
- b) The issue is to be made after two years from the formation of the company or after one year from the first allotment of shares.
- c) The shares should be offered to the equity shareholders in proportion to the capital paid-up on their shares.
- d) The offer should be made by a written notice specifying the no. of shares offered & the time limit for acceptance which should be atleast 15 days from the date of offer.
- e) Unless prohibited by the Articles, the offer should include & specify the power of the shareholder to renounce (sale) the right shares to others.

- f) The shares not taken up by the shareholders can be sold by the Board of Directors in a manner most beneficial to the company.
- g) Such right offer need not be made to the existing shareholders, if
  - i) A special resolution to that effect is passed by the shareholder in the General Meeting or
  - ii) An ordinary resolution to that effect is passed and approved from the Central Govt. is obtained for issue of shares to persons other than the existing shareholders.

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## 1.9 SURRENDER OF SHARES :

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A shareholder who is not able to pay the call money may surrender its shares to the company. The company cancels such surrender shares. Surrender is a voluntary act on the part of the shareholder, whereas Forfeiture is a compulsory act on part of the company. The effect of both surrender & Forfeiture is the same, i.e. cancellation of the shares. The company can accept surrender of shares if permitted by its Articles of Association. The accounting treatment in respect of surrender of shares is same as that of Forfeiture of Shares.

### Check Your Progress

- **Fill in the blanks**

1. In case of forfeiture of share, Share Capital Account is debited by -----
2. On forfeiture of shares amount already paid by the member is forfeited and credited to a separate account namely-----
3. In case of forfeiture of share the journal entry is -----
4. If the re-issue price is more than the paid-up value, here the re-issue is made at a-----
5. If the forfeited shares are re-issued at discount the discount amount is debited to the -----.
6. The formula for calculating the profit on re-issue is -----.
7. After re-issue of forfeited shares the balance amount on the Forfeited Shares account is transferred to -----
8. Authorised share capital is mentioned in the----- of the Company.
9. If the shareholder may not pay the money due from him the outstanding amounts is called as -----.

10. The Balance of calls-in-arrears account is deducted from the-----  
-----in the Balance Sheet.

11. Bonus issue is made out of -----.

• **State whether true or false**

1. No dividend is paid on calls in advance.
2. Share holders have unlimited liability it means they may lose whatever they have paid for their shares and no more.
3. Bonus Issue can be made out of Capital reserve.
4. Share Premium can be used by the company for Writing off the preliminary expenses of the company.
5. Right shares must be first offered to the existing equity shareholders in the proportion of the shares already held by them.
6. In case of issue of shares at discount the maximum rate of discount may exceed 10%.
7. Surrender is a mandatory act on the part of the shareholder

**Answers of Check Your Progress**

**Fill in the blanks**

1. Amount called-up
2. Forfeited shares account
3. Share Capital A/c-----Dr.(Amount called up)  
    To Share allotment/share call A/c (Amount un-paid)  
    OR  
    To Calls in arrears A/c  
    To Share forfeited A/c (Amount received)
4. Premium
5. Forfeited shares account
6. Amount forfeited Less Discount on Re-issue
7. Capital Reserve A/c
8. Memorandum of the Association
9. Calls-in-Arrears
10. Called-up capital
11. Accumulated profits

**State whether true or false**

True, False, False, True, True, False, False

