B.Com Honours in Accounting: 2nd Semester

Core Course (CC) 4: Corporate Accounting [BCOMHACCC202]

Unit 1: Accounting for Equity Share Capital

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What is Share Capital of a Company ?

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 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'.

Briefly Categories the 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 and issued capital are the same because if the number of share, subscribed is less than what is offered, the company allot 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. 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 call 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 Section 86 of 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 85 of The Companies Act, 1956, 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 non-participating. Similarly, these shares can be cumulative or non-cumulative, and redeemable or irredeemable.

Equity Shares:

According to Section 85 of The Companies Act, 1956, 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 share holders. 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.

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 instalment are termed as first call, second call and so on. The word final is suffixed to the last instalment. However, this in no way 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. 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 alloted, 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, at a premium or at a discount. 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 . When the shares are issued at a price less than the face value of the share, it is known as shares issued at a discount.

Irrespective of the fact that shares are issued at par, premium or discount, the share capital of a company as stated earlier, may be collected in instalments payable at different stages.

Minimum Subscription:

The minimum amount that, in the opinion of directors, must be raised to meet the needs of business operations of the company relating to:

- the price of any property purchased, or to be purchased, which has to be met wholly or partly out of the proceeds of issue;
- preliminary expenses payable by the company and any commission payable in connection with the issue of shares;
- the repayment of any money borrowed by the company for the above two matters;
- working capital; and
- any other expenditure required for the usual conduct of business operations.

Capital Reserve:

It is capital profit not available for distribution as dividend. It is represented in balance sheet of company as Reserves and Surplus under the heading Shareholder's Funds.

Stages of Share Issue:

The issue of shares for cash is required to be made in strict conformity with the procedure laid down by law for the same. When shares are issued for cash, the amount on them can be collected at one or more of the following stages:

(i) Application for shares
(ii) Allotment of shares
(iii) Call/Calls on shares.

Issues of Shares At Premium:

It is issue of share at more than face value. This premium can be utilized for :

1. Issue of fully paid bonus shares to the shareholders.
2. Write off preliminary expenses of the company.
3. Writing off securities issue expenses commission paid discount on issue of securities.
4. For providing the premium payable on redemption of Redeemable preference shares or debentures of the company.
5. For Buy back of its own shares.

Issue of shares at discount :

There are instances when the shares of a company are issued at a discount, i.e. at an amount less than the nominal or par value of shares, the difference between the nominal value and issue price representing discount on the issue of shares.

Shares Issue for Consideration Other than Cash

When a company purchases any fixed asset or business and makes the payment to the vendor in form of issue of shares in place of cash it is called the issue of shares for consideration other than cash.

Private Placement of Shares:

This is an issue of shares to institutional investors or some selected group of persons subject to prior approval of existing shareholders. There is no need of issuing formal prospectus and it is cost and time saving method of raising capital.

Under subscription :

When the number of Share application received is less than the number of shares offered to public it is under subscription.

Over subscription :

When the number of Share application received is more than the number of shares offered to public it is over subscription

1. Either reject the excess applications
2. Make pro-rata allotment
3. Partially refund amount and on other applications pro-rata allotment is made.

Calls in arrear :

Any Amount which has been called or demanded by company from shareholders but not paid by the shareholder till the last date mentioned in call letter is called as call in arrear, Company can charge interest on this at rate mentioned in Article of Association.

Calls in advance :

Any amount paid in excess of what they has asked to pay is called as call in advance. Interest is paid on this at rate mentioned in Article of Association.

Forfeiture of shares :

If any shareholder fail to pay the amount on any call, his money is forfeited or withheld by company this is called forfeiture of shares. Forfeiture of share refers to the cancellation or termination of membership of a share holder by taking away the shares and rights of membership.

Re-issue of Forfeited Shares:

The directors can either cancel or re-issue the forefeited shares. In most cases, they reissue such shares which may be at par, at premium or at a discount. Forfeited shares may be reissued as fully paid at a par, premium, discount. In this context, it may be noted that the amount of discount allowed cannot exceed the amount that had been received on forfeited shares at the time of initial issue, and that the discount allowed on reissue of forfeited shares should be debited to the ‘Forfeited Share Account’. The balance, if any, left in the Share-

Forfeited Account relating to reissued Shares, should be treated as capital profit and transferred to Capital Reserve Account.

What is allotment of shares?

The share capital of a company is the number of funds that a company can raise by the allotment of shares of its company but not exceeding the maximum amount mentioned in the memorandum of the company. When a company proposes to increase its subscribed capital by further issue of shares, then it can either issue equity or preference shares through the rights issue, preferential allotment or private placement of shares.

However, Article of Association of the Company must not restrict the right to make such allotment and also the authorise capital of the company must have the limit to allot the required shares. The procedure for allotment of shares can be time-consuming with the need to meet compliance at every step. You can avail affordable plans offered by StartupSeven to complete the process with ease.

What are the Provisions of companies act relating to issue and allotment of shares?

1. A public company must file a prospectus or statement in lieu of prospectus, inviting offers from the public for the purchase of shares in the company.
2. After studying the prospectus, the public applies for shares of the company in the printed prescribed forms. The company can ask for the issue price of the share to be paid in full along with the application or it can be payable in installments as share application money, share allotment money, share first call, share second call and so on. The amount payable as application money must be at least 5 percent of the nominal amount of the share.
3. No allotment of shares can be made unless the 'Minimum Subscription' as given in the prospectus had been subscribed or applied for. Minimum Subscription is the minimum amount which, in the estimate of the directors, is required to run the business. It has to be stated in the prospectus.
4. The amount of share application money must be deposited in a bank. It can be operated by the company only after getting the certificate of commencement.
5. If the minimum subscription amount of 90% of the issue was not achieved by the company within 60 days from the date of closure of the issue, the company has to refund the entire subscription amount immediately. For any delay beyond 78 days, the company has to pay an interest of 6% per annum.

After allotment, the directors can call upon the shareholders to pay the full amount due on shares in one or more installments as mentioned in the prospectus. The articles of a company usually contain provisions regarding calls. If there is no such provision in the Articles, the following provisions shall apply:

i. No call shall be for more than 25% of the nominal value of each share.
ii. Interval between any two calls should not be less than one month.
iii. At least 14 days' notice must be given to each member for a call specifying the amount, date and place of payment.
iv. Call should be made on a uniform basis on the entire body of shareholders falling under the same class.

What do you mean by Pro Rata Allotment?

A company may receive applications for shares more than the number of shares it has offered to the public. This is known as over-subscription of shares. Usually, the companies that are financially strong, have a good reputation in the market or have profitable future prospects, receive over-subscription of shares. Thus, Pro Rata Allotment becomes necessary.

In the case of over-subscription, it is not possible for the company to allot shares to every applicant in the number that he desires. The company needs to allot the shares in a proper manner. The company has the following three alternatives:

i. Accept some applications in full and reject the others totally.
ii. Make Pro-Rata Allotment.
iii. Adopt a combination of the above two.

Usually, the company does not consider the multiple applications from the same person. Also, generally a company takes the third course of action. The problem of accounting of over-subscription is usually resolved at the time of allotment of shares.

Pro-rata allotment refers to the allotment of shares in proportion of the shares applied for. When a company makes pro-rata allotment, it adjusts the excess money received at the time of application firstly, towards the allotment and then towards calls.

It refunds any surplus left after adjusting the amount towards allotment and calls to the applicants. The company advertises the allotment procedure in the leading newspapers.

For example, AB Ltd. offers 10000 shares to the public. The issue was heavily oversubscribed. It receives applications for 20000 shares.

When the company decides to allot the shares at pro-rata basis, then it has to allot 10000 shares to the applicants of 20000 shares. Thus, the ratio will be 20000:10000 i.e. 2:1. Hence, an applicant for 2 shares will receive 1 share. This is Pro-rata allotment

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