Lesson 3 Accounting for Share Capital

Key Concepts One Should Know

- Share capital
- Premium
- Bonus shares
- ESOP
- Rights issue
- Preference shares
- Capital Redemption Reserve

Learning Objectives

To understand the:

- Meaning of share capital, types of shares, a company's capital structure and its disclosure in the balance sheet.
- Accounting procedure of issuing of shares
- Accounting treatment in case of forfeiture and reissue of shares
- Nuances of redemption and concept of Capital Redemption Reserve
- Aspects of ESOPs, Sweat Equity Shares and Bonus Shares along with the accounting
- Procedure and accounting of buyback of shares.
- Steps for Underwriting and its methods
- Difference between marked applications and unmarked applications along with determining the liability of underwriters

Lesson Outline

- Share Capital- Meaning, Types and Disclosure
- Issue of Shares
- Accounting treatment of premium
- Forfeiture and Re-issue of Shares
- Buyback of Shares
- Bonus Shares
- ESOPs
- ESPS
- Rights Issue
- Sweat Equity Shares
- Redemption and Conversion
- Capital Redemption Reserve
- Underwriting
- LESSON ROUND UP
- TEST YOURSELF

MEANING OF SHARES

A share may be understood as an individual part or a singular unit into which the total share capital of a company is divided. Shares are used to raise the capital of a company and each share constitutes a unit of ownership which is offered for sale. A share represents a part of the share capital of the company.

For example, Company ABC has a share capital of Rs. 50,00,000 divided into 5,00,000 shares of Rs.10 each and Mr. Naveen is in possession of 6,000 shares, then he has a share of Rs. 60,000 in the share capital of the company.

The nature of shares of a company are considered as movable property which are transferable, as provided by the articles of the company.

According to Section 2(84) of the Companies Act, 2013, "share" means a share in the share capital of a company and its stock.

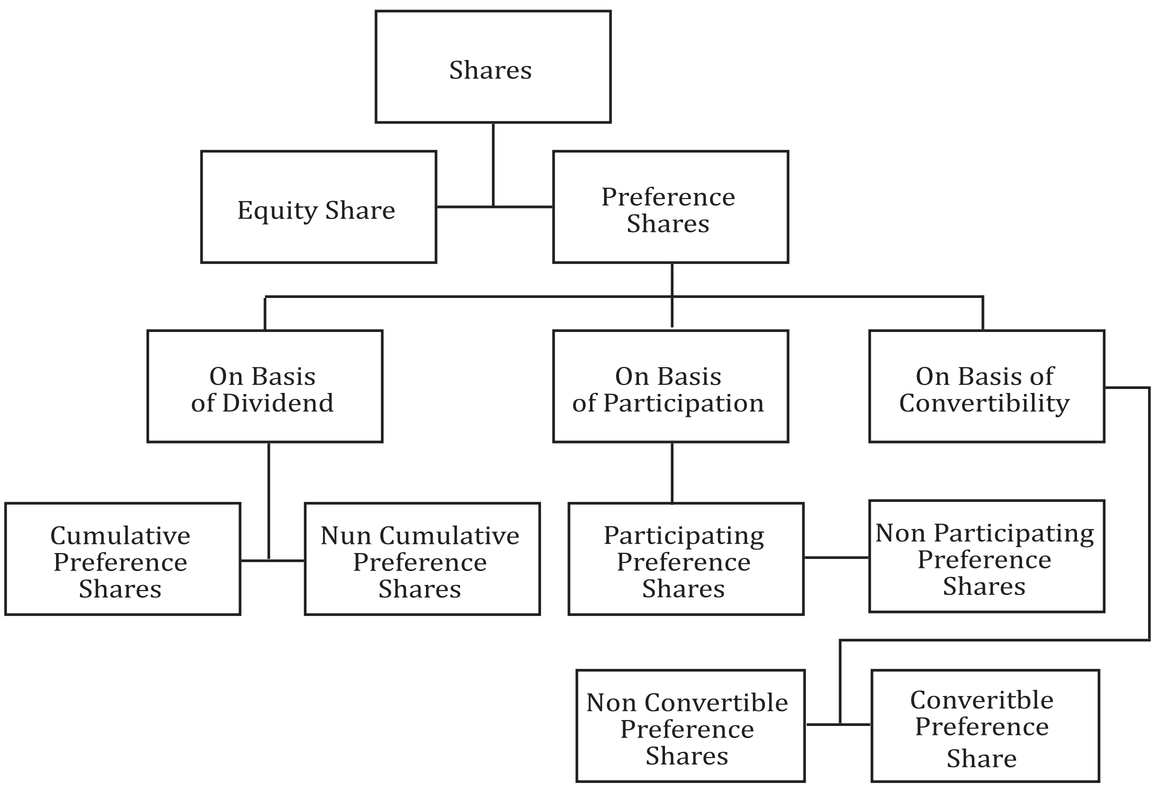
Nominal Value/ Share Denomination: Face value of the share which is the par value of the share.

Meaning of Share Capital

A company raises its capital by issuing its issue of shares to finance and carry out its business. The Memorandum of Association, which lays down the foundation of the company contains the amount of capital with which the company decides to register and the number of shares into which it is to be divided. It constitutes the basis of the capital structure of a company. When total capital of a company is divided into shares, then it is called share capital.

Kinds of Share Capital

The share capital of a company limited by shares can constitute of two kinds of share capital under the Companies Act, 2013, as follows:



I. **Equity Share Capital:** Equity share capital with reference to any company limited by shares means all share capital that does not come under preference share capital. Equity share capital can further be divided into the following types:

(i) with voting rights; or

(ii) with differential rights regarding dividend or voting or any other such rights.

II. **Preference Share Capital:** Preference, as the name suggests, with reference to any company limited by shares, refers to that share capital of the issued share capital of the company which would carry a preferential right with regard to-

- Payment of dividend-it can either be as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income tax; and
- Repayment- It is the case in winding up or repayment of capital, of the amount of the share capital paid up or deemed to have been paid up, whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company.

Deemed preference share capital: The share capital is deemed to be preference share capital, notwithstanding that it is entitled to either or both of the following rights, namely: -

- that in respect of dividends, in addition to the preferential rights to the payment of dividend, it has a right to participate, whether fully or to a limited extent, with capital not entitled to the preferential right aforesaid;
- that in respect of capital, in addition to the preferential right to the repayment, in case of a winding up, it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid.

The following table summarizes the major distinctions between Equity Share Capital and Preference Share Capital:

Basis	Equity Shares	Preference shares
1. Refund of Capital	On winding up, the equity share capital is paid after the preference share capital or equity shareholder receives residual amount	On winding up, the preference share capital is paid before the equity share capital is paid or preference shareholders have preference to get refund of capital over equity shareholders
2. Right of Dividend	Dividend is paid on equity shares after payment of dividend on preference shares	Dividend is paid on preference shares before payment of dividend on equity shares
3. Rate of Dividend	No fixed rate of dividend. It is decided by the board of directors every year and it varies periodically	Fixed rate of dividend is paid as prescribed on the face of preference shares, e.g., Issue at 12%, in that case prefer shares would have 12% rate of dividend
4. Right to Vote	Equity shareholders have the right to vote in a meeting of shareholders and they elect the director for managing the company	In normal course of business, preference shareholders do not enjoy the right to vote in the meetings of shareholders. But they may have the right to vote but only in special circumstances.
5. Redemption	Equity shares are not redeemable; however, a company may buy back its equity shares as conditions prescribed under Companies Act, 2013	Preference shares are always redeemable

TYPES/CLASSES OF PREFERENCE SHARES

(a) On basis of Dividend:

(i) Cumulative Preference Shares: Cumulative preference shares are the preference shares whose holders are entitled to receive arrears of dividend before any dividend is paid on equity shares.

(ii) Non-cumulative Preference Shares: Non-cumulative preference shares are the preference shares whose holders do not have the right to receive arrears of dividend. If no dividend is declared in any year due to any reason, they get nothing, nor can they claim unpaid dividend in any subsequent years.

(b) On basis of Participation

(i) Participating Preference Shares: In addition to the fixed preference dividend, such shares carry a right to participate in the surplus profit, if any, after providing dividend at a stipulated rate to equity shareholders.

(ii) Non-Participating Preference Shares: Such shares get only a fixed rate of dividend every year and do not have a right to participate in the surplus profit, if any.

(c) On basis of Convertibility

(i) Convertible Preference Shares: They are preference shares with a right/option to get converted into equity shares

(ii) Non-Convertible Preference Shares: These are preference shares which do not have the right/ option to get converted into equity shares.

DISCLOSURE OF SHARE CAPITAL

Capital refers to the amount which is invested in a business with the basic aim of generating revenue. Capital is raised from public and people who contribute to the share capital are known as shareholders.

Authorized Capital is also known as Nominal or Registered Capital which means the maximum amount of capital a company can issue. It is disclosed in the Memorandum of Association.

Issued Capital is a part of Authorized capital which is offered to the public for subscription.

Called Up Capital is the amount of nominal value of shares that has been called up by the company for payment from the shareholder.

Paid Up Capital is that part of Called Up Capital which the members of company or shareholders have paid for.

The following table describes the disclosure of Share Capital, as included in the Liabilities column of the Balance Sheet of a company:

Particulars	**Amount**
Equity and Liabilities	
Shareholders' Fund	
Share Capital:	
Authorized Capital:	
2,00,000 shares of Rs. 10 each	20,00,000
Issued Capital:	
1,50,000 shares of Rs. 10 each	15,00,000
Subscribed Capital:	
1,00,000 shares of Rs. 10 each	10,00,000
Paid up Capital	
1,00,000 shares of Rs. 10 each, Rs 5 paid up	5,00,000

Procedure for Issue of Shares

To issue shares, company has to follow a definite procedure with prescribed rules and regulations, which is controlled and regulated by the Companies Act, 2013 and Securities Exchange Board of India (SEBI).

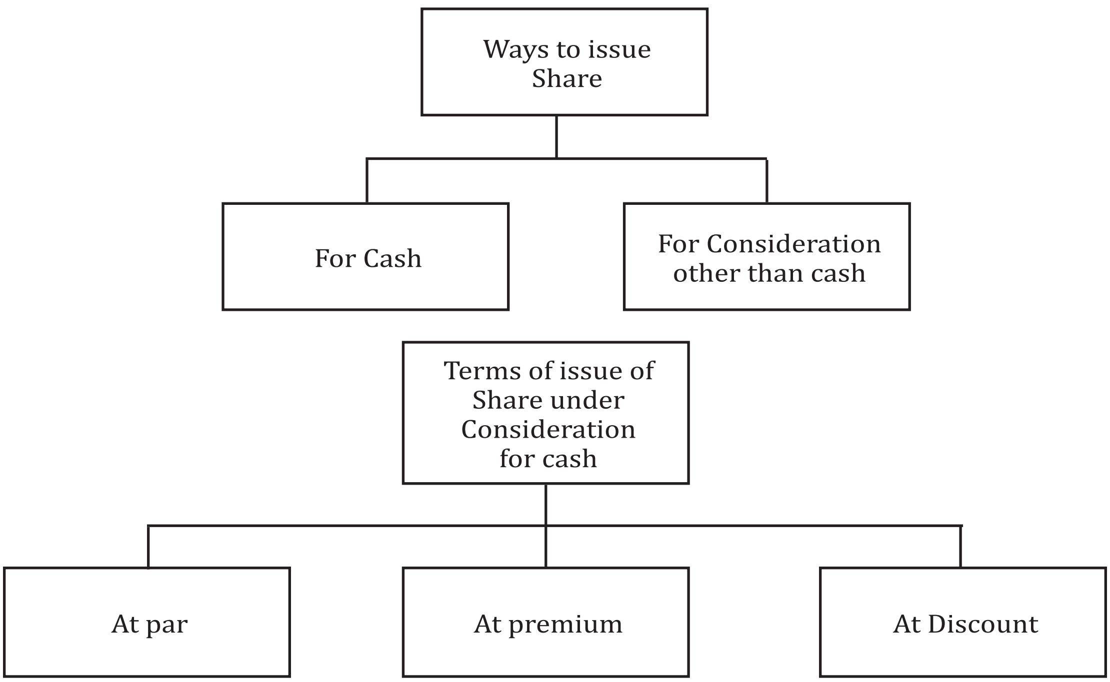
When a public company desires to raise capital by issuing its shares to the public, it must invite them to subscribe for the shares. The person who intends to become a shareholder must thus subscribe to those shares by making an application for the desired number of shares to the company. Consequently, the company will allot shares to the applicant.

Allotment means allocating or apportioning a certain number of shares to an applicant in response to his application. The company cannot allot more than the number of shares offered to the public for subscription through the prospectus. Moreover, the company cannot make allotment unless the amount stated in the prospectus as the minimum subscription has been subscribed and the sum payable on application for the stated amount has been received by the company.

If the number of shares applied for is less than the number of shares offered the allotment can be only for the shares applied for, provided minimum subscription is raised. Shares can be issued either for cash or for consideration other than cash

In general, shares are issued for cash. The company may call the share money either in one instalment or in two or more instalments.

Terms of Issue of Share



A. ISSUE OF SHARES AT PAR:

Shares are said to be issued at par when the issue price is equal to the face value or nominal value of the shares i.e., when the issue price is Rs. 10 and face value is also Rs. 10. When the shares are issued, the company may ask for the payment of the shares either payable in lump sum/single instalment or in multiple installments.

(a) When shares are issued at par and are payable in full in a lump sum:

(1) On receipt of application money -

Bank A/c Dr. (With the amount received on application)

To Share Application A/c

(Being application money received)

(2) On allotment of shares -

Share Application A/c Dr. (With the money received on the number of shares allotted)
To Share Capital A/c

(Being application money transferred to share capital)

Additional Points to note:

(i) Although shares may be of either kind, i.e., equity shares or preference shares, but if only the term shares is used it means equity shares.

(ii) Separate share application account will be opened for each class of shares, i.e., equity share application account/preference share application account and the like

(iii) Unless shares are allotted by the company, the receipt of application money is simply an offer and cannot be credited to Share Capital Account.

(iv) Refund of application money: If the company fails to raise the minimum subscription, then no shares can be allotted and the application money has to be returned to the applicants. For this, the entry will be as follows:

Share Application and Allotment Dr. (With the application money received now refunded)

To Bank

(v) In actual practice, the cash transactions are not journalized but the same have to be entered in the cash (bank columns) book. The entry in the Cash Book (Bank columns)will be as follows:

Cash Book (Bank Columns)

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Share Application A/c (Application money on shares @ Rs……per share)	XXX	By Share Application A/c (Refund of application money on shares @ Rs........ per share)	XXX

(c) When shares are issued at par and the amount is payable in installments:

When shares are not payable in lump sum/single installment, they can be called in number of installments. After allotment, whenever the need arises, the directors may require further installments from the shareholders towards payment of the value of shares subscribed by them. Such demands are termed as 'calls'. The different calls are distinguished from one another by their serial numbers, i.e., first call, second call, third call and so on. The last installment is also termed the final call along with the number of the last call.

1st installment	Application Money
2nd installment	Allotment Money
3rd installment	First Call Money
4th installment	Second Call Money
……	……
Last installment	Final Call Money

Journal Entries

(i) On receipt of application money with the total amount received on application

Bank A/c Dr.

To Share Application Account

(Being the application money received in respect of shares @ Rs............ per share)

(ii) On allotment of shares: After receiving application within prescribed time, Board proceeds to allot shares.

Share Application Account Dr. (with the amount of application money on allotted)

To Share Capital Account

(Being the application money on allotted shares now transferred to share capital account)

(iii) On refund of application money on rejected applications

Share Application Account Dr. (with the amount actually repaid)

To Bank Account

(Being application money on shares refunded)

(iv) Allotment money becoming due and received (second installment)

Share Allotment Account Dr. (with the amount due on allotment)

To Share Capital Account

(Being the allotment money due in respect of allotment of shares @ Rs........... each)

(v) On receipt of allotment money is received the following journal entry is made.

Bank Account Dr. (with the actual amount received as allotment money)

To Share Allotment Account

(Being the amount received on shares @ Rs..............each)

(vi) On making the first call

Share First Call Account Dr. (with the amount due on first call)

To Share Capital Account

(Being the amount due on first call @ Rs.......... per share on shares)

(vii) On receipt of first call money

Bank Account Dr. (with the amount received on first call)

To Share First Call Account

(Being the amount received in respect of first call @ Rs....... per share on .... shares)

(viii) When second call is made

Share Second Call Account Dr. (with the amount due on second call)

To Share Capital Account

(Being the amount due on second call @ Rs.......... per share on.... shares)

(ix) On receipt of second call money:

Bank Account Dr. (with the amount actually received on second call)

To Share Second Call Account

(Being the amount received in respect of second call @ Rs.....per share on....shares)

(x) When the final call is made:

Share Final Call Account Dr. (with the amount due on final call)

To Share Capital Account

(Being the amount due on final call @ Rs........ per share on....... shares)

(xi) On receipt of final call money:

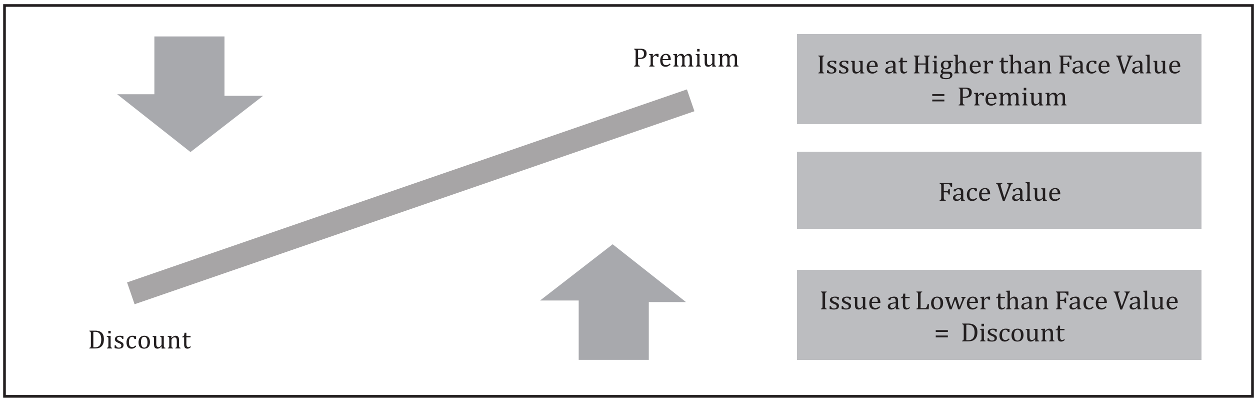
Bank Account Dr. (with the amount actually received on final call)

To Share Final Call Account

(Being the amount received in respect of final call @ Rs.......... per share on ...... shares)

B. ISSUE OF SHARES AT PREMIUM

A company can issue shares at face value. However, for good successful companies which attract higher value can issue shares at value higher than their face value. When shares are issued at a price higher than their face value, they are said to be issued at a premium. Thus, the excess of issue price over the face value is the amount of premium. For example, if a share of Rs. 10 is issued at Rs. 12, (Rs. 12 - 10) = Rs. 2 is the premium.



Securities Premium Account:

The premium on issue of shares is not to be treated as revenue profits. In fact it is considered as capital receipt.

As per the Companies Act, 2013, when a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium collected on shares must be credited to a separate account called "Securities Premium Account". There are no restrictions in the Companies Act on the issue of shares at a premium, but there are certain restrictions at the time of its disposal.

Restrictions on application of premium money received: Under Section 52(2) of the Companies Act, 2013, the Securities Premium Account may be applied by the company -

(a) towards the issue of unissued shares of the company 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, any issue of shares or debentures of the company;

(d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or

(e) for the purchase of its own shares or other securities under section 68.

It is to be noted here that utilization of the amount of Securities Premium Account except in any of the modes specified above, will attract the provisions relating to the reduction of share capital of a company under the Section 66 of the Companies Act, 2013.

> Disclosure: The Securities Premium Account must be shown as "Securities premium reserves" separately on the liabilities side of the balance sheet under the head "Reserves & Surplus".

Note: The premium is usually payable with the installment due on allotment. However, some companies may charge premium with share application money or partly with share application money and partly at the time of allotment of shares. It may be included in call money also.

ACCOUNTING TREATMENT OF THE ISSUE OF SHARES AT PREMIUM

Journal Entry

When allotment money becomes due:

Share Allotment A/c	Dr.	(with the money due on allotment including premium)
To Securities Premium A/c		(with the premium amount)
To Share Capital A/c		(with the share allotment amount)

(Being allotment money due on shares issued at premium)

C. ISSUE OF SHARES AT DISCOUNT:

When the issue price of a share is less than its face value, it is said to have been issued at a discount. For example, if a company issues shares of Rs. 10 each at Rs. 9 each, the shares are said to be issued at a discount. The amount of discount would be to Rs. 1 per share (i.e. Rs. 10 – Rs. 9) in this case. Discount on shares is a loss to the company.

Prohibition on the issue of Shares on Discount: As per Section 53 of Companies Act, 2013, a company shall not issue shares at a discount except as provided in Section 54 for issue of sweat equity shares. Any share issued by a company at a discounted price shall be void.

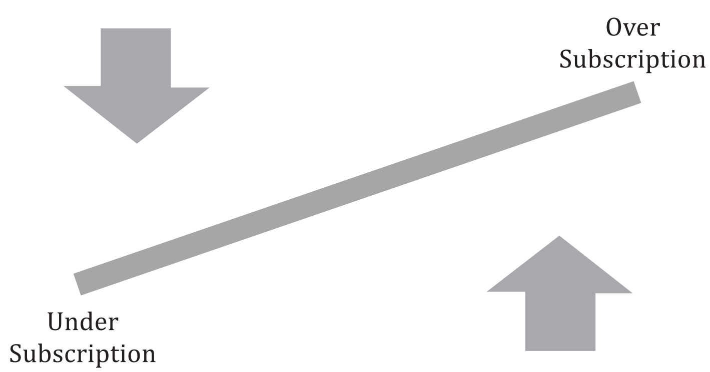
Further Section 53(3) of Companies Act, 2013 mentions of the penalty provisions which reads as: Where any company fails to comply with the provisions of this section, such company and every officer who is in default shall be liable to a penalty which may extend to an amount equal to the amount raised through the issue of shares at a discount or five lakh rupees, whichever is less, and the company shall also be liable to refund all monies received with interest at the rate of twelve per cent. per annum from the date of issue of such shares to the persons to whom such shares have been issued.

Subscription

Minimum Subscription– It is the minimum amount which has been mentioned in the prospectus that must be subscribed by the public before an allotment of any security can be made.

Prospectus : It is an invitation to public for subscription of shares or debentures.

Any company does not receive application equal to the number of shares offered for subscription and there may be either of the following two situations:



(i) Under Subscription

The issue is said to have been under subscribed when the company receives applications for less number of shares than offered to the public for subscription. In this case company does not face any problem regarding allotment since every applicant will be allotted the shares applied for, and the company can proceed with allotment provided the minimum subscription for shares is met.

(ii) Over Subscription

In case a company receives applications for more number of shares than the number of shares offered to the public for subscription, it is a case of over subscription. A company cannot allot more shares than what it has offered.

In case of over subscription company has the following options:

Option I

(i) Rejection of Excess Applications and Money Returned

The company may reject the applications for shares which are received in excess of the shares offered and a letter of rejection is sent to such applicants. In this case the application money received from these applicants is refunded to them in full.

The journal entry is as follows:

Journal Entry

Share Application A/c	Dr.	(with Excess application money)
To Bank A/c		
(Application money on … shares refunded to the applicants)		

(ii) Excess application money adjusted towards sums due on allotment

Journal Entry

Share Application A/c	Dr.	(with Excess application money)
To Share Allotment A/c		
(Excess application money adjusted towards sums due on allotment)		

If the application money received on partially accepted applications is more than the amount required for adjustment towards allotment money, the excess money is refunded.

However, if the Articles of the company so authorise, the directors may retain the excess money as calls in advance to be adjusted against the call/calls falling due at a later date. The consent of the applicant has to be taken either by a separate letter or by inserting a clause in the company's prospectus.

The company can retain the calls in advance at maximum to the amount as is sufficient to make the allotted shares fully paid up ultimately. The following entry is made:

Journal Entry

Share Application A/c	Dr.	(with Excess application money left over the amount due on application and allotment)
To Call-in-advance A/c		
(The adjustment of excess share application money retained as call-in advance in respect of ... shares)		

Option II

Partial acceptance of Applications (Pro-rata acceptance):

In some cases, the company accepts the applications for subscription partially. It means that the company does not allot the full number of shares that are applied for. The shares are accepted in a ratio, as determined, this is known as pro-rata acceptance.

> For example, if an applicant has applied for 5000 shares and is allotted only 2000 shares, then his application is said to has been partially accepted. The company may evolve some formula of accepting applications partially or making proportionate allotment/ the Pro-rata allotment means that the applicants are allotted shares proportionately such that no applicant is refused of shares and no applicant allotted shares in full.

In such a case, the company adjusts the excess share money received on application towards share allotment money due on partially accepted applications.

The journal entry recording the adjustment of application money towards share allotment money, is as under:

Journal Entry

Share Application A/c Dr. (with Excess application money)

To Share Capital Account

(Share application money transferred to Share Allotment Account in respect of ... shares)

Calls-in-Advance and Interest on Calls-in-Advance

Meaning: A company may receive the amount remaining unpaid on shares, from the shareholders, even though the amount has not been called up subject to the authorization in its articles. In a case where the number of shares allotted to a person is much smaller than the number applied for and the terms of issue permit the company to retain the amount received in excess of application and allotment money, it shall be calls-in advance. Of course, the company can retain only so much as is required to make the allotted shares fully paid ultimately. On actual time when calls are made, the calls-in-advance account is ultimately closed by transfer to the relevant call accounts.

Disclosure Treatment: The money received on calls-in-advance does not become part of the share capital. It is shown under a separate heading, namely 'calls-in-advance' on the liabilities side of the Balance Sheet. Further, the liability to sundry shareholders is to be treated as outstanding liability and should be shown under the head "Current Liabilities" in the balance sheet.

It is to be noted that no dividend can be paid on calls-in-advance.

Accounting Treatment

(i) On receipt of call money in advance:

Bank A/c Dr. (with the amount of call money received in advance)

To Call-in-Advance A/c

(Being the calls received in advance)

(ii) As and when calls are made:

Calls-in-Advance A/c Dr. (with the amount adjusted on relevant call becoming due)
To Relevant Call A/c

Interest on Calls-in-Advance

The amount received as calls-in-advance is a debt to the company and thus the company is liable to pay interest on the amount received as Calls-in-Advance from the date of receipt of the amount till the date when the call is scheduled and made due for payment.

Generally, the Articles of the company specify the rate at which interest will be payable on Calls-in-Advance. If the articles do not contain such rate, Table F of the Companies Act, 2013 will be applicable which leaves the matter to the Board of Directors to decide the rate of such interest, subject to a maximum rate of 12% p.a.

Note: Interest payable on Calls-in- Advance is a charge against the profits of the company. As such, Interest on Calls-in-Advance must be paid even when no profit is earned by the company.

Accounting Treatment:

(i) If Interest on Calls-in-Advance is paid in cash -

Interest on Calls-in-Advance A/c Dr. (with the amount of interest paid)

To Bank A/c

(Interest on Calls-in-Advance paid @ % p.a. on Rs…for… _

(ii) If interest on Calls-in-Advance is not paid in cash - months)

Interest on Calls-in-Advance A/c Dr. (with the amount of interest payable)

To Sundry Shareholders A/c

(iii) At the end of the year, when interest on Calls-in-Advance is transferred to Profit and Loss A/c -

Profit and Loss A/c Dr. (with the amount of interest)

To Interest on Calls-in-Advance A/c

Calls-in-Arrear and Interest on Calls-in-Arrear

Meaning: When calls are made upon shares allotted, the shareholders holding the shares are bound to pay the call money within the date fixed for such payment. If a shareholder makes a default in payment of the call money within the appointed date, the amount thus failed for payment on a call is called Calls-in-Arrear.

Interest on Calls-in-Arrear:

The interest is recoverable according to the provisions in this regard in Articles of the company.

But if the Articles are silent, Table 'F' of Schedule I of the Companies Act, 2013, shall be applicable which prescribes that if a sum called in respect of shares is not paid before or on the day appointed for payment, the person who failed to pay shall pay thereof from the day appointed for payment to the time of actual payment at a rate not exceeding 10% per annum. However, the Directors have the right to waive the payment of interest on Calls-in- Arrear.

The interest on Calls-on-Arrear Account is transferred to the Profit and Loss Account at the end of the year.

Journal Entries

(i) When call money is in arrear:

Calls-in-Arrear A/c Dr. (with the amount failed by the shareholders)

To Relevant Call A/c

(ii) On receipt of amount of Calls-in-Arrear with interest, on a subsequent date:

Bank A/c Dr. (with the amount received)

To Calls-in-Arrears A/c

(Being Amount due on allotment/ call remaining unpaid now received on……)

Issue of Shares for Consideration other than Cash

Meaning: Any allotment of shares against which cash is not to be received is called 'issue of shares for consideration other than cash'.

Case 1: In some cases, shares are issued to the promotors of the company in lieu of the services provided by them during the incorporation of the company. This would generate good will.

Journal Entries

(i) During incorporation of Company

Goodwill A/c Dr. (with the fair value of services, as agreed)

To Share Capital A/c

Case 2: In case a company does not have sufficient funds for the purchase of fixed assets or for payment to creditors, it may offer and allot its shares to vendors/ creditors in lieu of cash.

Such shares may be issued by the vendors either (i) at par, or (ii) at a premium.

Journal Entries

(i) When assets are acquired from the vendors -

Sundry Assets A/c (individually) Dr. (with the purchase price payable for the assets acquired)

To Vendors A/c

(ii) When fully paid shares are issued to vendors at par -

Vendors A/c	Dr.	(with the nominal value of the shares allotted)
To Share Capital A/c		

(iii) When fully paid shares are issued to vendors at a premium -

Vendors	Dr.	(with the purchase price)
To Share Capital A/c		(with the nominal value of the shares allotted)
To Securities Premium A/c		(with the amount of premium)

Case 3: Shares are also issued/ exchanged during a business purchase or merger of the companies. In such a situation, following entries are to be passed:

Journal Entries

(i) When purchase consideration is more than net assets acquired -

Sundry Assets A/c (individually)	Dr.	(at agreed purchase price)
Goodwill A/c (B/F)	Dr.	(at purchase price less net assets acquired)
To Sundry Liabilities A/c		
To Vendor A/c		

(ii) When purchase consideration is less than net assets acquired -

Sundry Assets A/c (individually)	Dr.	(at agreed price)
To Sundry Liabilities A/c		
To Vendor	(at agreed price)	
To Capital Reserve (B/F)	(at difference of Purchase price &net assets acquired)	

FORFEITURE OF SHARES

Meaning & Procedure: In case where a shareholder fails to pay the allotment money and/or calls made on him, his shares are liable to be forfeited. Forfeiture of shares may be said to be the compulsory termination of his membership by way of penalty for non-payment of allotment and/or any call money.

Effect: The effect of forfeiture of shares is that the defaulting shareholder loses all his rights in the forfeited shares and ceases to be a member of the company. The name of the shareholder is removed from the Register of Members and the amount already paid by him is forfeited. He is not entitled in future to dividends and rights of membership.

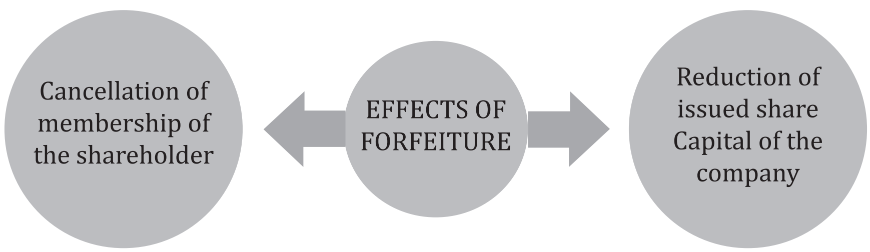


Illustration: S.K. Ltd. issued 100000 shares of Rs. 10 each payable as Rs. 2 on application, Rs. 2 on allotment, Rs. 3 on first call and Rs. 3 on second and final call. Mr. Harish, the allottee of 100 shares, fails to pay the second and final call money made by the company. In this case if the Board of Directors decides to forfeit his shares, his membership will be cancelled and the amount of Rs 700 paid by him (on 100 shares Rs. 2 on application, Rs. 2 on allotment and Rs.3 on first call per share) will be forfeited. Now Mr. Harish will no longer be the member of the company and the issued capital of the company will be reduced by Rs. 1000.

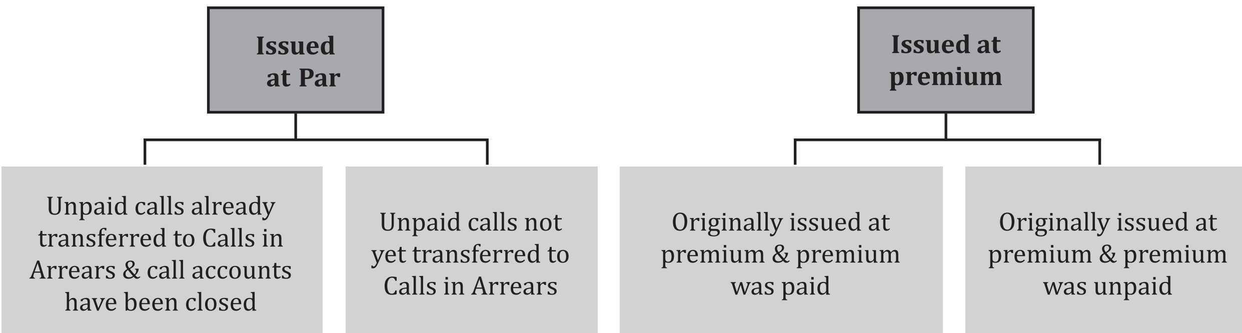
Procedure for Forfeiture of Shares

Articles of Association of the Company provide the authority to forfeit shares to the Board of Directors.

- The Board has to give at least 14 days' notice to the defaulting members calling upon them to pay outstanding amount, with or without interest as the case may be, before the specified date.
- The notice must also state that if the shareholders fail to remit the amount mentioned therein within the stipulated period, their shares will be forfeited.
- If they still fail to pay the amount within the specified period of time, the Board of Directors of the company may decide to forfeit such shares by passing a resolution.
- The decision regarding the forfeiture of shares should be communicated to the concerned allottees

Disclosure: Forfeited shares account is to be shown in the balance sheet by way of addition to the paid-up share capital on the 'liabilities' side, until the concerned shares are reissued.

Accounting Treatment as per below cases:



A: Forfeiture of Shares issued at par:

The forfeiture of shares can be recorded in following two ways:

1. Where the unpaid calls have already been transferred to Calls-in-

   Arrear A/c and the respective call accounts have been closed:

Share Capital A/c	Dr.	(with the amount of called up value of shares forfeited i.e. no. of shares forfeited x the called up value per share.)
To Shares Forfeited A/c		(with the amount already paid-up by the shareholders on the shares forfeited.)
To Calls-in-Arrear A/c		(with the amount of unpaid calls.)

OR

2. Where the unpaid calls have not been transferred to Calls-in-Arrear A/c and the respective call accounts are showing balances representing unpaid amounts:

Share Capital A/c	Dr.	(with the amount of called up value of shares forfeited i.e., no. of shares forfeited x the called up value per share.)
To Shares Forfeited A/c		(with the amount already paid up by the shareholders on the shares forfeited.)
To Share Allotment A/c		(with the amount failed on allotment, if any.)
To Share First Call A/c		(with the amount failed on first call, if any.)
To Share Final Call A/c		(with the amount failed on final call, if any.)

B. Forfeiture of Shares Issued at PREMIUM

Case 1: Where shares to be forfeited were issued at a premium and the premium money remained unpaid:

In such a case, the credit already given to the 'Securities Premium A/c' will be cancelled at the time of forfeiture of the shares by debiting the "Securities Premium A/c".

Journal Entries

Share Capital A/c	Dr.	with the amount of called up value of shares forfeited, i.e.,no. of shares forfeited x called up value per share. (excluding premium).
Securities Premium A/c	Dr.	(with the amount of premium money remaining unpaid on shares forfeited.)
To Shares Forfeited A/c		(with the amount already paid by the shareholders on the shares forfeited.)
To Calls-in-Arrear A/c		(with the amount unpaid on calls.)

OR

Share Capital A/c	Dr.	with the amount of called up value of shares for feited, i.e. no. of shares forfeited x called up value per share. (excluding premium).
Securities Premium A/c	Dr.	(with the amount of premium money remaining unpaid on shares forfeited.)
To Shares Forfeited A/c		(with the amount already paid by the shareholders on the shares forfeited.)
To Share Allotment A/c		(with the amount failed on allotment, if any.)
To Share First Call A/c		(with the amount failed on first call, if any.)
To Share Final Call A/c		(with the amount failed on final call, if any.)

Case 2: Where shares to be forfeited were issued at a premium and the premium money was duly received for the shares to be forfeited:

If the amount of premium on shares forfeited has been received by the company prior to the forfeiture, Securities Premium Account shall not be affected. In this case, Securities Premium Account is already credited at the time of making the call and will not be cancelled when the shares are forfeited. In such a case, the accounting entry on forfeiture will be the same as the one passed in case of shares issued at par.

Journal Entry

Share Capital A/c	Dr.	(with the amount of called up value of shares forfeited i.e. no. of shares forfeited x the called up value per share.)
To Shares Forfeited A/c		(with the amount already paid-up by the shareholders on the shares forfeited.)
To Calls-in-Arrear A/c		(with the amount of unpaid calls.)

Illustration 1:

M/s Herbal Tea Plantations Ltd. was registered with a capital of Rs 1 crore divided into equity shares of Rs 100 each. The company offered to public 50000 shares at a premium of Rs 20 per share. The amount on shares was payable as:

Rs 25 on application

Rs 50 (including Rs 20 premium) on allotment Rs 20 on first call and

Rs 25 on final call.

Applications were received for 75000 shares. Shares were alloted to the applicants on prorata basis. Kanti Bhai who was allotted 500 shares did not pay the allotment money. He also failed to pay the first call. His shares were forfeited. Sheetal was holding 200 shares did not pay the first call. Final call was not made.

Make journal entries in the books of the company.

Solution:

M/s Herbal Tea Plantations Ltd

Journal

Date	Particulars		Amount (Dr.)	Amount (Cr.)
1	Bank A/c	Dr.	18,75,000	
	To Share Application A/c			18,75,000
	(Being application money received on 75000 shares @ Rs 25 per share)			
2	Share Application A/c	Dr.	18,75,000	
	To Share Capital A/c			12,50,000
	To Share Allotment A/c			6,25,000
	(Application money of 50000 share transferred to share Capital A/c on their allotment and remaining adjusted towards shares allotment)			
3	Share Allotment A/c	Dr.	25,00,000	
	To Share Capital A/c			15,00,000
	To Securities premium A/c			10,00,000
	(Allotment money due including premium)			
4	Bank A/c	Dr.	18,56,250	
	To Share Allotment A/c			18,56,250
	(Allotment money received)			
5	Share First Call A/c	Dr.	10,00,000	
	To Share Capital A/c			10,00,000
	(First Call money due)			
6	Bank A/c	Dr.	9,86,000	
	Calls-in-Arrears	Dr	4,000	
	To Share First Call A/c			9,90,000
	(First call money received of 49300 shares, and of 200 shares debited to Calls in Arrears)			
7	Share capital A/c	Dr.	37,500	
	Securities premium A/c	Dr.	10,000	
	To Share Forfeited A/c			18,750
	To Share Allotment A/c			18,750
	To Share First Call A/c			10,000
	(Forfeiture of 500 shares on non- payment of allotment and call money)			

Working Notes:

Shares applied for 75,000; Share Allotted 50,000

Ratio = 3 : 2

Kanti Bhai Number of shares holding = 500 Number of shares applied= 750

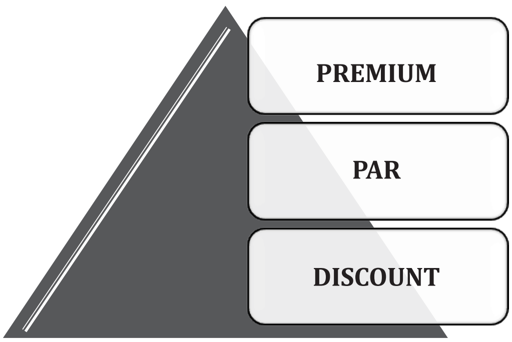
Excess application money received = 250 × 25 = Rs. 6,250 Share allotment money due = 500 × Rs. 50 = 25,000

Net Amount due after adjustment of excess application money= Rs. 25,000 – Rs. 6,250 = Rs. 18,750

Total allotment money due =	Rs. 25,00,000
Less excess application money adjusted	(Rs. 625,000)
Less Kanti Bhai's amount due on allotment	(Rs. 18,750)
Net Amount Received	**Rs. 18,56,250**

REISSUE OF FORFEITED SHARES

The Board of Directors can sell/ re-issue or dispose off the forfeited shares on such terms as it deems fit. However, the amount receivable on re-issue of such shares together with the amount already received from the defaulting member shall not, in any case, be less than the face value of the shares. Forfeited shares may be re-issued at:



RE-ISSUE OF FORFEITED SHARES - AT PAR: In one of the cases, forfeited shares can be re-issued at par. In such a case, the entire amount standing to the credit of Shares Forfeited Account for those shares would be treated as net gain and transferred to Capital Reserve Account.

Journal entries

1. On re-issue of shares:

Bank A/c	Dr.	(with the amount received on reissue i.e. no. of
To Share Capital A/c		shares re-issued x amount received per share.)

2. On transfer of Shares Forfeited Account to Capital Reserve Account:

Shares Forfeited A/c	Dr.	(with the forfeited amount on shares re-issued.)
To Capital Reserve A/c		

RE-ISSUE OF FORFEITED SHARES - AT A PREMIUM

If forfeited shares are re-issued at a premium, the amount of such premium should be credited to Securities Premium Account.

Also, in such a case, the entire amount standing to the credit of Shares Forfeited Account would be treated as net gain and transferred to Capital Reserve Account.

Journal entries

1. On Re-issue of shares:

Bank A/c	Dr.	(with the total amount received on re-issue.)
To Share Capital A/c		(with nominal value or paid-up value of shares.)
To Securities Premium A/c		(with the premium amount received.)

2. On transfer of Shares Forfeited A/c to Capital Reserve A/c:

Shares Forfeited A/c	Dr.	(with the forfeited amount on shares re-issued)
To Capital Reserve A/c		

Note: There may arise a situation when only part of shares forfeited be re-issued. In such a case, only the respective proportionate amount which represents the net gain on shares that are re-issued shall be transferred to the Capital Reserve Account and the remaining amount (balance) which represents the amount that is received on the forfeited shares, not yet re-issued, must be left in Shares Forfeited Account itself.

Disclosure: This amount is disclosed as addition to the paid up share capital on liabilities side of the balance sheet.

Forfeiture and Re-issue of Shares Allotted on Pro-rata Basis in Case of Over-subscription

In case where the shares of a Company are oversubscribed, it is not possible for the company to satisfy the demand of all the applicants. In such a case allotment may be made on a pro-rata basis, i.e., proportionately.

If such shares are subsequently forfeited for non-payment of allotment money and/or call money, the entries shall remain the same, but it may involve some difficulty in calculation. In such a case, it is to be noted carefully that if there is any excess amount received along with the application and it is adjusted against the allotment money which is failed by the shareholder, such amount should be deducted from the amount due on allotment to arrive at the net amount defaulted by the shareholder.

Example: Company A allots 10,000 shares on pro-rata basis among the applicants for 12,000 shares. In this case, the ratio between allotment of shares and application for shares will be 10,000: 12,000 or 5: 6, i.e., those applying for every 6 shares will be allotted 5 shares. If shares are allotted on pro-rata basis, the excess application money received on shares allotted will be retained by the company and may be adjusted subsequently against allotment money and/or call money

Illustration 2:

Arjun & Co. Ltd. issued a prospectus offering 2,00,000 shares of Rs.10 each on the following terms :

On Application	Rs. 1 per share
On Allotment	Rs.3 per share (including premium of Rs. 2)
On First Call (three months after allotment)	Rs.4 per share
On Second Call (three months after first call)	Rs.4 per share

Subscriptions were received for 3,17,000 shares on 3rd April and the allotment was made on 30th April as under :

Shares Allotted

(i)	Allotment in full (two applicants paid in full on allotment In respect of 4,000 shares each)	38,000
(ii)	Allotment of two-thirds of shares applied for	1,60,000
(iii)	Allotment of one-fourth of shares applied for	2,000

Cash amounting to Rs. 31,000 (being application money received with applications for 31,000 shares upon which no allotments were made) was returned to the applicants on 5th May. The amounts due were received on the due dates with the exception of the final call on 100 shares. These Shares were forfeited on 15th November and re-issued to Aayan on the 16th November for payment of Rs.9 per share. The company paid the interest due on calls-in-Advance on 31st October in cash.

Show the Journal and Cash Book Entries and draw a balance sheet of the Company giving effect to the above transactions.

Solution:

Journal

Date	Particulars		Amount(Dr.)	Amount(Cr.)
April 30	Share Application Account To Share Capital Account To Share Allotment Account (Being application money transferred to Share Capital Account on allotment of 2,00,000 shares and excess application money on 86,000 shares @ Rs. 1 per share utilized towards allotment)	Dr.	2,86,000	 2,00,000 86,000
" 30	Share Allotment Account To Share Capital Account To Securities Premium Account (Being allotment money due on 2,00,000 shares @ Rs.3 per share including Rs.2 per share)	Dr.	6,00,000	 2,00,000 4,00,000
July 31	Share first Call Account To Share Capital Account (Being amount due in respect of first call on 2,00,000 shares @ Rs.4 per share)	Dr.	8,00,000	 8,00,000
July 31	Calls-in-Advance Account To Share First Call Account (Being first call money received on 8,000 shares @ Rs. 4 per share received in advance is debited to the Calls-in-Advance Account)	Dr.	32,000	 32,000
Oct 31	Share Second and final Call Account To Share Capital Account (Being amount due in respect of second and final call on 2,00,000 shares @ Rs.4 per share)	Dr.	8,00,000	 8,00,000
Oct 31	Calls-in-Advance Account To Share Second and Final Call Account (Being second call money received on 8,000 shares @ Rs. 4 per share received in advance is debited to the Calls-in-Advance Account)	Dr.	32,000	 32,000
Nov. 15	Share Capital Account To Share Second and final Call Account To Share Forfeited Account (Being forfeiture of 100 shares for non-payment of second and final call)	Dr.	1,000	 400 600
Nov. 16	Share Forfeited Account To Share Capital Account To Capital Reserve Account (Being discount allowed on re-issue of 100 forfeited shares @ Rs. 1 per share and profit on re-issue transferred to Capital Reserve Account)	Dr.	600	 100 500

CASH BOOK

Date	Particulars	Amount	Date	Particulars	Amount
April 3	To Share Application A/c	3,17,000	May 5	By Share Application A/c	31,000
April 30	To Share Allotment A/c	514,000	Oct 31	By Interest on Calls-in-	1,440
April 30	To Calls-In-Advance A/c	64,000		Advance By Balance c/d	23,99,060
July 31	To Share First Call Account	768,000			
Oct. 31	To Share Second & Final Call A/c	7,67,600			
Nov. 16	To Share Capital A/c	900			
		24,31,500			**24,31,500**
	To Balance b/d	23,99,060			

Interest on Calls-in-Advance has been calculated as follows :Amount (Rs.)

On first call money from April 30 to July 31 @ 6% p.a. for 3 months

(Rs.32,000 * 6/100*3/12) 480

On second and final call money from April 30 to October 31@ 6% p.a.

For 6 months (Rs.32,000 * 6/100 * 6/12) 960

1,440

Balance Sheet of Arjun & Co. Ltd.
As at March 31, 20XX

Particulars	Amount
Equity and Liabilities:	
Share Capital:	20,00,000
Issued, Subscribed and Paid Up:	
2,00,000 shares of Rs. 10 each fully paid up Reserves and Surplus:	
Capital Reserve	500
Securities Premium Account	4,00,000
Total	**24,00,500**
Assets:	
CurrentAssets:	
Cash at Bank	23,99,060
Interest on Calls inAdvanceAccount (Pending adjustment)	1,440
Total	**24,00,500**

Working notes:

Analysis of Application Money Received

Shares Applied	Shares Allotted	Amount Received @ Rs.1 per share	Application Money	Adjusted as Allotment Money	Money Returned to Applicants
		Rs.	Rs.	Rs.	Rs.
38,000	38,000	38,000	38,000	-	-
2,40,000(160000 * 3/2)	1,60,000	2,40,000	1,60,000	80,000	-
8,000(2,000 * 4/1)	2,000	8,000	2,000	6,000	

(2,000 * 3)	-				
31,000	Nil	31,000	Nil	-	31,000
3,17,000	2,00,000	3,17,000	2,00,000	86,000	31,000

BUY-BACK OF SHARES

Buy-Back of Shares means the purchase of its own shares by the Company. It is kind of a corporate financial strategy and is an imperative mode of capital restructuring. It is a practice which is prevalent globally with the underlying objectives of increasing Earnings per Share, averting hostile takeovers, improving returns to the stakeholders and realigning the capital structure.

Buy-Back is an alternative way of Reduction of Share Capital. When a company has substantial cash resources, it may like to buy its own shares from the market particularly when the prevailing rate of its shares in the market is much lower than the book value or what the company perceives to be its true value. Buy back of shares enables the company to go back to its shareholders and off to purchase from them the shares that they hold.

Free Reserves: 'Reserves which, as per latest audited Balance Sheet of the company are free for distribution as dividend and shall include balance to the credit of Security Premium A/c but shall not include Share Application Money'.

Advantages of Buy Back:

I. To improve the earnings per share;

II. To improve return on capital, return on net worth and to enhance the long-term value for shareholders;

III. To provide an additional exit route to shareholders when shares are undervalued or thinly traded;

IV. It is an alternative mode of reduction in capital without requiring approval of the Court/CLB (NCLT),

V. To enhance consolidation of stake in the company;

VI. To prevent unwelcome takeover bids;

VII. To return surplus cash to shareholders;

VIII. To achieve optimum capital structure;

IX. To support share price during periods of sluggish market conditions;

X. To serve the equity more efficiently.

Example: Improvement in EPS can be explained by below example:

Particulars	Pre Buy – Back	Post Buy – Back
Profit	100	100
Number of Shares	10	5
EPS	10	20

Further, given below is a table for relevant sections and their applicability:

For Unlisted Public and Private Companies	• Section 68, 69 and 70 of Companies Act, 2013 • Rule 17 of Companies (Share Capital and Debentures) Rules, 2014
For Listed Companies	• Section 68, 69 and 70 of Companies Act, 2013 • Rule 17 of Companies (Share Capital and Debentures) Rules, 2014 • Securities and Exchange Board of India (Buy-back of Securities) Regulations, 1998 and Securities and Exchange Board of India (Buy-back of Securities) (Amendment) Regulations, 2013

RELEVANT EXTRACTS FOR SECTIONS 68, 69 AND 70 OF COMPANIES ACT, 2013 PROVIDES FOR BUY-BACK OF SHARES.

1. Purchase can be made out of:

According to section 68(1) of the Companies Act 2013, a company may purchase its own shares or other specified securities (referred to as buy-back) out of –

(a) its free reserves;

(b) the securities premium account; or

(c) the proceeds of the issue of any shares or other specified securities:

However, no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

2. Preliminary Conditions for buy-back:

According to section 68(2), following conditions must be satisfied in order to buy-back the shares :

(a) must be authorized by its articles;

(b) a special resolution has been passed at a general meeting of a company authorizing the buy-back, but

(c) the same is not required when:

  (i) the buy-back is 10% or less of the total paid-up equity capital and free reserves of the company; and

  (ii) such buy-back has been authorized by the Board by means of a resolution passed at its meeting;

(d) the buy-back is twenty-five per cent or less of the aggregate of paid-up capital and free reserves of the company. But in case of Equity Shares, the same shall be taken as 25% of paid up equity capital only;

(e) debt equity ratio should be 2:1, where debt is the aggregate of secured and unsecured debts owed by the company after buy-back and Equity is the aggregate of the paid-up capital and its free reserves; Provided that the Central Government may, by order, notify a higher ratio of the debt to capital and free reserves for a class or classes of companies;

(f) all the shares or other specified securities for buy-back are fully paid-up;

(g) if shares or securities are listed, buy-back will be in accordance with the regulations made by the Securities and Exchange Board in this behalf; and

(h) the buy-back in respect of unlisted shares or other specified securities is in accordance with such Rules as may be prescribed

(i) no offer of buy-back shall be made within a period of one year from the date of the closure of the preceding offer of buy-back, if any.

3. Explanatory Statement

Section 68(3) spells out additional requirements as follows:

The notice of the meeting at which the special resolution is proposed to be passed shall be accompanied by an explanatory statement stating -

(a) a full and complete disclosure of all material facts;

(b) the necessity for the buy-back;

(c) the class of shares or securities intended to be purchased under the buy-back;

(d) the amount to be invested under the buy-back; and

(e) the time-limit for completion of buy-back.

As per the rules, following more details are to be included in the Explanatory Statement:

(f) the date of the board meeting at which the proposal for buy-back was approved by the board of directors of the company;

(g) the number of securities that the company proposes to buy-back;

(h) the method to be adopted for the buy-back;

(i) the price at which the buy-back of shares or other securities shall be made;

(j) the basis of arriving at the buy-back price;

(k) the maximum amount to be paid for the buy-back, and the sources of funds from which the buy-back would be financed;

(l) Shareholding:

  (i) the aggregate shareholding of the promoters and directors, where the promoter is a company, and of the directors and key managerial personnel as on the date of the notice convening the general meeting;

  (ii) the aggregate number of equity shares purchased or sold by persons mentioned in the sub-clause during a period of twelve months preceding the date of the board meeting at which the buy-back was approved and from that date till the date of notice convening the general meeting;

  (iii) the maximum and minimum price at which purchases and sales referred to in sub-clause (ii) were made along with the relevant date;

(m) if the persons mentioned in l(i) intend to tender their shares for buy-back -

  (i) the quantum of shares proposed to be tendered;

  (ii) the details of their transactions and their holdings for the last twelve months prior to the date of the board meeting at which the buy-back was approved including information of number of shares acquired, the price and the date of acquisition;

(n) a confirmation that there are no defaults subsisting in repayment of deposits, interest payment thereon, redemption of debentures or payment of interest thereon, or redemption of preference shares or payment of dividend due to any shareholder, or repayment of any term loans, or interest payable thereon to any financial institution or banking company;

(o) a confirmation:

  (i) that the Board of Directors have made a full enquiry into the affairs and prospects of the company and that they have formed the opinion- general meeting is convened that there shall be no grounds on which the company could be found unable to pay its debts;

  (ii) that the company's prospect for the year immediately following that date and its financial resources be available to meet its liabilities as and when they fall due, and the company shall not be rendered insolvent within a period of one year from that date; and

  (iii) the directors have already taken into account the liabilities(including prospective and contingent liabilities), as if the company were being wound up under the provisions of the Companies Act, 2013.

(p) a report addressed to the Board of Directors by the company's auditors stating that-

  (i) they have inquired into the company's state of affairs;

  (ii) the amount of permissible capital payment for the securities in question is in their view properly

  (iii) determined;

  (iv) that the audited accounts on the basis of which calculation with reference to buy-back is done is not more than six months old from the date of offer document; and

(v) the Board of Directors have formed the opinion as specified in point 'o' on reasonable grounds and that the company, with regard to its state of affairs, shall not be rendered insolvent within a period of one year from that date.

Other Conditions for Buy-back

- Time period u/s Section 68(4): Every buy-back shall be completed within a period of one year from the date of passing of the special resolution, or as the case may be, the resolution passed by the Board.
- Options for buy-back: The buy-back can be:

  (a) from the existing shareholders or security holders on a proportionate basis;

  (b) from the open market;

  (c) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity. [Section 68(5)]
- Solvency Declaration:

  Before making such buy-back, it has to be filed with the Registrar a declaration of solvency signed by at least two directors of the company, one of whom shall be the managing director, if any, Form No. SH.9 may be prescribed and verified by an affidavit to the effect that the Board of Directors of the company has made a full inquiry into the affairs of the company, as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year from the date of declaration adopted by the Board. [Section 68(6)]
- Extinguish Certificate: Company shall extinguish and physically destroy the shares or securities so bought back within seven days of the last date of completion of buy-back. [Section 68(7)]
- No Further Issuance: When a company completes a buy-back of its shares or other specified securities, it shall not make a further issue of the same kind of shares or other securities including allotment of new shares or other specified securities within a period of six months except by way of:

  (a) issue a bonus, or

  (b) discharging of subsisting obligations, such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.
- Register to be maintained: A company shall maintain a register in Form No. SH.10 of the shares or securities so bought, the consideration paid for the shares or securities bought back, the date of cancellation of shares or securities, the date of extinguishing and physically destroying the shares or securities. The register of shares or securities bought back shall be maintained at the registered office of the company and shall be kept in the custody of the secretary of the company or any other person authorized by the board in this behalf. The entries in the register shall be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose.
- Return of Buy-Back & Declaration: A company shall, after the completion of the buy-back under this section, file with the Registrar a return in Form No. SH.11 containing such particulars relating to the buy-back within thirty days of such completion. There shall be annexed to the return, a certificate in Form No. SH.15 signed by two directors of the company including the managing director, if any, certifying that the buy-back of securities has been made in compliance with the provisions of the Act and the rules made thereunder.
- Punishment for Default: If a company makes any default in complying with the provisions of this section, it shall be punishable with fine which shall not be less than one lakh rupees and which may extend to three lakh rupees and every officer of the company who defaults shall be punishable with imprisonment for a term which may extend to three years or with a fine which shall not be less than one lakh rupees and which may extend to three lakh rupees, or with both.

TRANSFER OF CERTAIN SUMS TO CAPITAL REDEMPTION RESERVES ACCOUNT (SECTION 69)

Capital Redemption Reserves: Where a company purchases its own shares out of free reserves or securities premium account, a sum equal to the nominal value of the shares so purchased shall be transferred to the capital redemption reserves account and details of such transfer shall be disclosed in the balance sheet.

Utilization: The capital redemption reserve account may be applied by the company, in paying up unissued shares of the company to be issued to its members as fully paid bonus shares.

PROHIBITION ON BUY-BACK IN FOLLOWING CIRCUMSTANCES: (SECTION 70)

Restrictions on Buy-Back : No company shall directly or indirectly purchase its own shares or other specified securities

(a) through any subsidiary company including its own subsidiary companies;

(b) through any investment company or group of investment companies; or

(c) through a default made by the company in the repayment of deposits accepted either before or after the commencement of this Act, interest payment thereon, redemption of debentures or preference shares or payment of dividend to any shareholder, or repayment of any term loan or interest payable thereon to any financial institution or banking company, provided that the buy-back is not prohibited, if the default is remedied and a period of three years has lapsed after such default ceased to subsist.

Prohibitions: No company shall, directly or indirectly, purchase its own shares or other specified securities in case such company has not complied with the provisions of:

(a) Sections 92: Annual Return

(b) Section 123: Declaration and Payment of Dividend

(c) Section 127: Failure to pay Dividend

(d) Section 129: Failure to give True and Fair Statement

Companies (Share Capital and Debentures) Rules, 2014

Rule 17: Buy-back of shares or other securities:

Unless stated otherwise, the following norms shall be complied with by the Private companies and Unlisted public companies for buy-back of their securities.

1. **Information disclosure in Explanatory Statement to be annexed with Special Resolution and Notice of General Meeting:**

   The Explanatory Statement to be annexed to the notice of the general meeting pursuant to Section 102 shall contain the following disclosures, namely:-

   (a) The date of the board meeting at which the proposal for buy-back was approved by the Board of Directors of the company;

   (b) The objective of the buy-back;

   (c) The class of shares or other securities intended to be purchased under the buy-back;

   (d) The number of securities that the company proposes to buy-back;

   (e) The method to be adopted for the buy-back;

   (f) The price at which the buy-back of shares or other securities shall be made;

   (g) The basis of arriving at the buy-back price;

   (h) The maximum amount to be paid for the buy-back and the sources of funds from which the buy-back would be financed;

(i) The time-limit for the completion of buy-back;

(j) (i) The aggregate shareholding of the promoters and of the directors of the promoter, where the promoter is a company of the directors and key managerial personnel as on the date of the notice convening the general meeting;

(ii) The aggregate number of equity shares purchased or sold by persons mentioned in sub-clause (i) during a period of twelve months preceding the date of the board meeting at which the buy-back was approved and from that date till the date of notice convening the general meeting;

(iii) The maximum and minimum price at which purchases and sales referred to in sub-clause (ii) were made along with the relevant date;

(k) If the persons mentioned in sub-clause (i) of clause (j) intend to tender their shares for buy-back–

(i) The quantum of shares proposed to be tendered;

(ii) The details of their transactions and their holdings in the last twelve months prior to the date of the board meeting at which the buy-back was approved including information of number of shares acquired, the price and the date of acquisition;

(l) A confirmation that there are no defaults subsisting in repayment of deposits, interest payment thereon, redemption of debentures or payment of interest thereon or redemption of preference shares or payment of dividend due to any shareholder, or repayment of any term loans or interest payable thereon to any financial institution or banking company;

(m) A confirmation that the Board of Directors have made a full enquiry into the affairs and prospects of the company and that they have formed the opinion-

(i) That immediately following the date on which the general meeting is convened there shall be no

(ii) grounds on which the company could be found unable to pay its debts;

(iii) The the company's prospects for the year immediately following that date and its financial resources will be available to met its liabilities as and when they fall due and shall not be rendered insolvent within a period one year from that date; and

(iv) The directors have taken into account the liabilities(including prospective and contingent liabilities), as if the company were being wound up under the provisions of the Companies Act, 2013

(n) A report addressed to the Board of Directors by the company's auditors stating that–

(i) They have inquired into the company's state of affairs;

(ii) The amount of the permissible capital payment for the securities in question is in their view properly determined;

(iii) That the audited accounts on the basis of which calculation with reference to buy-back is done not more than six months before from the date of offer document; and

Provided that where the audited accounts are more than six months old, the calculations with reference to buy back shall be on the basis of un-audited accounts not older than six months from the date of offer document which are subjected to limited review by the auditors of the company.

(iv) The Board of Directors have to form the opinion as specified in clause (m) on reasonable grounds that the company, with regard to its state of affairs, shall not be rendered insolvent within a period of one year from that date.

2. File letter of offer with ROC in Form SH-8:

The company which has been authorized by a special resolution shall, before the buy-back of shares, file with the Registrar of Companies (ROC) a letter of offer in Form No. SH.8, along with the fee, provided that such letter of off shall be dated and signed on behalf of the Board of directors of the company by not less than two directors of the company, one of whom shall be the managing director, if there is one.

3. File declaration of solvency in Form SH-9 along with Form SH-8:

The company shall file with the Registrar along with the letter of offer and in case of a listed company with the Registrar and the Securities and Exchange Board a declaration of solvency in Form No. SH.9 along with the fee, and signed by at least two directors of the company, one of whom shall be the managing director, if there is one, and verified it shall be by an affidavit as specified in the said Form.

4. Circulate among the shareholders in 20 days from filing with ROC:

The letter of offer shall be dispatched to the shareholders or security holders immediately after filing the same with the Registrar of Companies but not later than twenty days from its filing with the Registrar of Companies.

5. Offer period between 15-30 days from the date of circulation

The offer for buy-back shall remain open for a period of not less than fifteen days and not exceeding thirty days from the date of dispatch of the letter of offer. Provided that where all members of a company agree, the offer for buy back may remain open for a period less than fifteen days.

6. Acceptance on proportionate basis:

In case the number of shares or other specified securities offered by the shareholders or security holders is more than the total number of shares or securities to be bought back by the company, the acceptance per shareholder shall be on proportionate basis out of the total shares offered for being bought back.

7. Verification by the company:

The company shall complete the verifications of the offers received within fifteen days from the date of closure of the offer and the shares or other securities lodged shall be deemed to be accepted unless a communication of rejection is made within twenty-one days from the date of closure of the offer.

8. Opening of separate bank account:

The company shall immediately after the date of closure of the offer, open a separate bank account and deposit therein, such sum, as would make up the entire sum due and payable as consideration for the shares tendered for buy-back in terms of these rules.

9. Make payment or return share certificates:

The company shall within seven days of the time specified in point 7-

(a) make payment of consideration in cash to those shareholders or security holders whose securities have been accepted; or

(b) return the share certificates to the shareholders or security holders whose securities have not been accepted at all, or the balance of securities in case of part acceptance

10. Other restrictions:

The company shall ensure that –

(a) the letter of offer shall contain true, factual and material information and shall not contain any misleading information and must state that the directors of the company accept the responsibility for the information contained in such document;

(b) the company shall not issue any new shares including by way of bonus shares from the date of passing of special resolution authorizing the buy-back till the date of the closure of the offer under these rules, except those arising out of any outstanding convertible instruments;

(c) the company shall confirm in its offer the opening of a separate bank account adequately funded for this purpose and to pay the consideration only by way of cash;

(d) the company shall not withdraw the offer once it has announced the offer to the shareholders;

(e) the company shall not utilize any money borrowed from banks or financial institutions for the purpose of buying back its shares; and

(f) the company shall not utilize the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities for the buy-back.

11. Maintain register of buy-back in Form SH-10

(a) The company shall maintain a register of shares or other securities which have been bought-back in Form No. SH.10.

(b) The register of shares or securities bought-back shall be maintained at the registered office of the company and shall be kept in the custody of the secretary of the company or any other person authorized by the board in this behalf.

(c) The entries in the register shall be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose.

12. File return of buy-back in Form SH-11:

The company, after the completion of the buy-back under these rules, shall file with the Registrar, and in case of a listed company with the Registrar and the Securities and Exchange Board of India, a return in the Form No. SH.11 along with the fee.

13. File compliance certificate in Form SH-15 along with Form SH-11:

There shall be annexed to the return filed with the Registrar in Form No. SH.11, a certificate in Form No. SH.15 signed by two directors of the company including the managing director, if there is one, certifying that the buy- back of securities has been made in compliance with the provisions of the Act and the rules made thereunder.

Time Schedule Summary:

Time Taken	Procedure
Starting Day say 'A'	Obtaining: • Auditors Report stating maximum amount permissible for buy-back; • Board of Directors Affidavit regarding solvency of company for one year; • Then holding Board meeting for considering proposal of buy-back, getting resolution passed and determine price for such buy-back.
A + 2	Issue of notice with Explanatory Statement (along with disclosures mentioned below) to all members.
A + 23	Holding EGM and passing special resolution, if required.
A + 24	Obtaining Declaration of Solvency (verified by an affidavit in e-form SH9); • Filing draft letter of Off with the ROC along with declaration of Solvency and e-form SH8; • Filing of e-form for registration of such resolution with MCA21.
A + 44	Maximum time for dispatch of letter of offer to all members.
Within 15 days from the closure of offer	Verification of offer to be completed; **Note:** Offer for buy-back shall remain open to the members for a period not less than 15 days and not exceeding 30 days from the date of dispatch of letter of offer. The shares or other securities lodged shall be deemed to be accepted unless a communication of rejection is made within twenty-one days from the date of closure of the offer.

Immediately on Closure of offer	Open a Special Bank Account with Schedule Bank.
Within 7 days from completion of Verification	Making payment in cash to those shareholders whose offer has been accepted or return the share certificates to the shareholders forthwith.
Within 7 days from completion of Acceptance	Extinguish and physically destroy the share certificates of shares bought back.
After completion of buy-back	File requisite return in e-form SH 11 with MCA21 and a declaration signed by 2 directors, one of whom shall be Managing Director, if there is one, in e-form SH 15

Accounting Entries

1. In case investments are sold for buying back own shares

   Bank A/c Dr.

   To Investment A/c

2. In case the proceeds of fresh issues are used for buy-back purpose

   Bank A/c Dr.

   To debentures/other Investment A/c

   To Securities Premium A/c (if any)

3. For Buying back of shares:

   Equity Shareholders A/c Dr.

   To Bank A/c (With the amount paid)

4. For cancellation of shares bought back:

   Equity Share Capital A/c Dr. (with the nominal value of shares bought back)

   Free reserves/Securities Premium A/c Dr. (with the excess amount/premium paid over nominal value)

   To Equity Shareholders A/c (with the amount payable)

5. In case the shares are bought back at discount:

   Equity Share Capital A/c Dr. (with the nominal value)

   To Equity shareholders A/c (with the amount paid)

   To Capital Reserves A/c (with the amount of discount on buy-back)

6. For transfer of nominal value of shares purchased out of free reserves/securities premium to Capital Redemption Reserves Account:

   Free Reserves A/c Dr. (with the amount transferred)

   Securities Premium A/c Dr. (with the amount transferred)

   To Capital Redemption Reserves A/c (with the nominal value of shares bought back)

7. For expenses incurred in buy-back of shares:

   Buy-back Expenses A/c Dr. (with the amount)

   To Bank A/c

   For transfer of buy-back expenses:

   Profit and Loss A/c Dr.

   To buy-back Expenses A/c

Illustration 4:

ALLUWALIA Ltd

BALANCE SHEET as at 31st March, 2019

I. EQUITIES AND LIABILITIES		
1. Shareholders' funds		
(a) Share Capital	1	10,00,000
(b) Reserve & Surplus	2	7,05,000
2. Non-Current Liability		
Long-term borrowings		
3. Current Liability	3	4,00,000
Trade payables		60,000
TOTAL		**21,65,000**
II. ASSETS		
1. Non-current assets		
(a) Fixed Assets		
(i) Tangible fixed assets	4	13,30,000
(b) Non-Current Investment		1,50,000
2. Current Assets		
Inventories	1,00,000	
Trade receivables	1,00,000	
Cash and cash equivalents Balance	4,85,000	6,85,000
TOTAL		**21,65,000**
Notes		
1. Share Capital		
Authorized Share Capital		
Issued, Subscribed Called-Up and Paid-Up Share Capital:-		
1,00,000 shares of Rs. 10 each fully paid-up		10,00,000
2. Reserve and Surplus		
Securities Premium	2,00,000	
General Reserve	5,05,000	7,05,000
3. Long-term borrowings		
14% Debentures		4,00,000
4. Tangible Fixed assets		
Land-building	9,30,000	
Plant and machinery	3,50,000	
Furniture and fitting	50,000	13,30,000

On 1st April, 2019 the shareholders of the company have approved the scheme of buy-back of equity shares as under:

(i) 5% of the equity shares would be bought back at Rs 15.

(ii) 12% Debentures to be issued for Rs 10,000 to finance for the buy-back, and balance from the General reserve may be utilized for this purpose.

(iii) Premium paid on buy-back of shares should be met from securities premium account.

(iv) Investments would be sold for Rs 275,000.

Pass journal entries to record the above transactions and prepare the balance sheet of the company immediately after the buy-back of shares.

Solution:

Alluwalia Ltd.

Journal

Particulars		**Dr. (Rs)**	**Cr. (Rs)**
Bank A/c	Dr.	275,000	
To Investments A/c			150,000
To Profit and Loss A/c			125,000
(Sale of investments, the profit being transferred to profit and loss account as per shareholder's special resolution)			
Shareholders A/c	Dr.	75,000	
To Bank A/c			75000
(Purchase of 5,000 of own shares @ Rs 15 each)			
Equity Share Capital A/c	Dr.	50,000	
Securities Premium A/c	Dr.	25,000	
To Shareholders A/c			75,000
(Cancellation of 5,000 equity shares bought back, and securities premium utilized as per shareholders' special resolution)			
General Reserve A/c	Dr.	40,000	
To Capital Redemption Reserve A/c			40,000
(Transfer of general reserve utilized to the extent of nominal value of shares bought back)			
Bank A/c	Dr.	10,000	
To 12% Debentures A/c			10,000
(Issue of 12% Debentures to partly finance the buy-back)			

Alluwalia Ltd.

Balance Sheet (After Buy-back) as at 1st April, 2019

I.	**EQUITIES AND LIABILITIES**		
	1. Shareholders' funds		950,000
	(a) Share Capital		
	(b) Reserve & Surplus		805,000
	2. Non-Current Liability Long-term borrowings		410,000
	3. Current Liability Trade payables		60,000
	TOTAL		**22,25,000**
II.	**ASSETS**		
	1. Non-current assets		
	(a) Fixed assets		13,30,000
	(i) Tangible fixed assets		
	2. Current Assets Stock	1,00,000	
	Sundry debtors	1,00,000	
	Cash and Cash equivalents	6,95,000	8,95,000
	TOTAL		**22,25,000**
	Notes		
	1. Share Capital		
	Authorized Share Capital		
	Issued, Subscribed Called Up And Paid Up Share Capital		
	95,000 shares of Rs/ 10 each fully paid up		9,50,000
	2. Reserve and Surplus	1,75,000	
	Securities Premium	4,65,000	
	General Reserve	40,000	
	Capital Redemption Reserve Profit and Loss Account	125,000	8,05,000
	3. Long-term borrowings		
	14% Debentures –	400,000	
	12%Debentures-	10,000	4,10,000

Note: The debt-equity ratio of the company after buy-back of shares:

Debt-equity ratio = Debt/ Equity (Capital and free reserves)

= (410000 + 60000) / (950,000 + 175,000 + 465,000 + 125,000)

= 0.274 : 1

The debt equity ratio is within the limit.

ISSUE OF BONUS SHARES (SECTION 63)

Issue & its related conditions

A company may issue fully paid up bonus shares to its members, in any manner out of -

(i) its free reserves;

(ii) the securities premium account; or

(iii) the capital redemption reserve account.

However, no issue of bonus shares shall be made by capitalizing reserves created by the revaluation of assets.

No company shall capitalize its profits or reserves for the purpose of issuing fully paid up bonus shares under above, unless -

(a) it is authorized by its articles;

(b) it has, on the recommendation of the Board, been authorized in the general meeting of the company;

(c) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;

(d) it has not defaulted in respect of the payment of statutory dues of the employees, such as contribution to provident fund, gratuity and bonus;

(e) the partly paid up shares, if any outstanding on the date of allotment, are made fully paid up;

(f) The company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same. [Rule 14 of Companies (Share Capital and Debentures) Rules, 2014]

(1) The bonus shares shall not be issued in lieu of dividend.

Journal Entries for Issue of Bonus Shares

(A) On capitalization of reserve for the issue of shares

Profit & Loss A/c	Dr.
General Reserve A/c	Dr.
Capital Reserve A/c (realised in cash only)	Dr.
Securities Premium A/c	Dr.
Capital Redemption Reserve A/c	Dr.
To Bonus Shareholders A/c	

(B) On issue of Bonus share

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

Note: If some shares are party paid up, first the shares are to be made fully paid up. Journal entries are as follows:

(c) Capitalization of Reserve for Issue of Shares

Profit & Loss A/c	Dr.
General Reserve A/c	Dr.
Capital Reserve Account (realized in cash only)	Dr.
To Bonus Shareholders A/c	

(d) On making the final call due

Share Final Call Account	Dr.
To Share Capital Account	

(e) On adjustment of final call

Bonus Shareholders A/c	Dr.
To Share Final Call A/c	

EMPLOYEE STOCK OPTION SCHEME (ESOP)

The idea that the employees should have an option to have an ownership stake in the company led to the emergence of concept of Employee Stock Option Plan (ESOP).The concept of ESOP is believed to be the brain child of Louis Kelso,a lawyer, economist and philosopher who persuaded a Senator from Louisiana to support legislation for legalizing ESOPs.

OBJECTIVE OF ISSUING ESOPs

- To provide an incentive to draw, retain and reward employees of the company;
- To motivate employees to contribute to the growth and profitability of the company.

IMPORTANT TERMS:

- **'Option' in stock options:** Having an option in stock option gives the employees the choice to purchase the shares of the company on the fulfillment of the conditions mentioned in the ESOP plan at the price decided at the time of grant of options.
- **Grant:** The eligibility of a particular employee for the grant of stock options is based on his role and performance, hence grant of option.
- **Vesting:** Vesting has two components – Vesting percentage and vesting period
- Vesting period implies the period on the completion of which the said portion can be exercised. Vesting percentage refers to that portion of total options granted, which the employee will be eligible to exercise.
- **Exercise:** The activity of converting the options granted to an employee into shares by paying the required exercise price is known as the exercise of options.
- **Exercise price and exercise period:** Exercise price is the price which the employee has to pay to convert the options into shares. The exercise period is the time frame within which the employee can decide to exercise the stock options.
- **Effective date of exercise:** The effective date of exercise is the date on which the Company allots the shares.

Issue of Employee Stock Options by Unlisted Public Company as per provisions of Companies Act

As per Section 2(37) of the Companies Act, 2013 "employees' stock option" means the option given to the directors, officers or employees of a company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined price.

As per provisions of Sec 62(1)(b) of Companies Act, 2013, "where at any time a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares shall be offered to employees under a scheme of employees' stock option, subject to special resolution passed by the company and subject to such conditions as may be prescribed."

Issue of Employee Stock Options

The above provision needs to be read with Rule 12 of The Companies (Share Capital and Debentures) Rules, 2014. As per the said Rule, a Company, other than a listed company, shall not offer shares to its employees under a scheme of employees' stock option, unless it complies with the following requirements, namely:-

(1) **Sanction by Special Resolution:** The issue of Employees Stock Option Scheme has been approved by the shareholders of the company by passing a special resolution.

Employees to whom ESOPs may be issued: For the purpose of above statement the word "Employee'' means -

(a) a permanent employee of the company who has been working in India or outside India; or

(b) a director of the company, but excluding an independent director; or

(c) an employee as defined in 1(a) or (b) above of a subsidiary, in India or outside India, or of a holding company of the company.

Excluding -

(i) an employee who is a promoter or a person belonging to the promoter group; or

(ii) a director who either himself or through his relatives or through anybody in corporate, directly or indirectly, holds more than ten percent of the outstanding equity shares of the company.

(2) **Disclosures in the explanatory statement annexed to the notice for passing of the resolution:** The company shall make the following disclosures in the explanatory statement annexed to the notice for passing of the resolution -

(a) total number of stock options to be granted;

(b) identification of classes of employees entitled to participate in the ESOP;

(c) the appraisal process for determining the eligibility of employees to participation the ESOP;

(d) the requirements of vesting and the period of vesting;

(e) the maximum period within which the options shall be vested;

(f) the exercise price or the formula for arriving at the same;

(g) the exercise period and process of exercise;

(h) the lock-in period, if any;

(i) the maximum number of options to be granted per employee and in aggregate;

(j) The method which the company shall use to value its options;

(k) the conditions under which option vested in employees may lapse, e.g., in case of termination of employment for misconduct;

(l) the specified time period within which the employee shall exercise the vested options in the event of a proposed termination of employment or resignation of employee; and

(m) a statement to the effect that the company shall comply with the applicable accounting standards.

(3) **Pricing:** The companies granting option to its employees pursuant to Employees Stock Option Scheme will have the freedom to determine the exercise price in conformity with the applicable accounting policies, if any.

(4) **Shareholders' approval by way of separate resolution:** The approval of shareholders by way of separate resolution shall be obtained by the company in case of-

(a) grant of option to employees of subsidiary or holding company; or

(b) grant of option to identified employees, during any one year, equal to or exceeding one percent of the issued capital of the company at the time of grant of option.

(5) (a) The company may by special resolution, vary the terms of ESOP not yet exercised by the employees

(b) The notice for passing special resolution for variation of terms of ESOP shall disclose full details of the variation, the rationale therefore, and the details of the employees who are beneficiaries of such variation.

(6) **Minimum vesting period:**

(a) There shall be a minimum period of one year between the grant of options and vesting of option. However, in a case where options are granted by a company under its Employees Stock Option Scheme in lieu of options held by the same person under an Employees Stock Option Scheme in another company, which has merged or amalgamated with the first mentioned company, the period during which the options granted by the merging or amalgamating company were held by him shall be adjusted against the minimum vesting period required (i.e., 1 year)

(b) Lock-in-period for shares issued on exercise of option : The company shall have the freedom to specify the lock-in period for the shares issued in pursuant to exercise of option.

(c) Right to receive dividends: The Employees shall not have right to receive any dividend or to vote or in any manner enjoy the benefits of a shareholder in respect of option granted to them, till shares are issued on exercise of option.

(7) **Forfeiture/ Refund of amount paid by employees under ESOP :** The amount, payable by the employees, at the time of grant of option -

(a) may be forfeited by the company if the option is not exercised by the employees within the exercise period; or

(b) the amount may be refunded to the employees if the options are not vested due to non-fulfillment of conditions relating to vesting of option as per the Employees Stock Option Scheme.

(8) (a) The option granted to employees shall not be transferable.

(b) The option granted to the employees shall not be pledged, hypothecated, mortgaged or otherwise encumbered or alienated in any other manner.

(c) Subject to clause (d), no person other than the employees to whom the option has been granted shall be entitled to exercise the option.

(d) In the event of the death of the employee while in employment, all the options granted to him till such date shall vest in the legal heirs or nominees of the deceased employee.

(e) In case the employee suffers a permanent incapacity while in employment, all the options granted to him as on the date of permanent incapacitation, shall vest in him on that day.

(f) In the event of resignation or termination of employment, all options not vested in the employee as on that day shall expire. However, the employee can exercise the options granted to him which were vested within the period specified in this behalf, subject to the terms and conditions under the scheme granting such options as approved by the Board.

(9) **Disclosures in Board of Directors Report :** The Board of Directors, shall, inter alia, disclose in the Directors' Report for the year, the following details of the Employees Stock Option Scheme: (a) options granted; (b) options vested; (c) options exercised; (d) the total number of shares arising as a result of exercise of option; (e) options lapsed; (f) the exercise price; (g) variation of terms of options; (h) money realized by exercise of options; (i) total number of options in force; (j) employee wise details of options granted to;- (i) key managerial personnel; (ii) any other employee who receives a grant of options in any one year of option amounting to five percent or more of options granted during that year. (iii) identified employees who were granted option, during any one year, equal to or exceeding one percent of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant;

(10) **Register of Employees Stock Options :**

(i) The company shall maintain a Register of Employee Stock Options in Form No. SH.6 and shall forthwith enter therein the particulars of option granted under clause (b) of sub-section (1) of section 62.

(ii) The Register of Employee Stock Options shall be maintained at the registered office of the

(iii) company or such other place as the Board may decide.

(iv) The entries in the register shall be authenticated by the company secretary of the company or by any other person authorized by the Board for the purpose.

Rule 12(11) specifically provides that, where the equity shares of the company are listed on a recognized stock exchange, the Employees Stock Option Scheme shall be issued in accordance with the regulations made by Securities and Exchange Board of India. In this behalf. SEBI (Share Based Employee Benefits) Regulations, 2014 issued in October 28, 2014 (applicable from the even date) have replaced the erstwhile SEBI Employee Stock Option Scheme and Employee Stock Purchase Scheme Guidelines (applicable for listed companies) 1999.

Illustration 5:

Raman Ltd. granted 1000 options on April 01, 2016 at Rs. 40 (nominal value Rs. 10 each) when the market price was Rs. 120, and the vesting period was 2.5 years. The maximum exercise period was one year. On Oct 1, 2018, 200 unvested options lapsed and 600 options were exercised. On 30th Oct, 2019 remaining 200 options lapsed at the end of exercise period.

Pass necessary journal entries.

Solution:

In the Books of Raman Ltd.

JOURNAL

Date	Particulars	Amount (Rs.)	Amount (Rs.)
2016 April 1	Deferred Employee Compensation Expense A/c Dr.	80,000	
	To Employee Stock Options Outstanding A/c		80,000
	(Being grant of 1,000 options at a discount of Rs. 80, i.e., Rs. 120 - Rs.40)		
2017 March 31	Employee Compensation Expense A/c Dr.	32,000	
	To Deferred Employee Compensation Expense A/c		32,000
	(Being amortization of Deferred Compensation, i.e., Rs. 80,000 / 2.5)		
2018 March 31	Employee Compensation Expense A/c Dr.	32,000	
	To Deferred Employee Compensation Expense A/c		32,000
	(Being amortization of Deferred Compensation, i.e., Rs. 80,000 / 2.5)		
2018 Oct 1	Employee Stock Options Outstanding A/c Dr.	16,000	
	To Employee Compensation Expense A/c		12,800
	[(200 * Rs.80) * 2/2.5]		
	To Deferred Employee Compensation Expense A/c		3,200
	[(200 * Rs.80) * 0.5/2.5]		
	(Being reversal of compensation accounting on lapse of 200 unvested options)		
2018 Oct 1	Employee Compensation Expense A/c Dr.	12,800	
	To Deferred Employee Compensation Expense A/c		12,800
	(Being amortization of Deferred Compensation) (800*80*0.5/2.5)		

2018 Oct 1	Bank A/c (600 *40) Dr. Employee Stock Options Outstanding A/c Dr. [Rs. 600 * (Rs. 120 - Rs. 40)] To Equity Share Capital A/c (600 * 10) To Securities Premium A/c [Rs.600 *(Rs. 120 - Rs. 10)] (Being excise of 600 options at an excise price of Rs. 20 each and an accounting value of Rs. 60 each)	24,000 48,000	 6,000 66,000
2019 Oct. 30	Employee Stock Options Outstanding A/c Dr. To Employee Compensation Expense A/c (Being reversal of compensation accounting on lapse of 200 vested options at the end of the excise period i.e., Rs.200 * 80)	16,000	 16,000

ISSUE OF SWEAT EQUITY SHARES (SECTION 54)

Sweat equity shares refer to equity shares which are given to the company's employees on favourable terms, in recognition of their work. Sweat equity shares are one of the modes of making share-based payments to employees. Sweat equity shares rewards the beneficiaries by giving them incentives in lieu of their contribution towards development of the company. Further, sweat equity shares facilitate greater employee stakes as well as interest in company's growth and encourages employees to add more value towards the company.

Definition

(1) Sweat Equity Shares: As per Section 2(88) of the Companies Act, 2013 "sweat equity shares" means such equity shares as are issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called;

For the purposes of above-

(i) the expressions ''Employee'' means-

(a) a permanent employee of the company who has been working in India or outside India; or

(b) a director of the company, whether a whole time director or not; or

(c) an employee or a director as defined in sub-clauses (a) or (b) above of a subsidiary, in India or outside India, or of a holding company of the company;

(ii) the expression 'Value additions' means actual or anticipated economic benefits derived or to be derived by the company from an expert or a professional for providing know-how or making available rights in the nature of intellectual property rights, by such person to whom sweat equity is being issued for which the consideration is not paid or included in the normal remuneration payable under the contract of employment, in the case of an employee.

Conditions to be fulfilled

(1) The issue is authorized by a special resolution passed by the company;

(2) The resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;

(3) The special resolution authorizing the issue of sweat equity shares shall be valid for making the allotment within a period of not more than twelve months from the date of passing of the special resolution.

(4) The sweat equity shares issued to directors or employees shall be locked in/non-transferable for a period of three years from the date of allotment and the fact that the share certificates are under lock-in and the period of expiry of lock-in shall be stamped in bold or mentioned in any other prominent manner on the share certificate.

(5) Where the equity shares of the company are listed on a recognized stock exchange, the sweat equity shares are issued in accordance with the regulations made by the Securities and Exchange Board in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with the Companies (Share Capital and Debentures) Rules, 2014.

Quantum of sweat equity share

The company shall not issue sweat equity shares for more than fifteen percent of the existing paid up equity share capital in a year or shares of the issue value of rupees five crores, whichever is higher.

Provided that the issuance of sweat equity shares in the company shall not exceed twenty five percent, of the paid up equity capital of the company at any time.

Provided further that a startup company, as defined in notification number GSR 180(E) dated 17th February, 2016 issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India, may issue sweat equity shares not exceeding fifty percent of its paid up capital upto five years from the date of its incorporati on or registration.

Pricing of sweat equity share

(1) The sweat equity shares to be issued shall be valued at a price determined by a registered valuer as the fair price giving justification for such valuation.

(2) The valuation of intellectual property rights or of know how or value additions for which sweat equity shares are to be issued, shall be carried out by a registered valuer, who shall provide a proper report addressed to the Board of Directors with justification for such valuation.

(3) A copy of gist along with critical elements of the valuation report obtained under clause (1) and clause (2) shall be sent to the shareholders with the notice of the general meeting.

Procedure for issue of sweat equity share

For issue to sweat equity shares, the following broad procedure needs to be followed:

(1) Convene and hold a board meeting to consider the proposal of issue of sweat equity shares and to fix up the date, time, place and agenda for general meeting and to pass a special resolution for the same.

(2) Issue notices in writing to shareholders for general meeting alongwith explanatory statement. The explanatory statement to be annexed to the notice for the general meeting pursuant to section 102 of the Act must contain the following particulars:

  (a) the date of the Board meeting at which the proposal for issue of sweat equity shares was approved;

  (b) the reasons or justification for the issue;

  (c) the class of shares under which sweat equity shares are intended to be issued;

  (d) the total number of shares to be issued as sweat equity;

  (e) the class or classes of directors or employees to whom such equity shares are to be issued;

  (f) the principal terms and conditions on which sweat equity shares are to be issued, including basis of valuation;

  (g) the time period of association of such person with the company;

  (h) the names of the directors or employees to whom the sweat equity shares will be issued and their relationship with the promoter or/and Key Managerial Personnel;

- (i) the price at which the sweat equity shares are proposed to be issued;
- (j) the consideration including consideration other than cash, if any to be received for the sweat equity;
- (k) the ceiling on managerial remuneration, if any, be breached by issuance of such sweat equity and how it is proposed to be dealt with;
- (l) a statement to the eff that the company shall conform to the applicable accounting standards; and
- (m) diluted Earnings per Share pursuant to the issue of sweat equity shares are calculated in accordance with the applicable accounting standards.

(3) Convene the General Meeting and Pass a special resolution;

(4) File the resolution with MCA in Form No. MGT-14 within 30 days of passing the same;

(5) Call a Board meeting and allot sweat equity shares in the meeting;

(6) File Form No. PAS-3 within 30 days of passing of the Board resolution for allotting sweat equity shares;

(7) The company shall maintain a Register of Sweat Equity Shares in Form No. SH-3 and shall forthwith enter therein the particulars of Sweat Equity Shares issued.

(8) The Register of Sweat Equity Shares shall be maintained at the registered office of the company or such other place as the Board may decide.

(9) The entries in the register shall be authenticated by the Company Secretary of the company or by any other person authorized by the Board for the purpose.

Disclosure in the directors' report in respect of sweat equity share

The Board of Directors shall, inter alia, disclose in the Directors' Report for the year in which such shares are issued. The following are the details about the issue of sweat equity shares namely:

(1) the class of director or employee to whom sweat equity shares were issued;

(2) the class of shares issued as Sweat Equity Shares;

(3) the number of sweat equity shares issued to the directors, key managerial personnel or other employees showing separately the number of such shares issued to them, if any, for consideration other than cash and the individual names of allottees holding one percent or more of the issued share capital;

(4) the reasons or justification for the issue;

(5) the principal terms and conditions for the issue of sweat equity shares, including pricing formula;

(6) the total number of shares arising as a result of issuing of sweat equity shares; the percentage of the sweat equity shares of the total post issued and paid up share capital;

(8) the consideration (including consideration other than cash) received or benefit accrued to the company from the issue of sweat equity shares;

(9) the diluted Earnings Per Share (EPS) pursuant to issuance of sweat equity shares.

Accounting treatment of sweat equity share issued

(1) Where sweat equity shares are issued for a non-cash consideration on the basis of a valuation report in respect thereof obtained from the registered valuer, such non-cash consideration shall be treated in the following manner in the books of account of the company

- (a) where the non-cash consideration takes the form of a depreciable or amortizable asset, it shall be carried to the balance sheet of the company in accordance with the accounting standards; or
- (b) where clause (a) is not applicable, it shall be expensed as provided in the accounting standards.

(2) The amount of sweat equity shares issued shall be treated as part of managerial remuneration for the purposes of sections 197 and 198 of the Act, if the following conditions are fulfilled, namely.-

(i) the sweat equity shares are issued to any director or manager; and

(ii) they are issued for consideration other than cash, which does not take the form of an asset which can be carried to the balance sheet of the company in accordance with the applicable accounting standards.

(3) In respect of sweat equity shares issued during an accounting period, the accounting value of sweat equity shares shall be treated as a form of compensation to the employee or the director in the financial statements of the company, if the sweat equity shares are not issued as pursuant to the acquisition of an asset.

(4) If the shares are issued as pursuant to the acquisition of an asset, the value of the asset, as determined by the valuation report, shall be carried in the balance sheet as per the Accounting Standards, and such amount of the accounting value of the sweat equity shares that is in excess of the value of the asset acquired, as per the valuation report, shall be treated as a form of compensation to the employee or the director in the financial statements of the company.

Explanation.- For the purposes of this sub-rule, it is hereby clarified that the accounting value shall be the fair value of the sweat equity shares as determined by a registered valuer under Rule 8(6) of the Companies (Share Capital and Debentures) Rules, 2014.

ISSUE OF RIGHT SHARES

Meaning: Right issue means offering shares to existing members in proportion to their existing shareholding

(1) Where at any time, a company having a share capital proposes to increase its subscribed capital by the issuing further shares, such shares shall be offered –

(a) to persons who, at the date of the offer, are holders of equity shares of the company in proportion, as nearly as circumstances admit, to the paid up share capital on those shares by sending a letter of offer subject to the following conditions, namely: -

(i) the offer shall be made by notice specifying the number of shares offered and limiting a time not being less than fifteen days and not exceeding thirty days from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined;

(ii) unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person; and the notice referred to in clause (i) shall contain a statement about this right;

(iii) after the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice was given and he declined to accept the shares offered, the Board of Directors may dispose of them in such manner which is not disadvantageous to the shareholders and company;

(b) to employees under a scheme of employees' stock option, subject to special resolution passed by company and subject to such conditions as may be prescribed; or

(c) to any persons, if it is authorized by a special resolution, whether or not those persons include the persons referred to in clause (a) or clause (b), either for cash or for a consideration other than cash, if the price of such shares is determined by the valuation report of a registered valuer subject to such conditions as may be prescribed.

(2) The notice referred to in sub-clause 1(a)(i) above shall be despatched through registered post or speed post or through electronic mode to all the existing shareholders at least three days before the opening of the issue.

(3) Nothing in this section shall apply to the increase of the subscribed capital of a company caused by the exercise of an option as a term attached to the debentures issued or loan raised by the company to convert such debentures or loans into shares in the company:

Provided that the terms of issue of such debentures or loans containing such an option have been approved before the issue of such debentures or the raising of loans by a special resolution passed by the company in the general body meeting.

ISSUE AND REDEMPTION OF PREFERENCE SHARES

Issue of preference shares

A company which is limited by shares, if the articles so authorize,can issue preference shares liable to be redeemed within a period not exceeding twenty years from the date of their issue under section 55 of the Companies Act, 2013. No company limited by shares shall issue any irredeemable preference shares.

A company may issue preference shares for a period exceeding 20 years but not beyond 30 years for infrastructure projects (Specified in Schedule VI). However, the redemption is subject to minimum 10% of such preference shares per year from the twenty-first year onwards or earlier, on proportionate basis, at the option of the preference shareholders.

Redemption of preference shares

The preference shares can be redeemed only when they are fully paid up -

– out of the 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 such redemption.

CAPITAL REDEMPTION RESERVE ACCOUNT

If preference shares are to be redeemed out of the profits of a company, a sum equal to nominal amount of shares that are to be redeemed, shall be transferred to a reserve called Capital Redemption Reserve Account out of profits of the company and provisions of this Act relating to reduction of share capital of a company shall apply as if the Capital Redemption Reserve Account were paid up share capital of the company.

> The capital redemption reserve account may be used by the company, in paying up of unissued shares of the company to be issued to members of the company as fully paid bonus shares.

Premium on redemption of preference shares

(a) For the companies whose financial statements comply with the accounting standards as prescribed in section 133, the premium payable on redemption shall be provided out of the profits of the company, before the shares are redeemed.

(b) For redemption of any preference shares issued on or before the commencement of Companies Act, 2013, the premium payable on redemption shall be provided out of the profits of the company, or out of the company's securities premium account, before such shares are redeemed.

(c) For companies whose financial statements need not comply with the accounting standards as under section 133, the premium payable on redemption shall be provided out of the profits of the company, or out of the company's securities premium account, before such shares are redeemed.

Case 1: Redemption of preference shares out of the profits of the company which would otherwise be available for dividend.

In case redeemable preference shares are redeemed out of company profits, which are otherwise available for dividend, the "Capital Redemption Reserve Account" is to be created that will represent the redeemable preference shares in the balance sheet after redemption. This capital redemption reserve should be equivalent to the amount of Preference Shares which are to be redeemed. The profits available for dividend have to be transferred to Capital Redemption Reserve Account.

Journal Entries

1. Transfer profits available for dividend to Capital Redemption Reserve Account:

General Reserve Account	Dr.	as the case may be
Profit and Loss Appropriation A/c	Dr.	
Dividend Equalization Account	Dr.	
To Capital Redemption Reserve A/c		with the nominal value of the shares to be redeemed

2. If current assets are realized to provide cash for redemption of preference shares:

Bank A/c	Dr.	
To Respective Assets Account		with the realized value of assets

3. On transfer of redeemable preference share-capital to be redeemed to Preference Shareholders Account:

Redeemable Preference Share-Capital A/c	Dr.	with the nominal value of the shares to be redeemed
To Preference Shareholders A/c		

4. If preference shares are redeemed at a premium:

Redeemable Preference Share-Capital A/c	Dr.	
Premium on Redemption of Preference Shares A/c	Dr.	with the amount of premium payable
To Preference Shareholders A/c		

5. For providing premium on redemption of preference shares:

Securities Premium Account	Dr.	with amount of premium paid on redemption
or Profit and Loss Appropriation A/c	Dr.	
To Premium on Redemption of Preference Shares Account		

6. On redemption of preference shares:

Preference Shareholders Account	Dr.	with the amount paid
To Bank A/c		

Illustration 6:

Hello Ltd. had an issue of 2,000, 10% Redeemable Preference Shares of Rs 100 each, repayable at a premium of 10%. These shares are to be redeemed out of the accumulated reserves, which are more than the necessary sum required for redemption. Show the necessary entries in the books of the company, assuming that the premium on redemption of shares has to be written off against the company's Securities Premium Reserves.

Solution:

Journal

Particulars		Dr. (Rs)	Cr.(Rs)
General Reserve Account	Dr.	2,00,000	
To Capital Redemption Reserve A/c			2,00,000
(Transfer of reserves to Capital Redemption Reserve Account on Redemption of Redeemable Preference Shares)			
10% Redeemable Preference Share Capital A/c	Dr.	2,00,000	
Premium on Redemption of Preference Shares A/c	Dr.	20,000	
To 12% Preference Shareholders A/c			2,20,000
(Amount payable to 10% preference shareholders on redemption of 10% preference shares at a premium of 10%)			

Securities Premium Reserves Dr.	20,000	
To Premium on Redemption of Preference Share A/c		20,000
(Application of Securities Premium Account to write off premium on Redemption of Preference Shares)		
10% Preference Shareholders A/c Dr.	2,20,000	
To Bank A/c		2,20,000
(Amount due to 10% preference shareholders on redemption paid)		

Note: Capital Redemption Reserve Account replaces the 10% Redeemable Preference Shares Capital Account and the capital structure of the company remains unchanged.

Case 2: If the redeemable preference shares are redeemed out of the proceeds of a fresh issue of shares made for the purpose of redemption:

In a case where redeemable preference shares are redeemed out of proceeds received from fresh issue of shares, the Share Capital Account raised by fresh issue shall take the place of Redeemable Preference Share Capital Account after redemption. Thus, in such a case, new Share Capital Account (Equity or Preference) must be equal to the redeemable preference shares redeemed.

First of all, entries for fresh issue of shares will be passed. Then entries for redemption passed as has been given in the previous case.

Illustration 7:

Diamond Ltd. has part of its share capital consisting of 20000, 12% Redeemable Preference Shares of Rs 100 each, repayable at a premium of 10%. The shares have now become ready for redemption. It is decided that the whole amount will be redeemed out of a fresh issue of 20,000 equity shares of Rs 10 each at Rs 15 each. The whole amount is received in cash and the 12% preference shares are redeemed for the relevant portion.

Show the necessary journal entries in the books of the company.

Solution:

Journal

Particulars	**Dr. Rs)**	**Cr. (Rs)**
Bank Dr.	3,00,000	
To Equity Share Application and Allotment A/c		3,00,000
(Application money on 20,000 equity shares @ Rs 15 per share including a premium of Rs 5 per share)		
Equity Share Application and Allotment A/c Dr.	3,00,000	
To Equity Share Capital A/c		200,000
To Securities Premium Reserves A/c		100,000
(Allotment of 20,000 equity shares Rs 10 each issued at a premium of 5 per share as per Board's Resolution dated....)		
12% Redeemable Preference Share Capital A/c Dr.	2,00,000	
Premium on Redemption of Preference Share A/c Dr.	10,000	
To 12% Preference Shareholders A/c		2,10,000
(Amount due to 12% preference shareholders on redemption of 8% preference shares at a premium of 5%)		

Securities Premium Reserves A/c Dr.	10,000	
To Premium on Redemption of Preference Shares A/c		10,000
(Application of Securities Premium Account to write off Premium on Redemption of Preference Shares)		
12% Preference Shareholders A/c Dr.	2,10,000	
To Bank A/c		2,10,000
(Amount due to 12% preference shareholders on redemption paid)		

Case 3: If the redeemable preference shares are redeemed partly out of the profits of the company which would otherwise be available for dividend and partly out of the proceeds of a fresh issue of shares made for the purpose of redemption:

In such a case, the Capital Redemption Reserve Account and the new Share Capital Account taken together

will replace the Redeemable Preference Share Capital redeemed.

Thus, Redeemable Preference Share Capital redeemed = Capital Redemption Reserve Account + New Share Capital Account (Equity or Preference).

Here, all the entries shown under Case (i) and Case (ii) have to be passed. But there are certain common entries which can be combined together.

Illustration 8

Jumpers Ltd

Balance Sheet as at 31st March, 2019

I. EQUITY AND LIABILITIES			
1. Shareholders' funds			
(a) Share Capital	1		350,000
(b) Reserve & Surplus	2		64,000
2. Current Liabilities			
Trade Payable		23,700	
Short-term provisions		38,500	62,200
TOTAL			4,76,200
II. ASSETS			
1. Non-current assets			
(a) Fixed Assets			
I. Tangible fixed assets			2,25,000
(b) Non-Current Investments			60,000
2. Current Assets			
Inventories		1,30,500	
Trade receivable		49,550	
Cash and cash equivalents		9,950	
Other current assets		1,200	1,91,200
TOTAL			4,76,200

Notes

1. Share capital

Authorized Share Capital	
40,000 equity shares of Rs 10 each fully paid up	4,00,000
1000, 8% preference shares of Rs 100 each	1,00,000
	5,00,000
Issued, Subscribed Called Up And Paid up Share Capital	
1000, 10% Preference shares of Rs 100 each fully paid up	1,00,000
25,000 equity shares of Rs 10 each fully paid up	2,50,000
	3,50,000

2. Reserve and Surplus

Securities Premium Reserves	9,000
Surplus Account	55,000
	64,000

In order to redeem its preference shares, the company issued 5,000 equity shares of' 10 each at a Premium of 10% and sold its investment of' 70,800. Preference shares were redeemed at a premium of 10%.

Show the necessary journal entries in the books of the company.

Solution:

Particulars		**Dr. (Rs)**	**Cr. (Rs)**
Bank A/c	Dr.	55,000	
To Equity Share Application and Allotment A/c			55,000
(Application money received on 5,000 equity shares of Rs. 10 at a premium of 10%).			
Equity Share Application and Allotment A/c	Dr.	55,000	
To Equity Share Capital A/c			50,000
To Securities Premium Reserves A/c			5,000
(Allotment of 5000 equity shares of Rs. 10 each issued at a premium of 10% as per Board's resolution dated....)			
Surplus A/c	Dr.	50,000	
To Capital Redemption Reserve A/c			50,000
(Transfer of the balance amount of the nominal value preference shares to be redeemed not covered by fresh issue, i.e., Rs 1,00,000 - 50,000 on redemption to Capital Redemption Reserve A/c)			
Bank A/c	Dr.	70,800	
To Investments A/c			60,000
To Surplus A/c			10,800
(Sale on Investments at a profit and transfer of profit on sale to Profit and Loss A/c)			

10% Redeemable Preference Share Capital A/c	Dr.	1,00,000	
Premium on Redemption of Preference Shares A/c	Dr.		10,000
To 10% Preference Shareholders A/c			1,10,000
(Amount due to 8% preference shareholders on redemption)			
Securities Premium Reserves A/c	Dr.	10,000	
To Premium on Redemption of Preference Shares A/c			10,000
(Application of securities premium to write off premium on redemption of preference shares)			
10% Preference Shareholders A/c	Dr.	1,10,000	
To Bank A/c			1,10,000
(Amount due to 10% Preference Shareholders on redemption paid)			

Note: In the above example, the capital structure of the company remains unchanged, as seen by fact - the Equity Share Capital is issued at Rs 50,000 and Capital Redemption Reserve is at Rs 50,000, which jointly replaces 10% Redeemable Preference Share Capital Rs 1,00,000.

UNDERWRITING OF SHARES

1. Underwriting is a process which refers to a definite and unambiguous assurance by underwriter(s) to take up a fixed number of shares/ debentures of a company irrespective of shares or debentures subscribed for by public. In such cases, underwriters are committed to subscribe to pre-agreed number of shares or debentures, along with unsubscribed shares or debentures, if any. Even if issue of shares is over-subscribed, underwriters are liable to take up the decided number of shares of debentures.

2. *Underwriters and Brokers*:

   Brokers merely promise to attempt to secure subscriptions of shares or debentures issued. However, they are not responsible for subscribing to shares or debentures of the company. Brokers only procure subscriptions for shares/debentures from public on company's behalf. The remuneration they get for their service rendered to the company is known as brokerage.

   Underwriters are the individuals or institutions underwriting a public issue of shares or debentures. The underwriters may be individuals, partnership firms or joint stock companies Some specialized financial institutions set up by the Government in public sector also play an active role in underwriting shares or debentures.

3. *Types of Underwriting*

   Two kinds of underwriting agreement are given below:

   (a) Complete Underwriting

   In case of complete underwriting, the whole issue of shares or debentures is underwritten. It may be underwritten by a single firm or institution, agreeing to take the complete risk. It can also be done by multiple firms or institutions together, each agreeing to take risk only to a limited extent.

   (b) Partial Underwriting

   In cases where only a part of shares or debentures issue of a company is underwritten, it is said to be partial underwriting.

4. *Underwriting Commission*

   It is the consideration which is payable to underwriters for underwriting an issue of shares/ debentures of a company. Underwriting commission is paid at a specified rate on the issue price of the whole of the shares or debentures underwritten, whether the underwriters are called upon to take up any shares or debentures not. In totality, the risk bore by the underwriters, bears them the fruit of commission. Underwriting commission may also be along with a brokerage amount.

5. *Payment of Underwriting Commission*

Section 40(6) of the Companies Act 2013, provides that a company may pay commission to any person in connection with the subscription or procurement of subscription to its securities, whether absolute or conditional, subject to the following conditions which are prescribed under Companies (Prospectus and Allotment of Securities) Rules, 2014:

(a) the payment of such commission shall be authorized in the company's articles of association;

(b) the commission may be paid out of proceeds of the issue or the profit of the company or both;

(c) the rate of commission paid or agreed to be paid shall not exceed, in case of shares, five percent (5%) of the price at which the shares are issued or a rate authorized by the articles, whichever is less, and in case of debentures, it shall not exceed two and a half per cent (2.5%) of the price at which the debentures are issued, or as specified in the company's articles, whichever is less;

(d) the prospectus of the company shall disclose -

- the name of the underwriters;
- the rate and amount of the commission payable to the underwriter; and
- the number of securities which is to be underwritten or subscribed by the underwriter absolutely or conditionally.

(e) there shall not be paid commission to any underwriter on securities which are not offered to the public for subscription;

(f) a copy of the contract for the payment of commission is delivered to the Registrar at the time of delivery of the prospectus for registration.

Thus, the underwriting commission is limited to 5% of issue price in case of shares, and 2.5% in case of debentures. The rates of commission given above are the maximum rates, and if the company negotiates with the underwriter, it may pay lower rates also.

Marked and Unmarked Applications

When shares/ debentures issue of a company is underwritten by two or more persons, the applications for shares/ debentures sent through underwriters should bear a stamp of the respective underwriters. If it is not done, it would be very difficult for the company to determine the number of applications from each underwriter and in turn it will become an issue in determining the liability of each of the underwriters. Hence, "Marked Applications" are the ones bearing stamp of respective underwriters, while the applications received directly by the company, and which do not bear the stamp of underwriters are known as "Unmarked Applications".

If the entire share/debenture issue is underwritten by a single underwriter, marking of applications becomes immaterial since he is to get paid for all the applications. Whether sent through him or received directly while determining his liability. When the shares/ debentures issue is underwritten by more than one underwriter, the risk is distributed among all underwriters in a pre-agreed ratio.

6. *Determining the Liability of Underwriters*

An underwriter's liability can be determined in the following ways: In case of Complete Underwriting:

(a) *In case of a single underwriter*: The underwriter will be liable to take up all the shares or debentures that have not been subscribed for by the public. In such a case, it is not material to know how many applications are sent through him and how many applications are received directly by the company. Thus, the liability of the underwriter in such a case will be as follows:

Liability = Shares or debentures offered - Total applications received.

If shares/ debentures are oversubscribed or fully subscribed by the public, the underwriter is free from his liability and is not liable to take up any shares or debentures of the company. However, he will be entitled to get the commission which is due to him on the total issue price of the shares or debentures.

(b) In case issue is underwritten by a number of underwriters in an agreed ratio the liability of the respective underwriters can be determined as under:

Gross liability of every individual underwriter in agreed ratio would first be reduced by marked applications and then credit may be given in respect of unmarked applications, sent directly to the company by way of deduction from the balance left in the ratio of their gross liability. The liability of each underwriter in such a case will be:

Gross liability according to the agreed ratio	....
Less: Marked applications	....
Balance left	....
Less: Unmarked applications in the ratio of gross liability	....
Net liability	....

At times credit to unmarked application is given in the ratio of gross liability as reduced by the marked applications. In this case, the individual liability calculated will differ from the liability calculated as per the previous procedure.

Note: In case some figure is negative it will be transferred to other underwriters' account in the ratio of gross liability inter se.

In case of Partial Underwriting

(a) If a part of the issue of shares or debentures is underwritten only by one underwriter: In such a case only a part of the whole issue, like 60% or 70% is underwritten only by a single underwriter and for the balance 40% or 30% of the issue, company itself is said to underwrite the same. In this case, unmarked applications are treated as marked as far as the company is concerned.

In such a case, the gross liability of the underwriter will be that part of the issue of shares or debentures which is underwritten, say 60% or 70% and the net liability will be determined by deducting the marked applications (the applications sent through him) from the gross liability. Thus, the net liability will be determined as follows:

(b) Net liability = Gross liability (say 60% or 70% of the issue) - Marked applications.

(c) If the part of the issue of shares or debentures is underwritten by a number of underwriters: In such a case part of the whole issue, like 70% or 80% is underwritten by a number of underwriters and for the balance 30% or 20%, the company itself is said to have underwritten the same. As such, the unmarked applications are treated as marked so far as the company is concerned. In such a case, the method of determining the net liability of the respective underwriters is similar to the method discussed above (a).

7. *Firm Underwriting*

In the case of 'firm underwriting', the underwriters take up the agreed number of shares or debentures to be 'firm underwritten' in addition to unsubscribed shares or debentures, if any. In such an instance an underwriter is not allowed to set off his firm underwriting against his liability otherwise determined, he will then have to subscribe for both shares/debentures 'underwritten firm' and for shares which he has to take under the underwriting contract, ignoring firm underwriting.

While computing the individual liability of the underwriters, the 'firm underwriting' can be dealt with in any of the below mentioned manner in case of no specific instructions:

(a) The 'firm underwriting' may be adjusted against the individual liability of each underwriter separately or may be treated at par with marked applications.

When firm underwriting is treated at par with marked applications the statement of liability of underwriters will be as under :

Gross Liability (agreed ratio-total shares underwritten)	....
Less: Marked applications including firm underwriting	....
Balance left	....
Less: Unmarked application (ratio of gross liability)	....
Net liability	....
Add: Firm underwriting	....
Total Liability	....

(b) The benefit of 'firm underwriting' may be shared by all underwriters or 'firm underwriting' may be treated at par with unmarked applications. In such a case, the shares/debentures underwritten firm will be included in the unmarked forms. Hence, the state of liability of underwriters will appear as shown above except that shares/debentures underwritten firm by each underwriter will not be specifically adjusted against his individual liability but will be included in the total unmarked forms to be distributed amongst all underwriters in the ratio of their gross liability.

Note : If the question is not specific regarding the treatment of 'firm underwriting' students may follow anyone of the treatments discussed above and may give a footnote to this effect.

8. *Accounting Treatment relating to Underwriting of Shares or Debentures*

(a) *Whe*n the shares or debentures are allotted to the underwriters in respect of their liability:

Underwriters A/c	Dr.	with the value of the shares or debentures taken
To Share Capital A/c		up by the underwriters
To Debentures A/c		

(b) When commission becomes payable to the underwriters:

Underwriters Commission A/c	Dr.	with the amount of commission due on the total
To Underwriters A/c		issue price of the shares underwritten

(c) When the net amount due from the underwriters on the shares or debentures taken up by them is received:

Bank	Dr.	with the net amount due
To Underwriters A/c		

Note: Underwriting commission is not generally paid in cash. Instead the same is adjusted against the money due on shares or debentures taken up by the underwriters and only the net amount (i.e., total amount due on shares or debentures taken up by the underwriters minus the underwriting commission) is received from the underwriters.

Illustration 9:

Lillies Ltd. issued 1,00,000 equity shares, where the issue was underwritten by 3 underwriters as follows: A 40%; B 30%; C 30%

Applications for 60,000 shares were received in all, out of which applications for 20,000 shares had the stamp of A; those for 10,000 shares that of B and those for 20,000 shares that of C. The remaining applications for 10,000 shares did not bear any stamp.

Determine the liability of the underwriters.

Solution:

Net Liability of Underwriters

	A (40%) Shares	B (30%) Shares	C (30%) Shares
Gross liability in the agreed ratio of 40 : 30 : 30	40,000	30,000	30,000
Less: Marked applications	20,000	10,000	20,000
Balance left	20,000	20,000	10,000
Less: Unmarked applications in the ratio of gross liability, i.e., 40 : 30 : 30 (10,000 Unmarked)	4,000	3,000	3,000
Net liability	16,000	17,000	7,000

Illustration 10:

Ramona Ltd., issued 50,000 equity shares of which only 60% was underwritten by Green. Applications for 45,000 shares were received in all out of which application for 26,000 were marked.

Determine the liability of Green.

Solution:

Gross liability of Green being 60% of 50,000 shares	=	30,000 shares
Less: Marked applications Net liability of Green	=	26,000 shares
Net liability of Green	=	4,000 shares

Notes:

(1) Had the marked applications been were for 30,000 shares or more, Green would have had no liability at all.

(2) Had the applications received by the company been for all the 50,000 shares Green would have had no liability at all, even though the marked applications were for 26,000 shares.

(3) Had the applications received by the company been for 48,000 shares, Green's liability would have had restricted to (50,000 - 48,000) = 2,000 shares, even though the marked applications were for 26,000 shares.

Working Assumption: In case the marked and unmarked applications is not be given in the question, then one can assume the number of applications received as marked applications (as proportionate to that part of the issue underwritten as received through the underwriters.)

Illustration 11:

ABC Ltd. issued 30,000, 6% debentures of Rs. 100 each. 60% of the issue was underwritten by Delton. Applications for 28,000 debentures were received by the company. Determine the liability of Delton.

Solution:

Gross liability of Delton being 60% of 30,000 debentures	= 18,000 debentures
Less: Marked applications (assumed 60%) i.e., 60/100 x 28,000	= 16,800 debentures
Net liability of Delton	= 1,200 debentures

Alternatively Delton's liability can be determined in the following way:

Number of debentures not subscribed for by the public = (30,000 - 28,000)	= 2,000 debentures
Delton's liability = 60% of 2,000 debentures	= 1,200 debentures

Illustration 12:

Binsar Ltd. issued 12% 10,000 Preference Shares of Rs 10 each. The issue was underwritten as follows: Apple 30%, Mango 30%, Orange 20%. Application for 8,000 shares were received by the company in all. Determine the liability of the respective underwriters.

Solution:

	Apple (30%) Shares	**Mango (30%) Shares**	**Orange (20%) Shares**
Gross liability in the agreed ratio or 30 : 30 : 20	3,000	3,000	2,000
Less: Marked application, i.e., 8,000 application in the ratio of 3/10 : 3/20 : 2/10	2,400	2,400	1,600
Net liability	600	600	400

Alternatively the liability of the respective underwriters can also be determined in the following manner:

Shares issued 10,000

Less: Applications received 8,000 Unsubscribed shares 2,000

Apple's liability = 30% of 2,000 = 600 shares

Mango's liability = 30% of 2,000 = 600 shares

Orange's liability = 20% of 2,000 = 400 shares

Total liability of Apple, Mango and Orange = 600 + 600 + 400 = 1,600 shares.

which represent 80% of the total issue underwritten. The balance (2,000 - 20% of the issue not underwritten will remain as unissued. 1,600) = 400 shares representing

Illustration 13:

Emess Ltd. issued 40,000 shares which were underwritten. P: 24,000 shares Q: 10,000 shares and R: 6,000

shares. The underwriters made applications for firm underwriting as under:

P: 3,200 shares; Q: 1,200 shares; and R: 4,000 shares. The total subscriptions excluding firm underwriting (including marked applications) were 20,000 shares.

The marked applications were - P: 4,000 shares; Q: 8,000 shares; and R: 2,000 shares

Prepare a statement showing the net liability of underwriters

Solution:

Working Note: Firm underwriting shares are treated as unmarked applications.

Statement of Computation of Liability

	P	**Q**	**R**	**Total**
Gross Liability	24000	10000	6000	40000
Less: marked Applications	4000	8000	2000	14000
Balance	20000	2000	4000	26000
Less: Unmarked Applications in ratio of gross Liability (12:5:3)	8640	3600	2160	14400
Balance Net	11360	(1600)	1840	11600
Credit of Q's capital over P & R in ratio of 12:3	(1280)	+1600	(320)	

Net Liability	10,080	0	1,520	11,600
Add: Firm Underwriting	3,200	1,200	4,000	8,400
Total Liability	**13,280**	**1,200**	**5,520**	**20,000**

Illustration 14:

Sam Limited invited applications from public for 1,00,000 equity shares of Rs 10 each on a premium of X 5 per share. The entire issue was underwritten by the underwriters Anita, Babita, Chavi and David to the extent of 30%, 30%, 20% and 20% respectively with the provision of firm underwriting of 3,000, 2,000, 1,000 and 1,000 shares respectively. The underwriters were entitled to the maximum commission permitted by law.

The company received applications for 70,000 shares from public out of which applications for 19,000, 10,000; 21000 and 8,000 shares were marked in favour of Anita, Babita, Chavi and David respectively.

Calculate the liability of each one of the underwriters. Also ascertain the underwriting commission @ 2.5% payable to the different underwriters.

Solution:

Statement of Liability of Underwriters:

Note: by treating 'firm underwriting shares' on a par with marked applications

	Anita	**Babita**	**Chavi**	**David**	**Total**
Gross Liability	30000	30000	20000	20000	100,000
Less: marked Applications	19000	10000	21000	8000	58000
Balance	11000	20000	(1000)	12000	42000
Less: unmarked Applications in ratio of gross Liability (30;30:20:20)	3600	3600	2400	2400	12000
Balance Net	7400	16400	(3400)	9600	30000
Less: Firm Underwriting	3000	2000	1000	1000	7000
Balance	4400	14400	(4400)	8600	23000
Less: Credit of excess to others in ratio (30:30:20)	(1650)	(1650)	+4400	(1100)	
Net Liability	2750	12750	0	7500	23000
Total Liability, including Firm Underwriting	**5750**	**14750**	**1000**	**8500**	**30000**

Alternatively, the 'firm underwriting shares' may be treated on a par with unmarked applications. Applications received including firm underwritten = 70,000 + 7,000 = 77,000

Less: Marked application = 58,000

Net Unmarked Application liability of underwriters (No. of Shares) = 19,000

	Anita	**Babita**	**Chavi**	**David**	**Total**
Gross Liability	30000	30000	20000	20000	100,000
Less: unmarked Applications in ratio of gross Liability (30:30:20:20)	5700	5700	3800	3800	19,000
Balance	24300	24300	16200	16200	81,000
Less: Marked Application	19000	10000	21000	8000	58000
Balance Net	5300	14300	(4800)	8200	23000

Adjustment of excess	(1800)	(1800)	+4800	(1200)	
Balance	3500	12500	-	7000	23000
Add: Firm Liability	3000	2000	1000	1000	7000
Total Liability, including Firm Underwriting	6500	14500	1000	8000	30000

Calculation of Underwriting commission

Underwriting commission is payable at the rate of 2.5% of the issue price of shares;	Amount
A = 30000 * 15 * 2.5%	11,250
B = 30000 * 15 * 2.5%	11,250
C = 20000 * 15 * 2.5%	7,500
D = 20000 * 15 * 2.5%	7,500

LESSON ROUND-UP

- Share represents a singular unit into which the total share capital of a company is divided.
- Share capital includes majorly the following two types of shares under the Companies Act, 2013:
  (a) preference shares and (b) equity shares.
- An equity share is the one which is not a preference share. Equity shares are also known for their risk-bearing. Preference shares are the shares that hold preferential rights as to the payment of dividend at a fixed rate; and the return of capital on winding up of the company.
- Shares may be issued for cash or for a consideration other than cash. When a company allots fully paid shares to promoters or to creditors or to any other party for the services rendered by them, it is known as issue of shares for consideration other than cash.
- Shares of a company may be issued at :
  a. Par – When shares are issued on a price equivalent to its face value.
  b. Premium – When shares are issued at a price higher than the face value.
  c. Discount – When shares are issued at a price lower than the face value.
- Restrictions on the usage of the Securities premium money received has been laid under section 52 (2) of Companies Act 2013
- When the number of shares applied for exceeds the number of shares issued, the shares are said to be oversubscribed. In such a case, some applications may be rejected; some applications are accepted in full; and allotment is made to the remaining applicants on pro-rata basis.
- Forfeiture of shares is considered as the compulsory termination of membership by way of penalty for non-payment of allotment and/or any call money.
- The forfeited shares may be reissued at:
  a. Par
  b. Premium
  c. Discount
- In case of reissue of forfeited shares at a premium, the entire amount standing to the credit of Shares Forfeited Account would be treated as net gain and transferred to Capital Reserve Account.

- In case the forfeited shares are reissued at a discount, the amount of discount can, in no case, exceed the amount credited to Shares Forfeited Account.
- As per Section 68, 69, 70 of the Companies Act, 2013, a company may purchase its own shares or other specified securities out of its free reserves and this is known as buy-back.
- A company is under a legal obligation to first offer the subsequent issue of shares to its existing equity shareholders. This right is called rights issue.
- Company may issue fully paid up bonus shares to its members, in any manner out of (i) its free reserves; (ii) the securities premium account; or (iii) the capital redemption reserve account.
- Sweat equity shares refers to equity shares given to the company's employees/ directors on favourable terms in recognition of their work at a discount or consideration other than cash
- Underwriting is known as a guarantee given by the underwriters to the company that the shares or debentures offered to the public will be subscribed for in full. An underwriting agreement may be:
  a. Complete Underwriting
  b. Partial Underwriting. Firm Underwriting.

TEST YOURSELF

1. Distinguish between equity shares and preference shares.
2. Discuss the classes of shares on the basis of participation.
3. Enumerate the restrictions on application of premium money received.
4. ABC Ltd. brought out an issue which was oversubscribed. What option does the company have in case of over subscription?
5. Describe the accounting treatment of Calls in advance.
6. What do you mean by share forfeiture?
7. Discuss the advantages of buy-back of shares.
8. Enumerate the procedure for issue of sweat equity shares.
9. Elaborate the types of underwriting options available to a company.