

SHARES AND SHARE CAPITAL

Introduction:

There are three main types of business organisation: (1) sole proprietorship (2) partnership (3) company. Each form of business organisation is required capital to carry on its business smoothly. On sole proprietorship the whole capital is contributed by sole proprietor in partnership the capital is invested by the partners and in case of company capital is invested by the public.

Meaning of share and share capital:

A share is one unit into which the total share capital is divided. Share capital of the company can be explained as a fund or sum with which a company is formed to carry on the business and which is raised by the issue of shares.

The amount collected by the company from the public towards its capital, collectively is known as share capital and individually is known as share.

A share is not a sum of money but is an interest measured by a sum of money and this interest also contains bundle of rights and obligations contained in the contract i.e. Article of Association.

Investment in the shares of any company is a basis of ownership in the company and the person who invest in the shares of any company, is known as the shareholder, member and the owner of that company.

Definition:

According to the section 2(46) of the Company's Act 1956, share means a part in the share capital of the company and it also includes stock except where a distinction between stock and share capital is made expressed or implied.

Types of shares:

As per the provision of section 85 of the Companies Act, 1956, the share capital of a company consists of two classes of shares, namely:

Preference Shares

Equity Shares

Preference Shares:

According to Sec 85(1), of the Companies Act, 1956, a preference share is one, which carries the following two preferential rights:

- (a) The payment of dividend at fixed rate before paying dividend to equity shareholders.
- (b) The return of capital at the time of winding up of the company, before the payment to the equity shareholder.

Both the rights must exist to make any share a preference share and should be clearly mentioned in the Articles of Association.

Preference shareholders do not have any voting rights, but in the following conditions they can enjoy the voting rights:

- (1) In case of cumulative preference shares, if dividend is outstanding for more than two years.
- (2) In case of non-cumulative preference shares, if dividend is outstanding for more than three years.
- (3) On any resolution of winding up.
- (4) On any resolution of capital reduction.

Types of preference shares:

In addition to the aforesaid two rights, a preference shares may carry some other rights. On the basis of additional rights, preference shares can be classified as follows:

Cumulative Preference Shares: Cumulative preference shares are those shares on which the amount of dividend if not paid in any year, due to loss or inadequate profits, then such unpaid dividend will accumulate and will be paid in the subsequent years before any dividend is paid to the equity share holders. Preference shares are always deemed to be cumulative unless any express provision is mentioned in the Articles.

- 1) **Non-Cumulative Preference Shares:** Non-cumulative preference shares are those shares on which arrear of dividend do not accumulate. Therefore if dividend is not paid on these shares in any year, the right to receive the dividend lapses and as such, the arrear of dividend is not paid out of the profits of the subsequent years.
 - 2) **Participating Preference Shares:** Participation preference shares are those shares, which, in addition to the basic preferential rights, also carry one or more of the following rights:
 - (a) To receive dividend, out of surplus profit left after paying the dividend to equity shareholders.
 - (b) To have share in surplus assets, which remains after the entire capital has been paid on winding up of the company.
 - 4) **Non-Participating Preference Shares:** Non-participation preference shares are those shares, which do not have the following rights:
 - (a) To receive dividend, out of surplus profit left after paying the dividend to equity shareholders.
 - (b) To have share in surplus assets, which remains after the entire capital has been paid on winding up of the company.
- Preference shares are always deemed to be non-participating, if the Article of the company is silent.
- 5) **Convertible Preference Shares:** Convertible preference shares are those shares, which can be converted into equity shares on or after the specified date according to terms mentioned in the prospectus.
 - 6) **Non-Convertible Preference Shares:** Non-convertible preference shares, which cannot be converted into equity shares. Preference shares are always deemed to be non-convertible, if the Article of the company is silent.
 - 7) **Redeemable Preference Shares:** Redeemable preference shares are those shares which can be redeemed by the company on or after the certain date after giving the prescribed notice. These shares are redeemed in accordance with the terms and sec. 80 of the Company's Act 1956.

- 8) **Irredeemable Preference Shares:** Irredeemable preference shares are those shares, which cannot be redeemed by the company during its life time, in other words it can be said that these shares can only be redeemed by the company at the time of winding up. But according to the sec. 80 (5A) of the Company's (Amendment) Act 1988 no company can issue irredeemable preference shares.

Equity shares:

According to section 85 (2), of Companies Act, 1956, Equity share can be defined as the share, which is not preference shares. In other words equity shares are those shares, which do not have the following preferential rights:

- (a) Preference of dividend over others.
- (b) Preference for repayment of capital over others at the time of winding up of the company.

These shares are also known as 'Risk Capital', because they get dividend on the balance of profit if any, left after payment of dividend on preference shares and also at the time of winding up of the company, they are paid from the balance asset left after payment of other liabilities and preference share capital. Apart from this they have to claim dividend only, if the company in its A. G. M. declares the dividend. The rate of dividend on such shares is not pre-determined, but it depends on the profit earned by the company.

The equity shareholders have the right to vote on each and every resolution placed before the company and the holders of these shares are the real owners of the company.

Distinction between Preference Shares and Equity Shares:

Basis of difference	Preference Share	Equity Share
Rate of dividend	The rate of dividend on preference share is fixed.	The rate of dividend on equity share is changed from year to year depending upon the availability of profits.
Payment of dividend	They have a right to receive dividend before any dividend is paid on equity shares.	Dividend on equity shares is paid, after any dividend is paid on preference shares.
Participation in management	Preference shareholders are not entitled to participate in management.	Equity shareholders are entitled to participate in management.
Winding up	On the winding up, they have a right to return of capital ahead (before) of the capital returned on equity shares.	In this case, they have been paid only when preferences capital is paid in full.
Arrears of dividend	If dividend is not paid on these shares in any year, the arrear of dividend may accumulate.	In case of equity shares, dividend cannot accumulate.
Voting rights	Preference shareholders do not have any voting rights.	Equity shareholders enjoy voting rights.

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Sub-division of share capital:

The word capital in connection with a company may mean any of the following divisions of capital:

- 1) **Authorised capital:** An authorised capital refers to that amount which is stated in the 'Capital Clause' of the Memorandum of Association as the share capital of the company. This is the maximum limit of the company which it is authorised to raise and beyond which company cannot raise unless the capital clause in the Memorandum is altered in accordance with the provisions of Sec. 94 of the Companies Act, 1956.
- 2) **Issued capital:** An issued capital refers to the nominal value of that part of authorised capital, which has been (1) subscribed for by the signatories to the Memorandum of Association, (2) allotted for cash or for consideration other than cash and (3) allotted as Bonus shares.
- 3) **Subscribed capital:** Subscribed capital refers to the paid-up value of the issued capital i.e. the total amount called by the company less calls-in-arrear. It is only the actual liability for the company hence it will be only be added while totalling the liability side.

Difference between Authorised Capital and Issued Capital:

Basis of difference	Authorised Capital	Issued Capital
Meaning	It refers to that amount which is stated in the Memorandum of Association as the share capital of the company.	It refers to the nominal (actual) value of that part of authorised capital which has been: (i) Subscribed for by the signatories to the Memorandum of Association and (ii) Allotted for cash or consideration for other than cash.
Consideration of future requirements	Its amount is determined after considering present and future requirements.	Its amount is determined after considering the present requirements.
Disclosure in Memorandum of Association	Its amount is required to be disclosed in Memorandum of Association.	Its amount is not required to be disclosed in Memorandum of Association.
Is it the based of stamp duty?	Stamp duty is payable on the based of authorised capital.	It is not based for calculating stamp duty.
Is it based of company registration fees?	Company registration fee is payable on the based of authorised capital.	It is not the basis for registration fees.
Does the change amount to an alteration of Memorandum?	Any change in the amount of authorised capital amounts to an alteration of Memorandum of Association.	Any change in the amount of issued capital does not amount to an alteration of Memorandum of Association.
Whether one can exceed other	It can exceed issued capital.	It cannot exceed authorised capital.

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Distinction between authorised capital and subscribed capital:

Basis of difference	Authorised Capital	Subscribed capital
Meaning	It refers to that amount which is stated in the Memorandum of Association as the share capital of the company.	It refers to the paid up value of the issued capital.
Consideration of future requirements	Its amount is determined after considering present and future requirements.	Its amount is determined after considering the present requirements.
Disclosure in Memorandum of Association	Its amount is required to be disclosed in Memorandum of Association.	Its amount is not required to be disclosed in Memorandum of Association.
Is it the based of stamp duty?	Stamp duty is payable on the based of authorised capital.	It is not based for calculating stamp duty.
Is it based of company registration fees?	Company registration fee is payable on the basis of authorised capital.	It is not the basis for registration fees.
Does the change amount to an alteration of Memorandum?	Any change in the amount of authorised capital amounts to an alteration of Memorandum of Association.	Any change in the amount of issued capital does not amount to an alteration of Memorandum of Association.
Whether one can exceed other	It can exceed subscribed capital.	It cannot exceed authorised capital.

Meaning of reserve capital:

Under **Section 99** of the Companies Act 1956, sometimes a company by means of special resolution decides that certain portion of its uncalled capital shall not be called up during its existence and it would be available as an additional security to its creditors in the event of its liquidation. Such a portion of uncalled capital is termed as 'Reserve Capital'. It cannot be converted into ordinary uncalled capital without the leave (order) of the court and also it cannot be charged by the company.

Meaning of Capital Reserve:

Capital Reserve originates from sources other than the regular activities of the business. In other words, the reserve, which is created out of capital profit, is known as capital reserve. Dividend cannot be distributed out of this reserve but it can be used to meet capital losses or to declare a bonus share. It is shown in the liability side of the Balance Sheet under the heading of '**Reserve and Surplus**'. Following are the principal sources of capital reserve:

- Profit on sale of a fixed asset.
- Profit on revaluation of assets and liabilities.
- Profit on forfeiture and re-issue of forfeited shares.
- Profit on redemption of debentures at a discount.
- Profit earned by a company prior to its incorporation.

Difference between Reserve capital and capital reserve:

Bases of difference	Reserve Capital	Capital Reserve
Meaning	It means that certain portion of uncalled share	Capital reserve is that reserve which is created out

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	capital which shall not be called up except in the case of liquidation.	of capital profits.
Resolution	A special resolution is passed by the company for its creation.	No need to pass any resolution for its creation.
Amount	It represents the amount which has not been received.	It represents the amount which has already been received.
Accounting treatment	No accounting treatment is made in the books.	Accounting treatment is made in the books and it is shown in the company's Balance Sheet.
Use	It can be called up only at the time of liquidation and used by the company.	It can be used to meet capital losses or to declare a bonus share any time during the life of a company.

Preliminary expenses:

Expenses incurred on the formation of a company are termed as 'Preliminary Expenses'. These include the following:

- Expenses incurred on the preparation and printing of various documents needed for the registration of a company.
- Stamp duty and registration fees on these documents.
- Duty payable on authorised capital.
- Expenses incurred on the preparation, printing, and issue of prospectus.
- Underwriting commission.
- Cost of preliminary books and the common seal.
- In case the company has been formed to purchase a running business, the fees charged by accountant or valuer valuing the assets and liabilities of that business.
- This may be written off against Security Premium account, or against Capital Reserve, otherwise, these may be written off from Profit and Loss Account gradually over some period. The unwritten off portion of such expense is shown on the assets side of the Balance Sheet under the heading 'Miscellaneous Expenditure'.

Procedure of issue of shares:

When company has been registered, the following procedure is adopted by the company to collect money from the public by issuing of shares:

- Issue of prospectus:** When a Public company intends to raise capital by issuing its shares to the public, it invites the public to make an offer to buy its shares through a document called 'Prospectus'. According to Section 60 (1), a copy of prospectus is required to be delivered to the Registrar for registration on or before the date of publication thereof. It contains the brief information about the company, its past record and of the project for which company is issuing share. It also includes the opening date and the closing date of the issue, amount payable with application, at the time of allotment and on calls, name of the bank in which the application money will be deposited, minimum number of shares for which application will be accepted, etc.
- To receive application:** After reading the prospectus if the public is satisfied then they can apply to the company for purchase of its shares on a printed prescribed form. Each application form along with application money must be deposited by the public in a schedule bank and get a receipt for the same. The

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company cannot withdraw this money from the bank till the procedure of allotment has been completed (in case of first allotment, this amount cannot be withdrawn until the certificate to commence business is obtained and the amount of minimum subscription has been received). The amount payable on application for share shall not be less than 5% of the nominal amount of share.

3. **Allotments of shares:** Allotments of shares means acceptance by the company of the offer made by the applicants to take up the shares applied for. The information of allotment is given to the shareholders by a letter known as 'Allotment Letter', informing the amount to be called at the time of allotment and the date fixed for payment of such money. It is on allotment that share come into existence. Thus, the application money on the share after allotment becomes a part of share capital. Decision to allot the share is taken by the Board of Directors in consultation with the stock exchange. After the closure of the subscription list, the bank sends all applications to the company. On receipt of applications, each application is carefully scrutinised to ascertain that the application form is properly filled up and signed and the money is deposited with the bank.
4. **To make calls on shares:** The remaining amount left after application and allotment money due from shareholders may be demanded in one or more parts which are termed as 'First Call' and 'Second Call' and so on. A word 'Final' word is added to the last call. The amount of call must not exceed 25% of the nominal value of the shares and at least 1 month have elapsed since the date which was fixed for the payment of the last preceding call, for which at least 14 days notice specifying the time and place must be given.

Modes of issue of shares:

A company can issue shares in two ways:

1. For cash.
2. For consideration other than cash.

Issue of shares for cash: When the shares are issued by the company in consideration for cash such issue of shares is known as issue of share for cash. In such a case shares can be issued at par or at a premium or at a discount. Such issue price may be payable either in lump sum along with application or in instalments at different stages (e.g. partly on application, partly on allotment, partly on call). Accounting procedure for the issue of shares for cash is given below:

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S tep s	Conditions	Treatment
1.		Record the receipt of application money
2.	a) When number of shares applied is equal to the number of shares issued.	Transfer the full amount of application money received to Share Capital A/c.
	b) When number of shares applied are less than the number of shares issued.	• <u>If the minimum subscription has at least been received:</u> Transfer the full amount of application money received to Share Capital A/c. • <u>If the minimum subscription has not been received:</u> Refund the total application money to all the applicants.
3.		Make due the allotment money on shares allotted.
4.		Record the receipt of allotment money.
5.		Make due the call money on shares allotted.
6.		Record the receipt of call money.

Issue of shares at par: Shares are said to be issued at par when they are issued at a price equal to the face value. For example, if a share of Rs. 10 is issued at Rs. 10, it is said that the share has been issued at par.

Issue of shares at premium: When shares are issued at an amount more than the face value of share, they are said to be issued at premium. For example, if a share of Rs. 10 is issued at Rs. 15; such a condition of issue is known as issue of shares at premium. The difference between the issue price and the face value [i.e. Rs. 5 (Rs.15 – Rs.10)] of the shares is called premium. It is a capital profit for the company and will show credit balance; hence it will be shown in the liability side of the Balance Sheet under the heading '**Reserves and Surplus**' in a separate account called '**Security Premium Account**'.

Shares of those companies can be issued at premium which offer attractive rate of dividend on their existing shares, having a good profit track for last few years and whose shares are in demand. The amount of premium depends upon the profitability and demand of shares of such company.

Note: The Company may collect the amount of security premium in lump sum or in instalments. Premium on shares may be collected by the company either with application money or with the allotment money or even with one of the calls. In absence of any information, the amount of the premium is to be recorded with allotment.

Utilisation of Security Premium Amount: According to Section 78 of the Companies Act 1956, the amount of security premium may be applied only for the following purposes:

- (i) To issue fully paid up bonus shares to the existing shareholders.
- (ii) To write off preliminary expenses of the company.

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- (iii) To write off the expenses, or commission paid, discount allowed on issue of the shares or debentures of the company.
- (iv) To pay premium on the redemption of preference shares or debentures of the company.
- (v) To buy-back its own shares as per section 77A.

If the company wishes to use the premium amount for any other purpose, it will have to first obtain the sanction of the court for the same or it will be treated as reduction of capital.

Issue of shares at discount: Shares are said to be issued at a discount when they are issued at a price lower than the face value. For example if a share of Rs. 10 is issued at Rs. 9, it is said that the share has been issued at discount. The excess of the face value over the issue price [i.e. Rs. 1 (Rs. 10 – Rs. 9)] is called as the amount of discount.

Share discount account showing a debit balance denotes a loss to the company which is in the nature of capital loss. Therefore, it is desirable, but not compulsory, to write it off against any Capital Profit available or Profit and Loss Account as soon as possible, and the unwritten off part of it is shown in the asset side of the Balance Sheet under the heading of '**Miscellaneous Expenditure**' in a separate account called '**Discount on issue of Shares Account**'.

Conditions for issue of shares at discount: For issue of shares a discount the company has to satisfy the following conditions given in section 79 of the Companies Act 1956:

- (i) At least one year must have elapsed since the company became entitled to commence business. It means that a new company cannot issue shares at a discount at the very beginning.
- (ii) The company has already issued such types of shares.
- (iii) An ordinary resolution to issue the shares at a discount has been passed by the company in the General Meeting of shareholders and sanction of the Company Law Tribunal has been obtained.
- (iv) The resolution must specify the maximum rate of discount at which the shares are to be issued but the rate of discount must not exceed 10% of the face value of the shares. For more than this limit, sanction of the Company Law Tribunal is necessary.
- (v) The issue must be made within two months from the date of receiving the sanction of the Company Law Tribunal or within such extended time as the Company Law Tribunal may allow.

Accounting entries for issue of shares:

Par	Premium	Discount
For receipt of application money		
Bank A/c Dr To Share application A/c	Bank A/c Dr To Share application A/c	Bank A/c Dr To Share application A/c
For transferring application money to Share Capital A/c		
Share application A/c Dr To Share capital A/c	Share application A/c Dr To Share application A/c To Security Premium A/c	Share application A/c Dr Discount on issue of shares A/c Dr To Share application A/c
For allotment money becoming due		
Share allotment A/c	Share allotment A/c	Share allotment A/c

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Dr To Share capital A/c	Dr To Share capital A/c To Security Premium A/c	Dr Discount on issue of shares A/c Dr To Share application A/c
For receipt of allotment money		
Bank A/c Dr To Share allotment A/c	Bank A/c Dr To Share allotment A/c	Bank A/c Dr To Share allotment A/c
For call money becoming due		
Share call A/c Dr To Share capital A/c	Share call A/c Dr To Share application A/c To Security Premium A/c	Share call A/c Dr Discount on issue of shares A/c Dr To Share application A/c
For receipt of call money		
Bank A/c Dr To Share call A/c	Bank A/c Dr To Share call A/c	Bank A/c Dr To Share call A/c

Joint Application and allotment account:

These days it is becoming a practice to open only one account in respect of application and allotment and not two separate accounts. This is based on the reasoning that allotment without application is impossible while application without allotment is meaningless so that the stages of the share capital transactions are closely interrelated, hence, from this point of view, Share Application and Share Allotment Account appear more logical. If combined account for application and allotment is opened, in such a case instead of passing first 4 entries following 3 entries will be passed:

Par	Premium	Discount
For receipt of application money		
Bank A/c Dr To Share application & allotment A/c	Bank A/c Dr To Share application & allotment A/c	Bank A/c Dr To Share application & allotment A/c
For transferring application and allotment money to Share Capital A/c		
Share application & allotment A/c Dr To Share capital A/c	Share application & allotment A/c Dr To Share application A/c To Security Premium A/c	Share application & allotment A/c Dr Discount on issue of shares A/c Dr To Share application A/c
For receipt of allotment money		
Bank A/c Dr To Share application & allotment A/c	Bank A/c Dr To Share application & allotment A/c	Bank A/c Dr To Share application & allotment A/c

Call-in-arrear and interest thereon:

If a shareholder makes a default in sending the call money due on allotment or on any calls according to the conditions, the money not so sent is called calls-in-arrear. In other words, the portion of called up capital which is not paid by the shareholder within a specified time is known as calls-in-arrear. The company is authorised to charge interest

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at a specified rate on calls-in-arrear from the due date to the date of actual payment of the allotment money or the calls. But if the Articles of Association are silent, **Table A** shall be applicable which provides for interest at 5% per annum. However, the directors have the right to waive the payment of interest on call-in-arrear.

Accounting treatment of calls-in-arrear:

There are two methods of dealing with the accounting of calls-in-arrear:

1. **By opening Calls-in-arrear Account:** In such a case, a separate account for calls-in-arrear is opened. If the amount of calls has not been paid by some shareholders, such amount is transferred to newly opened '**Calls-in-arrear Account**'. Thus allotment and other call accounts will not show any balance but the Calls-in-arrear account will show a debit balance equal to the total unpaid on allotment / calls, which will be shown as deduction from the amount of the subscribed capital on the liabilities side of the Balance Sheet.

Accounting treatment:

<u>For calls-in-arrear:</u> Bank A/c Dr Calls-in-arrear A/c Dr To Share allotment A/c To Share call A/c	<u>For receipt of arrear amount at subsequent date:</u> Bank A/c Dr To Call-in-arrear A/c
<u>On making the interest on call-in-arrear due:</u> Shareholder's A/c Dr To Interest on call-in-arrear A/c	<u>For receipt of interest on calls-in-arrear:</u> Bank A/s Dr To Shareholder's A/c
<u>For transferring interest on calls-in-arrear A/c to P/L A/c at the end of the accounting year:</u> Interest on calls-in-arrear A/c Dr To Profit and Loss A/c	

2. **Without opening calls-in-arrear account:** It is not necessary to open a separate account for calls-in-arrear. In that case, amount actually received from the shareholders is credited to the relevant allotment / call account and the various allotment / call accounts will show debit balance equal to the total unpaid amount of allotment / calls, which will be shown as deduction from the amount of the subscribed capital on the liabilities side of the Balance Sheet.

Accounting treatment:

<u>For calls-in-arrear:</u> Bank A/c Dr To Share allotment A/c To Share call A/c	<u>For receipt of amount at subsequent date:</u> Bank A/c Dr To Share allotment A/c To Share call A/c
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Calls-in-advance and interest thereon:

Calls-in-advance is just opposite to calls-in-arrear. When a company accepts money paid by some of its shareholders for the call not yet due, such amount is known as 'Call-in-Advance'. It may also happen in case of partial or pro-rata allotment of shares when the company retains excess amount received on application of shares. Since the amount has not become due, hence, it is a liability of the company; therefore it is transferred to the credit of a newly opened account called '**Calls-in-advance**'.

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Account'. A company may, if authorised by its articles, accept calls in advance from its shareholders.

In case of calls-in-advance, the company must pay interest at the rate prescribed in its Articles of Association. However, in the absence of interest clause in the Articles of Association, the provisions of **Table A** of the Companies Act will apply according to which the company will have to pay interest @ 6% p.a. on calls-in-advance, from the date of receipt till the date when the call becomes due.

Accounting treatment:

<u>For receipt of advance money:</u> Bank A/c Dr To Share allotment A/c To Share call A/c To Calls-in-advance A/c	<u>For adjustment of calls-in-advance:</u> Calls-in-advance A/c Dr To Respective call A/c
<u>On making the interest on call-in-advance due:</u> Interest on calls-in-advance A/c Dr To Shareholder's A/c	<u>For payment of interest on calls-in-advance:</u> Shareholder's A/c Dr To Bank A/c
<u>For transferring interest on calls-in-advance A/c to P/L A/c at the end of the accounting year:</u> Profit and Loss A/c Dr To interest on calls-in-advance A/c	

Distinction between Calls-in-arrear and Calls-in-advance:

	Calls-in-arrears	Calls-in-advance
Basis of difference		
Meaning	Calls-in-arrear is the amount called up by the company, but not paid by the shareholders.	Calls-in-advance is the amount not called up by the company, but paid by the shareholders.
Interest	Interest is charged on calls-in-arrear.	Interest is allowed on calls-in-advance.
Rate of interest	5% - as per Table A.	6% - as per Table A.
Authority under Articles of Association	Articles of Association do not have any clause to this effect as non-payment is beyond the company's control.	A company may accept calls-in advance only if Articles of Association authorise to do so.
Disclosure	Its amount is shown by way of deduction from the Subscribed-capital in the Balance Sheet.	Its amount is shown as separate item, under the head current liabilities.

Forfeiture of shares:

When any company allots share to the applicants, it is done on the basis of a legal contract between the company and the applicant, which makes it binding upon the shareholders to pay the amount of allotment and calls whenever they are due. Now if any shareholder fails to pay the allotment and or call money due to him, the shareholder violates the contract and the company is entitled to take its share back, which is known as forfeiture of shares. The company can forfeit such shares if authorised by the Articles of Association. Forfeiture of share can be done according to the rules laid down in the Articles and if no rules are given in Articles, the provisions of Table A, regarding forfeiture will apply. Forfeiture of shares means cancellation of allotment to defaulting shareholders and to treat the amount already received on such shares is not returnable to him – it is forfeited.

Procedure for forfeited shares:

The usual procedure is that the defaulting shareholder must be given a minimum 14 days notice requiring him to pay the amount due on his shares along with interest on it stating that if he fails to pay the amount and the interest on it, the shares will be forfeited. In spite of this notice, the shareholder does not pay the unpaid amount. The directors after passing a resolution will forfeit the shares and information will be given to the defaulting shareholder about the forfeiture of his shares.

Effect of forfeiture of shares:

1. **Termination of membership:** The membership of the defaulting shareholder will be terminated and they lose all the rights and interest on those shares i.e. ceases to be the member / shareholder / owner of the company and his name will be removed from the Register of Members
2. **Seizure of money paid:** The amount already paid on the forfeited shares by the defaulting shareholders will be seized by the company and in no case will be refunded back to the shareholder.
3. **Non payment of dividend:** When shares are forfeited the shareholder remains no longer the member of the company therefore he loses the right to receive future dividend.
4. **Reduction of share capital:** Forfeiture of shares results in the reduction of share capital to the extent of amount called up on such shares.

Accounting Entries:

Since the company issues shares at par, at premium, or at discount. As such the accounting entries for forfeiture of shares in all the above cases are different, which are as following:

Forfeiture of shares issued at Par:

If calls-in-arrear account is opened

Share capital A/c Dr To Calls-in-arrear A/c To Share forfeiture A/c	With the called up amount With the amount of arrear on shares forfeited With the amount paid by the shareholder
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If call-in-arrear account is not opened:

Share capital A/c Dr To Share allotment A/c To Share call A/c To Share forfeiture A/c	With the called up amount With the amount of arrear on allotment With the amount arrear on call With the amount paid by the shareholder
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Forfeiture of shares issued at Premium:

If calls-in-arrear account is opened:

Share capital A/c Dr Security Premium A/c Dr To Calls-in-arrear A/c To Share forfeiture A/c	With the called up amount excluding premium amount If amount of premium is not paid With the amount of arrear on shares forfeited With the amount paid by the shareholder
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If call-in-arrear account is not opened:

Share capital A/c Dr Security Premium A/c Dr To Share allotment A/c To Share call A/c To Share forfeiture A/c	With the called up amount excluding premium amount If amount of premium is not paid With the amount of arrear on allotment With the amount arrear on call With the amount paid by the shareholder
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Forfeiture of shares issued at Discount:

If calls-in-arrear account is opened:

Share capital A/c Dr To Calls-in-arrear A/c To Discount of shares A/c To Share forfeiture A/c	With the called up amount With the amount of arrear on shares forfeited With discount on shares forfeited With the amount paid by the shareholder
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If calls-in-arrear account is not opened:

Share capital A/c Dr To Discount of shares A/c To Share allotment A/c To Share call A/c To Share forfeiture A/c	With the called up amount With discount on shares forfeited With the amount of arrear on allotment With the amount arrear on call With the amount paid by the shareholder
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Forfeiture of fully paid up shares:

Usually the shares are forfeited for non-payment of the calls. But at the same time fully paid up shares can be forfeited in such cases as default in fulfilling any agreement between the members or on expulsion of members where the articles specifically provide for such details.

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Surrender of shares:

When a shareholder feels that he cannot pay further calls; he may himself surrender the shares to the company. These shares are then cancelled. Surrender of shares is a voluntary return of shares for the purposes of cancellation. The directors can accept the surrender of shares only when the Articles of Association authorise them to do so. Surrender is lawful only in two cases viz. **(a)** where it is done as a short cut to forfeiture to avoid the formalities for a valid forfeiture and **(b)** where shares are surrendered in exchange for new shares of the same nominal value. A surrender will be void if it amounts to purchase of the shares by the company or if it is accepted for the purpose of relieving a member from his liabilities. Entries are passed just like forfeiture of shares.

Thus, surrender of shares is at the instance of shareholder whereas forfeiture of shares at the instance of company.

Re-issue of Forfeited of shares:

Shares forfeited becomes the property of the company and the directors of a company have an authority to re-issue the shares once forfeited by them in accordance with the provisions contained in Articles of Association. Table 'A' provides that "A forfeited shares may be sold or otherwise disposed off on such terms and in such manner as the Board thinks fit". They can re-issue the forfeited shares at par, at premium or at discount. However, if the shares are re-issued at discount, the amount of the discount does not exceed the amount paid on such shares by the original shareholder but in case of shares originally issued at a discount, the maximum permissible discount will be amount paid on such shares by the original shareholder plus the amount of original discount.

Accounting treatment for re-issue of forfeited shares: Following are the journal entries for re-issue of forfeited shares:

Re-issue of forfeited shares at par:

Bank A/c Dr To Share Capital A/c	With the amount received on re-issue With the amount credited as paid-up / called up
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Re-issue of forfeited shares at premium:

Bank A/c Dr To Share capital A/c To Security premium A/c	With the amount received on re-issue With the amount credited as paid-up / called up With the amount of premium on re- issue
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Re-issue of forfeited shares at discount:

Bank A/c Discount on shares A/c Share forfeiture A/c To Share Capital A/c	Dr Dr Dr	With the amount received on re-issue With the amount of original discount With the excess of re-issue discount With the amount credited as paid-up / called up
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Note: If after re-issue of shares there is still a profit, it should be credited to the Capital Reserve Account. Following entry will be passed for this:

Share forfeiture A/c
Dr
To Capital reserve A/c

Over subscription of issue:

When the application received from the public are more than the shares issued by the company, this situation is called as over subscription of issue. The Board of Directors cannot allot shares more than that offered to the public, in such a condition the Directors of the company make the allotment of shares on the basis of reasonable criteria. Any allotment to be made by the company in case of over subscription should be according to the scheme, which is finalized with the consultation of **Security and Exchange Board of India** (S.E.B.I.)

The journal entry for application money will be passed for all the shares applied for, but while transferring the application money to share capital account, only the application money on shares issued will be considered.

Following three alternatives are available to deal with the situation of oversubscription:

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Alternative 1	Course of action	Journal entry	
To reject the excess applications and to allot in full to other applicants	Letter of regret along with the refund of application. Letters of regret along with the refund of application money are sent to the applicants of rejected applications and letters of allotment are sent to applicants of accepted applications.	Share application a/c Dr To Bank A/c To Share capital A/c	With the total amount received on application With the amount refunded on applications rejected With the application money on shares issued

Alternative 2	Course of action	Journal entry	
To reject the excess applications and to allot in full to other applicants	Letters of allotment are sent to all the applicants and excess application money received is adjusted towards the amount due on allotment, calls of shares allotted and the balance application money left after adjustment will be refunded.	Share application a/c Dr To Share allotment A/c To Calls-in-advance A/c To Bank A/c	With the total amount received on application With the amount retained for allotment With the amount retained for calls With the amount refunded on applications rejected

Alternative 3	Course of action	Journal entry	
Any combination of the above two alternatives such as: a) To reject some of the applications and make pro-rata allotment to remaining applicants. b) To allot in full to some of the applicants and make pro-rata allotment to remaining applicants	Letters of regret along with the refund of application money are sent to the applicants of rejected applications and letters of allotment are sent to the applicants and excess application money received is adjusted towards the amount due on	Share application a/c Dr To Share allotment A/c To Calls-in-advance A/c To Bank A/c	With the total amount received on application With the amount retained for allotment With the amount retained for calls With the amount refunded on applications rejected

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c) To reject some of the applications allot in full to some of the applications and make pro-rata allotment to remaining applicants	allotment, calls of shares allotted and the balance application money left after adjustment will be refunded		
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Under subscription of issue:

Shares are said to be under-subscribed when the number of shares applied for is less than the number of shares offered, but at least minimum subscription (According to the guidelines issued by S.E.B.I. minimum subscription means 'If the company does not receive a minimum subscription of 90% of the issued amount within 60 days from the date of closure of the issue, the company shall forthwith refund the entire subscription amount') is received. For example, in case has offered 5,000 shares to public but the public applied for 4,500 shares only, it is called a case of under-subscription. Journal entries are passed on the basis of shares applied for.

Difference between over-subscription and under-subscription:

Basis	Under-subscription	Over-subscription
Shares applied	Number of shares applied is less than the shares offered for subscription.	Number of shares applied is more than the shares offered for subscription.
Acceptance	All the applicants for shares are accepted, i.e. full allotment is made.	All the applications are not accepted. Some are rejected. Alternatively, shares are allotted on pro-rata basis.
Refund	As all the applications are accepted, there is no excess money to be refunded.	Excess application money is to be refunded or adjusted towards allotment.
Minimum subscription	The company may face the problem of 'Minimum Subscription'.	The company does not face such a problem.

Private placement of shares:

According to Section 81 (1A) of the Companies Act, 1956 private placement of shares implies issue and allotment of shares to a selected group of persons such U.T.I., L.I.C. etc. in other words; an issue which is not a public issue but offered to a select group of persons is called Private Placement of shares.

Preferential allotment:

A preferential allotment is one that is made at a pre-determined price to the pre-identified people who wish to take a strategic stake in the company such as promoters, venture capitalists, financial institutions, buyers of companies products ore its suppliers. In other such a case, the allottees will not sell their securities in the open

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market for a minimum period of three years from the date of allotment. This period is known as the lock-in-period.

The preferential allotment can take place only if three-fourths of the shareholders agree to the issue on preferential basis. S.E.B.I. has prescribed that the minimum price of such an issue has to be an average of highs and lows of the 26 week preceding the date on which the board resolves to make the preferential allotment.

Employee stock option plan:

In order to retain high caliber employees or to give them a sense of belonging, companies may offer their equity shares to be purchased at their will. Such scheme is called Employee stock option plan (ESOP). Following are the characteristics of this scheme:

- 1) ESOP implies the right, but not an obligation.
- 2) The employee has a right to exercise the option of purchase of shares within the vesting period, i.e., the time period during which the scheme remains in operation.
- 3) Any share issued under the scheme of ESOP shall be locked-in for a minimum period of one year from the date of allotment.

Buy-back of shares:

The term buy-back of share implies the act of purchasing its own shares by a company either from free reserves, securities premium or proceeds of any shares or securities. According to Section 77A of the Companies Act 1956, a company can buy its own shares either from the:

- a) Existing equity shareholders on a proportionate basis.
- b) Open market
- c) Odd lot shareholders
- d) Employees of the company pursuant to a scheme of stock option or sweat equity.

Right shares:

Under Section 81 of the Companies Act, the existing shareholders have a right to subscribe, in their existing proportion, to the fresh issue of capital or to reject the offer, or sell their rights. The existing shareholders can authorize the company by passing a special resolution to offer such shares to the public.