Corporate Accounting

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Underwriting of Shares

Meaning : underwriting is an agreement/contract between the company and underwriter, who undertake to purchase and pay for the share/debentures not subscribed (applied for) by the public.

importance : when a public issue of shares/debentures is made by the company, there is a risk of non or under subscription, resulting into refund of subscription and causing a lot of issue expenditure to go waste. this uncertainty can be avoided by getting the issue underwritten.

provisions regarding underwriters commission :

in consideration of such a service the underwriters get commission from the company called underwriting commission.

Provisions

- As per 76(b) (ii) of the company Act commission should be paid at a rate authorized by Articles.
- Subject to maximum allowed by law on Shares 5% of issue price and on Debentures 2.5% of issue price.
- No commission can be paid in respect of Shares / Debentures which have not been offered to general public for subscription.

Terms used in Underwriting :

- Marked Application – The application form bearing the stamp of the underwriter are termed as "Marked Application forms". While calculating underwriters liability credit for marked applications are given to concerned underwriter.
- Unmarked Application – Those applications which do not bear the stamp of any underwriter are unmarked applications. The credit for unmarked applications in case of underwriters is given in the ratio of gross liability.
- Full Underwriting – When the entire issue is underwritten such underwriting is termed as full underwriting.
- Partial underwriting – When only a part of issue is underwritten such underwriting is termed as partial underwriting.

Term used in underwriting

- Sole underwriting – When the issue is underwritten only by one underwriter is termed as sole underwriting.
- Joint underwriting – When the issue is underwritten by two or more underwriters, such underwriting is termed as joint underwriting.
- Firm underwriting – In firm underwriting, the underwriter agrees to subscribe up, a certain number of shares/debentures irrespective of the nature of public response to issue of securities.
- Underwriter gets these securities even if the issue is fully or over subscribed. These securities are taken up by the underwriter in addition to his liability for securities not subscribed by the public.

Accounting Entries : In the books of company.

- Underwriters liability in case undersubscription and firm allotment.
- Underwriters (personal) A/c Dr.
- To Equity Share Capital A/c.
- to Securities premium (if any) A/c.

Accounting Entries

- Commission Due.
- Underwriting commission A/c Dr.
- To Underwriters (personal) A/c.
- Settlement of Account.
- i) Payment from underwriters.
- Bank A/c Dr.
- To underwriters (personal) A/c.
- Ii) Payment to underwriters.
- Underwriters (personal) A/c Dr.
- To Bank A/c.

Determination of Underwriters Liability (In Shares)

Particulars	Underwriters			Total No. of Shares
	A	B	C	

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Issue of Equity Shares

Share – the act defines a share as 'share' in the capital of the company and include stock.

equity shares may be issued at a price which is expressed as – at par, at premium and at discount.

- **at par – to pay equal the face/nominal value of that share.**
- **at premium – to pay more than the face/nominal value of that share**
- **at discount – to pay less than the face/nominal value of share.**
- **accounting procedure for the issue of shares for cash and at par**
- **step 1. record the receipt of application money**

Accounting procedure

- Step 2. Situation I – When number of shares applied = Number of shares offered.
- Then transfer application money on the share allotted to share capital A/c.
- Situation II – When number of shares applied < (less than) number of shares offered.
- a) If the minimum subscription has at least been received, then transfer application money on the shares allotted to 'share capital A/c.
- b) If the minimum subscription has not been received then refund application money to all the applicants.
- Situation III – When number of shares applied > (greater than) number of shares offered, then transfer application money on the shares allotted to share capital A/c and transfer excess application money to allotment A/c in case of particularly accepted and refund application money in case of rejected applications.
- Step 3. Make the allotment call on shares allotted.
- Step 4. Record the receipt of allotment money.
- Step 5. Make the first call on shares allotted.
- Step 6. Record the receipt of first call and so on.

Accounting treatment for issue of Equity shares at par

1. On receipt of application money.
   Bank A/c Dr.
   To Equity share application A/c.
2. On allotment of shares.
a) Equity share application a/c Dr.
   To Equity share capital a/c.
b) Allotment money due.
   Equity share allotment a/c Dr.
   To Equity share capital a/c.
3. When shares are oversubscribed.
   a) Excess money refunded.
   Equity share application a/c Dr.
   To Bank a/c.
   b) Excess money adjusted against allotment.
   Equity share application a/c Dr.

To Equity share allotment a/c.	(Adjust allotment)
To Calls in advance a/c	(surplus after above adjustment)
To Bank a/c.	(surplus refunded)

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Accounting treatment

4. On receipt of allotment money.
   Bank a/c Dr.
   To Equity share allotment a/c.
5. if some shareholders fail to pay allotment money.
   Calls in arrears a/c Dr.
   To Equity share allotment a/c.
6. Making calls –When shareholders paid amount of shares in instalments.

a) Amount due on first or subsequent call.
   Equity share --- call a/c Dr.
   To Equity share capital a/c.

b) Bank a/c Dr.
   To Equity share --- call a/c.

c) Non payment of call money.
   Calls in arrears a/c Dr.
   To Equity share --- call a/c.

d) on adjustment of 'calls in advance' – if any
   Calls in advance a/c Dr.
   To Equity share --- call a/c.

Issue of Equity Shares

Calls In Arrears – Any amount called by the company but not paid by the shareholders is known as calls in arrears.

When shareholders fail to pay the amount due on allotment and or calls. The allotment account or calls a/c will show a debit balances equal to the total unpaid amounts of each instalment. Generally such amount is transferred to a special account called 'calls in arrears a/c.'

Calls in advance – A shareholders may remit (pay) the money in advance on calls which are not yet due. The sum paid by the shareholders is known as 'calls in advance'

Calls in advance generally arise when there is an oversubscription of shares. Here, the excess application money received is adjusted against the amount due on allotment or calls, The excess application money after adjustment for allotment should be transferred to a special account called 'calls in advance a/c.'

Forfeiture of shares – means the taking away of the shares by the company for non payment of any money due on any calls on the held by the shareholders.

The power of forfeiture must be exercised strictly having regard to the rules and regulations provided in the Articles of Association.

When shares are forfeited, the title of such shareholders is extinguished but the amount paid to date is not refunded to him. The shareholders then has no further claim on the company.

Accounting treatment for forfeiture of shares

Situation 1. Forfeiture of shares which were issued at par.

Share capital a/c. Dr.	(no. of shares x called up value per share)
To share allotment a/c.	(amount due but not paid)
To share first call a/c.	(amount due but not paid)
To final call a/c.	(amount due but not paid)
To Share forfeited a/c.	(amount received)

Situation 2. Forfeiture of shares which were issued at a premium.

a) When share premium is not received.

Share capital a/c. Dr.	(called up capital)
Securities/share premium a/c.	(share premium amount)
To forfeited shares a/c.	(with amount received)
To share allotment a/c.	(unpaid amount with premium)
To share call a/c.	(unpaid amount)

Accounting treatment for forfeiture of shares

Situation 2. b) When share premium is received.

Share capital a/c. Dr. (with called value of shares forfeited)

To shares forfeited a/c. (with the amount already paid up on the shares forfeited excluding share premium)

To unpaid shares call a/c. (with amount unpaid on calls)

(* According to section 78 of Co. Act share premium once collected can not ne cancelled even if these shares are forfeited later on. It implies that share premium is not considered as gain of forfeiture and is not included in shares forfeited a/c.)

Situation 3. Forfeiture of shares which were issued at discount.

Share capital a/c. Dr. (no. of shares x called up value per share)

To share allotment a/c. (amount due but not paid)

to unpaid share calls a/c. (amount due but not paid)

To shares forfeited a/c. (amount received)

To Discount issue of shares a/c. (no, of shares x discount per share)

Reissue of Forfeited shares

According to Law and Articles of the company, A company is empowered to reissue its forfeited shares. The forfeited shares can be reissued by the directors even at a discount provided,. The discount on reissue does not exceed the amount forfeited per share. The discount (loss on reissue) thus allowed to be debited to the share forfeited account.

A forfeited share is merely a share available for sale and therefore rules relating to allotment of shares do not apply to reissue of forfeited shares.

In practice, forfeited shares are disposed off by auction. These shares can be reissued at any price. So long as the total amount received (from the original allottee & second purchaser) for those shares is not less than the amount in arrears on those shares.

Accounting Entries

1. If reissued at par - a) Bank a/c Dr. (with the amount received)
To share capital a/c

b) Forfeited shares a/c Dr. (with the forfeited amount)
To Capital Reserve a/c.

2. If reissued at a discount –

a) Bank a/c Dr. (amount received)
Forfeited shares a/c Dr. (discount on reissue)
To share capital a/c . (with paid up value of share)

Reissue of Forfeited shares

b) Forfeited shares a/c Dr. (balance in forfeited shares account)
To Capital Reserve a/c.

3. If reissued at a premium.

a) Bank a/c . Dr. (with amount received)
To share capital a/c. (paid up value of share)
To Securities/share premium a/c. (amount of premium)

b) Forfeited shares a/c. Dr. (balance of forfeited shares account)
To Capital Reserve a/c.

Issue of Shares for consideration other than cash.

Companies generally issue their shares for cash and use such cash for the purchase of various assets of the business. Sometimes however, a company may issue shares in a direct exchange for Land & building or other assets. Shares may also issued in payment for services rendered by promoters, lawyers in the formation of company. In the balance sheet these shares should be shown separately.

Accounting Entries - 1. Issue of shares for purchase of Assets.

Sundry Assets a/c. Dr.
To Vendors/ property owners a/c

2. Shares issued to vendors/ property owners

Vendors / property owners a/c . Dr.
To share capital a/c.

3. Shares issued to promoter of the company.

Goodwill a/c. Dr.
To share capital a/c.

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Accounting for buy back of shares

Meaning – the term buy back of shares implies the act of purchasing its own share by a company.

objectives –

1. to reduce the excess share capital.

2. to use surplus cans lying idle in the business.

3. to increase intrinsic value of shares.

4. to increase earning per share (eps).

5. to support share price during periods of sluggish market condition.

6. to prevent take over of attempts of competitors.

effect –

1. there is a reduction in the share capital to the extent of the face value of shares bought back.

2. there is payment from the company for share buyback.

3.shreholders name are removed from the register of members. -

Provisions of buy back of shares section 68 to 70 of the Companies Act 2013

1. **Purchase can be made out of** – a) its Free Reserve. b) The Securities premium A/c or c) The proceeds of the issue of any shares or other specified securities.
2. Must be authorized by its Articles.
3. The securities to be bought back must be fully paid.
4. Where buy back of shares is made out of free reserves or securities premium a/c, it shall be transfer an amount equal to nominal value of such shares to Capital Redemption Reserve a/c.
5. Every buy back shall be completed within 12 months from the date of resolution.
6. No fresh issue of same securities within 06 months, except bonus shares.
7. Buy back can be done by using following methods.

   a) On proportionate basis. b.) From open market

   c) From odd Lot. C) From employee securities.
8. The buy back of equity shares in any year must not exceed 25% of total paid capital.
9. The debt equity ration must not be more than 2:1 after such buy back.

Accounting Entries

To make partly paid shares fully paid.
a) Equity share final call a/c. Dr.
To Equity share capital a/c.
b) Bank a/c. Dr.
To Equity share final call a/c.
2. Sale of investment/Assets to provide cash for buy back.
Bank a/c Dr.
To Investment (book value) a/c.
Note. If any profit/loss transfer to P & L A/c.
3. To issue fresh shares.
Bank a/c Dr.
To share capital a/c.
Note – If any premium or discount is recorded separately.

Accounting Entries

4. Recording amount payable on buy back.
   Equity share capital a/c Dr.
   Premium on buy back of shares a/c. Dr.
   To Equity share buy back a/c.
   Note – If the buy back is at discount the amount of discount is credited to Capital Reserve a/c.
5. Transfer of free reserve to CRR.
   Profit and Loss a/c. Dr.
   Free Reserve a/c. Dr.
   Securities premium a/c. Dr.
   To Capital Redemption Reserve a/c.
6. Payment to shareholders.
   Equity share buy back a/c. Dr.
   To Bank a/c.
7. premium on buy back adjusted.
   Securities Premium a/c. Dr.
   P & L a/c. / Revenue Reserve a/c. Dr.
   To premium on buy back of shares a/c.

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Valuation of Shares

Share capital – is that part of the capital of a company which is represented by the total nominal value of the share which it has issued.

share – the act defines a share is a share in the share capital of the company and include stock.

nature/types of shares –

1. preference shares.

2. equity shares.

3. non voting right shares.

need for valuation of shares : -

the value of every share is printed on share certificate, such a share is called face value of the share. the actual price may be different and therefore, it becomes necessary to value the shares on many occasions. such as -------

1. **sale or purchase of shares of company whose shares are not quoted on the stock exchange.**

2. when two or more companies are amalgamate or one company absorb another com

Needs for Valuation of Shares

3.When two or more companies are amalgamate or one company absorb another company.

4. When a purchaser acquires majority of shares of Ltd. company.

5. If loan is to be raised on the security of shares.

6. Conversion of one class of shares into another class.

7.For taxation purpose e.g. Gift tax, Wealth tax etc.

8. under a scheme of nationalization when the shares of the company are taken by the government.

Methods of valuation of shares –

1. Net Assets method. 2. Yield method.

1. Net Assets Method – This method is also called Assets Backing / Intrinsic value / Breakup value method.
2. This method may be used for valuation of --- a) Equity shares b) Non participating Pref. shares. C) participating Pref. Shares.

Under this method an attempt is made how to determine as to how much amount per share a shareholder will receive on the date of determination of the value of shares. For this purpose, it is necessary to calculate Net Assets and following steps.

Steps in Net Assets Method

Step	Particulars		Amount Rs.
1	Tangible fixed assets		x x x
2	Less – External liabilities		x x x
		net Assets	x x x
3.	Less Pref. share capital	x x x	
	(premium on redemption if any)	x x x	x x x
4.	less – share in surplus of participating		
	(Preference shareholders, if any)		(x x x)
5.	Net assets available for equity shareholders		x x x

6. Value per share = Equity shareholders fund ÷ No.of equity shares

Notes – 1. Net Assets can be computed on "Liability Basis" as(Equity shar cap + Reserve surplus + Profit revaluation of assets – Fictitious assets – accumulated losses - loss on revaluation of assets).

2. Depreciation fund – If there is depreciation fund in respect of any fixed assets and no change in the value of assets given, the depreciation fund to be deducted from the assets.

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Valuation of Shares

3. Proposed dividend – If the examination problem is silent, students should made suitable assumption, normally it is treated as liability.

4. If the preference shares have no priority for repayment(if specially given) then the net assets apportioned between pref. and equity shares in the ratio of paid up capital.

2. **Yield Method / Market value Method**

Investors are interested in income. They have to price share upon the size of expected dividends. Under this method prospective earnings of the company with normal rate of dividend is prevailing in that industry.

There are different ways of calculating market values as ------

a) On the basis of rate of dividend –

Value of share = Expected rate of dividend ÷ Normal rate of dividend x Paid up value of share.

Note – When the rate of dividend is not given, it may be ascertained as ---

Rate of dividend = profit available for equity shareholders ÷ Equity share capital (paid up) x 100

The dividend on equity share is calculated by deducting – taxation, transfer to reserve, transfer to Debenture fund, preference dividend.

Yield / Market value method

If average profit is available instead of taking current year, average profit is to be taken.

This method is suitable for valuing small block of shares.

b) Capitalization Method - According to this method the profits available to equity shareholders are converted into capital on the basis of normal expectation as under ----

Capital = 100 ÷ expected % **x** profits available for equity shareholders

Capital thus arrived at is divided by the number of shares.

For ex. Suppose the capital is 20000 shares of Rs. 100 each and the profit earned Rs. 300000 . The normal rate of return is 10% . The market value of share is as under - 100 ÷ 10 x 300000 = 3000000

Then 3000000 ÷ 20000 = Rs. 150 is the market value of each equity share.

3. Fair value Method = Intrinsic value + yield method value ÷ 2

This is not a method but a comprehensive formula which fixes the value of shares as the average of the values obtained by Intrinsic value method and Yield method.