FOUNDATION PROGRAMME

Supplement For

- BUSINESS ENVIRONMENT AND ENTREPRENEURSHIP (Paper 1)
- BUSINESS MANAGEMENT ETHICS AND COMMUNICATION (Paper 2)
- BUSINESS ECONOMICS (Paper 3)
- FUNDAMENTALS OF ACCOUNTING AND AUDITING (Paper 4)

This supplement is based on those sections of the Companies Act, 2013 and the rules made there under which have been notified by the Government of India and came into force w.e.f. April 01, 2014 (Including amendments / clarifications / circulars issued there under upto June, 2014). In respect of sections of the Companies Act, 2013 which have not been notified, applicable sections of Companies Act, 1956 have been dealt with.

The students having 2012 edition of Study Material are advised to read their Study Material with reference to this supplement. This supplement is updated upto 30th June, 2014.
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CONTENTS

1. Business Environment and Entrepreneurship (Paper 1)
   o Lesson 7: Elements of Company Law-I
   o Lesson 8: Elements of Company Law-II

2. Business Management Ethics and Communication (Paper 2)
   o Lesson 8: Business Ethics

3. Business Economics (Paper 3)
   o Lesson 12: Theory of Probability

4. Fundamentals of Accounting and Auditing (Paper 4)
   o Lesson 9: Introduction to Company Accounts
   o Lesson 13: Auditor and Related Provisions
FOUNDATION PROGRAMME

BUSINESS ENVIRONMENT AND ENTREPRENEURSHIP

PAPER-1
LESSON OUTLINE

- Introduction
- Company - Meaning and Characteristics
- Distinction with Other Forms of Business
- Advantages and Disadvantages of Incorporation
- Kinds of Companies
- Promotion and Incorporation of a Company
- Registration of Company
- Commencement of Business
- How does a company function
- Lesson Round Up
- Self-Test Questions

LEARNING OBJECTIVES

Industrialisation plays vital role in the development of the India. In the post independence era, industrial regulation is employed as a principle means in the strategy for attaining constitutional values. Companies are no doubt powerful instrument of development. Besides bringing returns and financial benefits to the capital and labour they help amelioration of the living conditions of masses. In a developing society like India, vast varieties of consumer goods are manufactured or produced and different kinds of public utility services are generated both for general welfare and consumption purposes. Obviously, it is beyond the capacity of one or a few entrepreneurs to engage into such activities. Because the problem of raising large capital needed for such enterprises, there is a looming danger of market risks.

Hence, taking sources to the device of incorporation is the only efficacious way to surmount all these hurdles.

Corporation: An ingenious device for obtaining profit without individual responsibility.

Ambrose Bierce
A. COMPANY — MEANING AND CHARACTERISTICS

COMPANY – IT’S MEANING

The word “company” is derived from the Latin (Com = with or together; panis = bread), and originally referred to an association of persons who took their meals together. It may be assumed, since human nature does not change that in the leisurely past no less than in the speedy present, merchants took advantage of festive gatherings, to discuss business matters. Now-a-days, the business matters have become most complicated and cannot be discussed at length on festive gatherings. Therefore, the word “company” has assumed great importance as it denotes a joint stock enterprise in which the capital is contributed by a large number of people. Thus, in popular parlance, company denotes an association of like minded persons formed for the purpose of carrying on same business or undertaking. Though an association may be brought into existence for multifarious purposes, in Company Law it figures predominantly as a business association with a large and fluctuating membership formed for making a gain as profit. There may also be non-profit trading concerns like a club or a society. In Smith v. Anderson, (1880) 15 Ch.D.247, it was observed that “a company, in broad sense, may mean an association of individuals formed for some purpose”.

A company may be an incorporated company or a “corporation” or an unincorporated company. An incorporated company is a separate person distinct from the individuals constituting it whereas an unincorporated company, such as a partnership, is mere collection or aggregation of individuals. Therefore, unlike a partnership firm, a company is a corporate body and a legal person having status and personality distinct and separate from that of the members constituting it.

It is called a body corporate because the persons composing it are made into one body by incorporating it according to the law, and clothing it with legal personality, and, so turn it into a corporation (The word “corporation” is derived from the Latin term “corpus” which means “body”). Accordingly, “corporation” is a legal person created by the process other than natural birth. It is, for this reason, sometimes called artificial person. This corporate being is capable of enjoying many of the rights and incurring many of the liabilities of a natural person - a human being.

The incorporated company owes its existence to a special Act of Parliament or to Companies Law. The public corporations like Life Insurance Corporation of India and Damodar Valley Corporation have been brought into existence through special Acts of Parliament whereas companies like Tata Steel Ltd., Reliance Industries Ltd. have been formed under the Companies Act, 1956 which is being replaced by Companies Act, 2013. The trading partnership which is governed by Partnership Act is the most apt example of an unincorporated association.

In the legal sense, a company is an association of both natural and artificial persons incorporated under the existing law of a country. As per section 2(20) of the Companies Act, 2013 “company” means a company incorporated under Companies Act, 2013 or under any previous company law;”. In common law, a company is a “legal person” or “legal entity” separate from, and capable of surviving beyond the lives of, its members. However, an association formed not for profit acquires a corporate life and falls within the meaning of a company by reason of a licence under Section 8 of the Companies Act, 2013.

COMPANY – ITS CHARACTERISTICS

The main characteristics of a company are as follow:

Corporate Personality

By incorporation under the Act, the company is vested with a corporate personality quite distinct from individuals who are its members. Being a separate legal entity it bears its own name and acts under a corporate name. It
has a seal of its own. Its assets are separate and distinct from those of its members. It is also a different ‘person’ from the members who compose it. As such it is capable of owning property, incurring debts, borrowing money, having a bank account, employing people, entering into contracts and suing or being sued in the same manner as an individual. Its members are its owners but they can be its creditors simultaneously as it has a separate legal entity. A shareholder cannot be held liable for the acts of the company even if he holds virtually the entire share capital. The shareholders are not the agents of the company and so they cannot bind it by their acts. The company does not hold its property as an agent or trustee for its members and they cannot sue to enforce its rights, nor can they be sued in respect of its liabilities. The case of Salomon v. Salomon and Co. Ltd., (1897) A.C. 22, has clearly established the principle that once a company has been validly constituted under the Companies Act it becomes a legal person distinct from its members and for this purpose it is immaterial whether any member has a large or small proportion of the shares, and whether he holds those shares beneficially or as a mere trustee. The facts of this case are as follows:

Salomon had, for some years, carried on a prosperous business as leather merchant and boot manufacturer. He formed a limited company consisting of himself, his wife, his daughter and his four sons as the shareholders, all of whom subscribed for 1 share each so that the actual cash paid as capital was £ 7. Salomon sold his business (which was perfectly solvent at that time), to the Company for the sum of £ 38,782. The company’s nominal capital was £ 40,000 in £ 1 shares. In part payment of the purchase money for the business sold to the company, debentures of the amount of £ 10,000 secured by a floating charge on the company’s assets were issued to Salomon, who also applied for and received an allotment of 20,000 £ 1 fully paid shares. The remaining amount of £ 8,782 was paid to Salomon in cash. Salomon was the managing director and two of his sons were other directors.

The company soon ran into difficulties and the debentureholders appointed a receiver and the company went into liquidation. The total assets of the company amounted to £6050, its liabilities were £10,000 secured by debentures, £8,000 owing to unsecured trade creditors, who claimed the whole of the company’s assets, viz., £6,050, on the ground that, as the company was a mere ‘alias’ or agent for Salomon, they were entitled to payment of their debts in priority to debentures. They further pleaded that Salomon, as principal beneficiary, was ultimately responsible for the debts incurred by his agent or trustee on his behalf. The trial judge and the Appellate Court agreed with these contentions and decreed against Salomon. The House of Lords disagreeing with the lower Courts, repudiated these contentions and reversed the order of the Appellate Court. The House of Lords held that on registration, the company comes into existence and attains maturity on its birth. There is no period of minority, no interval of incapacity. It has its own existence or personality separate and distinct from its members and, as a result, a shareholder cannot be held liable for its acts even though he holds virtually the entire share capital. Thus, the case also established the legality of what is known as “one-man company”. The case also recognised that subscribers do not have to be independent or strangers to one another. The case also recognised the principle of limited liability. It also established that a person can be at the same time a member, a creditor and an employee of the company, as well as its director.

Their Lordships observed:

“When the memorandum is duly signed and registered, though there be only seven shares taken, the subscribers are a body corporate capable forthwith of exercising all the functions of an incorporated company. It is difficult to understand how a body corporate thus created by statute can lose its individuality by issuing the bulk of its capital to one person. The company is at law a different person altogether from the subscribers of the memorandum; and though it may be that after incorporation the business is precisely the same as before, the same persons are managers, and the same hands receive the profits, the company is not in law their agent or trustee.”

Limited Liability

The company being a separate entity, leading its own business life, the members are not liable for its debts.
The liability of the members of a company is limited to the extent of the nominal value of the shares held by them. In no event can a shareholder be asked to pay anything more than the unpaid value of his shares. In the case of a company limited by guarantee, the members are liable only to the extent of the amount guaranteed by them and not beyond, and only when the company goes into liquidation.

**Perpetual Succession**

Members may come and members may go but the company goes on for ever. Variation in members or their identity does not affect the legal existence and identity of a company. It is a creation of law and can be dissolved only under the law.

**Transferability of Shares**

The capital of a company is divided into parts, called shares. The shares are said to be movable property and, subject to certain conditions, freely transferable, so that no shareholder is permanently or necessarily wedded to a company. The shares of joint stock companies are freely transferable. In the case of a private company, the Companies Act requires it to put certain restrictions on the transferability of shares. Every member owing fully paid-up shares is at liberty to dispose them off according to his choice but subject to the articles of the company. Any absolute restriction on the right to transfer shares is void.

**Separate Property**

As a corporate person, the company is entitled to own and hold property in its own name. No member can claim ownership of any item of the company's assets.

**Common Seal**

On incorporation, a company acquires legal entity with perpetual succession and a common seal. Since the company has no physical existence, it must act through its agents and all such contracts entered into by its agents must be under the seal of the company. The common seal of the company is of very great importance. It acts as the official signature of a company. The name of the company must be engraved on its common seal. A rubber stamp does not serve the purpose. A document not bearing common seal of the company is not authentic and has no legal force behind it.

**Capacity to Sue and Be Sued**

A company being a body corporate, can sue and be sued in its own name. All legal proceedings against the company are to be instituted in its own name. Similarly, the company may bring an action against anyone in its own name. In case of unincorporated association an action may have to be brought in the name of the members either individually or collectively.

**Company as Distinguished from other Associations of Persons**

Though there are a number of similarities between a limited company and other forms of associations, there are many dissimilarities. In both the cases individuals are the subjects, and trading is generally the object. In the following paragraphs a limited company is distinguished from a partnership firm, a Hindu Joint Family business, a club and a registered society.

Though there are a number of similarities between a limited company and other forms of associations, there are a great number of dissimilarities as well. In both the cases individuals are the subjects, and trading is generally the object. In the following paragraphs, a limited company is distinguished from a partnership firm, a Limited Liability Partnership, a Hindu Joint Family business and a registered society.
Distinction between Company and Partnership

The principal points of distinction between a company and a partnership firm, are as follows:

1. A company is a distinct legal person. A partnership firm is not distinct from the several persons who compose it.

2. In a partnership, the property of the firm is the property of the individuals comprising it. In a company, it belongs to the company and not to the individuals comprising it.

3. Creditors of a partnership firm are creditors of individual partners and a decree against the firm can be executed against the partners jointly and severally. The creditors of a company can proceed only against the company and not against its members.

4. Partners are the agents of the firm, but members of a company are not its agents. A partner can dispose of the property and incur liabilities as long as he acts in the course of the firm’s business. A member of a company has no such power.

5. A partner cannot contract with his firm, whereas a member of a company can.

6. A partner cannot transfer his share and make the transferee a member of the firm without the consent of the other partners, whereas a company's share can ordinarily be transferred.

7. Restrictions on a partner’s authority contained in the partnership contract do not bind outsiders; whereas such restrictions incorporated in the Articles are effective, because the public are bound to acquaint themselves with them.

8. A partner’s liability is always unlimited whereas that of shareholder may be limited either by shares or a guarantee.

9. A company has perpetual succession, i.e. the death or insolvency of a shareholder or all of them does not affect the life of the company, whereas the death or insolvency of a partner dissolves the firm, unless otherwise provided.

10. A company may have any number of members except in the case of a private company which cannot have more than fifty members (excluding past and present employee members). In a public company there must not be less than seven persons and in a private company not less than two. Further, a new concept of one person company has been introduced which may be incorporated with only one person. On the other hand, a partnership firm cannot have more than 100 members.

11. A company is legally required to have its accounts audited annually by a chartered accountant, whereas the accounts of a firm are audited at the discretion of the partners.

12. A company, being a creation of law, can only be dissolved as laid down by law. A partnership firm, on the other hand, is the result of an agreement and can be dissolved at any time by agreement.

Distinction between company and Limited Liability Partnership (LLP)

LLP is an alternative corporate business form that gives the benefits of limited liability of a company and the flexibility of a partnership. LLP can continue its existence irrespective of changes in partners. It is capable of entering into contracts and holding property in its own name. LLP is a separate legal entity, is liable to the full extent of its assets but liability of the partners is limited to their agreed contribution in the LLP.

Further, no partner is liable on account of the independent or un-authorized actions of other partners, thus individual partners are shielded from joint liability created by another partner's wrongful business decisions or misconduct.
Mutual rights and duties of the partners within a LLP are governed by an agreement between the partners or between the partners and the LLP as the case may be. The LLP, however, is not relieved of the liability for its other obligations as a separate entity.

Since LLP contains elements of both ‘a corporate structure’ as well as ‘a partnership firm structure’ LLP is called a hybrid between a company and a partnership.

LLP is a body corporate and a legal entity separate from its partners, having perpetual succession. LLP form is a form of business model which :(i) is organized and operates on the basis of an agreement,(ii) provides flexibility without imposing detailed legal and procedural requirements (iii) enables professional/technical expertise and initiative to combine with financial risk taking capacity in an innovative and efficient manner.

A basic difference between an LLP and a company lies in that the internal governance structure of a company is regulated by statute (i.e. Companies Act) whereas for an LLP it would be by a contractual agreement between partners.

The management-ownership divide inherent in a company is not there in a limited liability partnership. LLP have more flexibility as compared to a company. LLP have lesser compliance requirements as compared to a company.

### Distinction between Company and Hindu Joint Family Business

1. A company consists of heterogeneous members, whereas a Hindu Undivided Family Business consists of homogenous members since it consists of members of the joint family itself.

2. In a Hindu Joint Family business the Karta (manager) has the sole authority to contract debts for the purpose of the business, other coparceners cannot do so. There is no such system in a company.

3. A person becomes a member of Joint Hindu Family business by virtue of birth. There is no provision to that effect in the company.

4. No registration is compulsory for carrying on business for gain by a Hindu Joint Family even if the number of members exceeds twenty [Shyamlal Roy v. Madhusudan Roy, AIR 1959 Cal. 380 (385)]. Registration of a company is compulsory.

### Distinction between a Company and a Club

1. A company is a trading association. A club, on the other hand, is a non-trading association.

2. Registration of a company is compulsory. Registration of a club is not compulsory.

### Distinction between a Company and a Corporation (i.e. Company vis-à-vis Body Corporate)

Generally speaking, an association of persons incorporated according to the relevant law and clothed with legal personality separate from the persons constituting it is known as a corporation. The word ‘corporation’ or words ‘body corporate’ is/are both used in the Companies Act, 2013.

Definition of the same which is reproduced below is contained in Clause (11) of Section 2 of the Act:

“Body corporate” or “corporation” includes a company incorporated outside India, but does not include—

(i) a co-operative society registered under any law relating to co-operative societies; and

(ii) any other body corporate (not being a company as defined in this Act),

which the Central Government may, by notification, specify in this behalf;

A society registered under the Societies Registration Act has been held by the Supreme Court in Board of Trustees v. State of Delhi, A.I.R. 1962 S.C. 458, not to come within the term ‘body corporate’ under the Companies
Act, though it is a legal person capable of holding property and becoming a member of a company.

Advantages of Incorporation

As compared to other types of business associations, an incorporated company has the following advantages:

A. **Corporate Personality:** Unlike a partnership firm, which has no existence apart from its members, a company is a distinct legal or juristic person independent of its members. Under the law, an incorporated company is a distinct entity, even the one-man company as discussed above in Salomon & Co. Ltd., case is different from its shareholders.

As per section 9 of the Companies Act, 2013 from the date of incorporation mentioned in the certificate of incorporation, such subscribers to the memorandum and all other persons, as may, from time to time, become members of the company, shall be a body corporate by the name contained in the memorandum, capable of exercising all the functions of an incorporated company under the Act and having perpetual succession and a common seal with power to acquire, hold and dispose of property, both movable and immovable, tangible and intangible, to contract and to sue and be sued, by the said name.

B. **Limited Liability:** The Companies Act provides that in the event of the company being wound-up, the members shall have liability to contribute to the assets of the company in accordance with the Act. In the case of companies limited by shares, no member is bound to contribute anything more than the nominal value of the shares held by him which remains unpaid. The privilege of limiting the liability is one of the principal advantages of doing business under the corporate form of organisation.

C. **Perpetual Succession:** As stated in Section 9 of the Companies Act, 2013 an incorporated company has perpetual succession. Notwithstanding any change in its members, the company will be the same entity with the same privileges and immunities, estate and possessions. The death or insolvency of individual members does not in any way, affect the corporate entity, its existence or continuity. The company shall continue to exist indefinitely till it is wound-up in accordance with the provisions of the Companies Act. “Members may come and members may go but the company can go on forever”.

D. **Transferable Shares:** Section 44 of the Companies Act, 2013 provides the shares or other interest of any member in a company shall be movable property, transferable in the manner provided by the articles of the company. This encourages investment of funds in the shares, so that the members may encash them at any time. Thus, it provides liquidity to the investors as shares could be sold in the open market and in stock exchange. It also provides stability to the company.

E. **Separate Property:** A company as a legal entity is capable of owning its funds and other assets. “The property of the company is not the property of the shareholders, it is property of the company” [Gramophone & Typewriter Co. v. Stanley, (1906) 2 K.B. 856 at p. 869]. “The company is the real person in which all the property is vested, and by which it is controlled, managed and disposed of”. In the eyes of law, even a member holding majority of shares or a managing director of a company is held liable for criminal misappropriation of the funds or property of the company, if he unauthorisedly takes it away and uses it for his personal purposes.

F. **Capacity to Sue:** As a juristic legal person, a company can sue in its name and be sued by others. The managing director and other directors are not liable to be sued for dues against a company.

G. **Flexibility and Autonomy:** The company has an autonomy and independence to form its own policies and implement them, subject to the general principles of law, equity and good conscience and in accordance with the provisions contained in the Companies Act, Memorandum and Articles of Association. The company form of management of business disassociates the “ownership” from the “control” of business, and helps promote professional management and efficiency. The Key Managerial Personnel can carry on the business activities with freedom, authority and accountability in accordance with the Company Law. The Companies
Act, 2013 has for the first time recognized the concept of **Key Managerial Personnel**. As per section 2(51) "key managerial personnel", in relation to a company, means –

(i) the Chief Executive Officer or the managing director or the manager;

(ii) **the company secretary**;

(iii) the whole-time director;

(iv) the Chief Financial Officer; and

(v) such other officer as may be prescribed.

**Disadvantages of Incorporation**

There are, however, certain disadvantages and inconveniences in Incorporation. Some of these disadvantages are:

1. **Formalities and expenses**: Incorporation of a company is coupled with complex, cumbersome and detailed legal formalities and procedures, involving considerable amount of time and money. Such elaborate procedures have been laid down to deter persons who are not serious about doing business, as a company enjoys various facilities from the community. Even after the company is incorporated, its affairs and working must be conducted strictly in accordance with legal provisions. Thus various returns and documents are required to be filed with the Registrar of Companies, some periodically and some on the happening of an event. Certain books and registers are compulsorily required to be maintained by a company. Approval and sanction of the Company Law Board/National Company Law Tribunal / National Company Law Appellate Tribunal, the Government, the Court, the Registrar of Companies or other appropriate authority, as the case may be, is necessarily required to be obtained for certain corporate activities. Certain corporate activities such as corporate meetings, accounts, audit, borrowings, lending, investment, issue of capital, dividends etc. are necessarily required to be conducted and carried out strictly in accordance with the provisions of the Act and within the prescribed time. Any breach of the legal provisions is followed by severe penal consequences. Other forms of business organisations are comparatively free from these legal complexities and procedural formalities.

2. **Corporate disclosures**: Notwithstanding the elaborate legal framework designed to ensure maximum disclosure of corporate information, the members of a company are having comparatively restricted accessibility to its internal management and day-to-day administration of corporate working.

3. **Separation of control from ownership**: Members of a company are not having as effective and intimate control over its working as one can have in other forms of business organisation, say, a partnership firm. This is particularly so in big companies in which the number of members is too large to exercise any effective control over its day-to-day affairs. No member of a company can act in his individual capacity for and on behalf of the company. The members of a company are neither the owners nor the agents of the company. Thus, the position of ownership of members is more passive in nature. The members may not have an active and complete control over the company's working as the partners may have over the firm’s affairs.

4. **Greater social responsibility**: Having regard to the enormous powers wielded by the companies and the impact they have on the society, the companies are called upon to show greater social responsibility in their working and, for that purpose, are subject to greater control and regulation than that by which other forms of business organisation are governed and regulated.

5. **Greater tax burden in certain cases**: In certain circumstances, the tax burden on a company is more than that on other forms of business organisation. A company is liable to tax without any minimum taxable limit as is prescribed in the cases of registered partnership firms and others. Also it has to pay income-tax on
the whole of its income at a flat rate whereas others are taxed on graduated scale or slab system. These tax implications may have crucial bearing on a decision regarding the selection of any form of business organisation and the time when the existing form of business organisation should be changed to a new one. Thus, tax implications may direct the adoption of the partnership form of business organisation as expedient at the initial stage to be converted into a company later on, when the tax implications may be more favourable because of the size of the organisation and its scale of operations.

6. **Detailed winding-up procedure:** The Act provides elaborate and detailed procedure for winding-up of companies which is more expensive and time consuming than that which is applicable to other forms of business organisation.

There are, however, some exceptions to the principles of Corporate Personality and the Limited Liability of members. These are discussed below:

### Lifting or Piercing the Corporate Veil

Law has clothed a corporation with a distinct personality, yet in reality it is an association of persons who are in fact, in a way, the beneficial owners of the property of the body corporate. A company, being an artificial person, cannot act on its own, it can act only through natural persons.

Indeed, the theory of corporate entity is still the basic principle on which the whole law of corporations is based. But as the separate personality of the company is a statutory privilege, it must be used for legitimate business purposes only. Where a fraudulent and dishonest use is made of the legal entity, the individuals concerned will not be allowed to take shelter behind the corporate personality. The Court will breakthrough the corporate shell and apply the principle of what is known as “lifting of or piercing through the corporate veil”. The Court will look behind the corporate entity and take action as though no entity separate from the members existed and make the members or the controlling persons liable for debts and obligations of the company.

The corporate veil is lifted when in defence proceedings, such as for the evasion of tax, an entity relies on its corporate personality as a shield to cover its wrong doings. [*BSN (UK) Ltd. v. Janardan Mohandas Rajan Pillai* [1996] 86 Comp. Cas. 371 (Bom).]

In the following cases the Courts have lifted the corporate veil:

1. Where the corporate veil has been used for commission of fraud or improper conduct, Courts have lifted the veil and looked at the realities of the situation. In *Gilford Motor Co. v. Horne*, (1933) 1 Ch. 935, a former employee of a company made a covenant not to solicit its customers. He formed a company which undertook solicitation. The company was restrained by the Court.

2. Where the corporation is really an agency or trust for some one else and the corporate facade is used to cover up that agency or trust. In *R.G. Films Ltd.*, (1953) 1 All E.R. 615, an American company produced a film in India technically in the name of a British Company, 90% of whose capital was held by the President of the American Company which financed the production of the film. Board of Trade refused to register the film as a British film on the ground that English company acted merely as the nominee of the American corporation.

3. Where the doctrine conflicts with public policy, Courts have lifted the corporate veil for protecting the public policy. In *Connors Bros. v. Connors* (1940) 4 All E.R. 179, the principle was applied against the managing director who made use of his position contrary to public policy. In this case, the House of Lords determined the character of the company as “enemy” company, since the persons who were *de facto* in control of its affairs, were residents of Germany, which was at war with England at that time. The alien company was not allowed to proceed with the action, as that would have meant giving money to the enemy, which was considered as monstrous and against “public policy”.

4. For determining the true character or status of the company. In *Daimler Co. Ltd. v. Continental Tyre and Rubber Co.*, (1916) 2 A.C. 307, the Court looked behind the facade of the company and its place of registration in order to determine the true character of the company, i.e., whether it was an “enemy” company.

5. Where the veil has been used for evasion of taxes and duties, the Court upheld the piercing of the veil to look at the real transaction. (*Commissioner of Income Tax v. Meenakshi Mills Ltd.*, A.I.R. (1967) S.C. 819).

6. Where it was found that the sole purpose for which the company was formed was to evade taxes the Court will ignore the concept of separate entity, and make the individuals liable to pay the taxes which they would have paid but for the formation of the company. In the case of *Sir Dinshaw Manakjee Petit*, AIR 1927 Bombay 371, the assessee was a wealthy man enjoying large dividend and interest income. He formed four private companies and agreed with each to hold a block of investment as an agent for it. Income received was credited in the accounts of the company but the company handed back the amount to him as a pretended loan. This way he divided his income in four parts in a bid to reduce his tax liability. The Court disregarded the corporate entity on the grounds that the company was formed by the assessee purely and simply as a means of avoiding tax and the company was nothing more than the assessee himself.

7. Where the purpose of company formation was to avoid welfare legislation. Where it was found that the sole purpose for the formation of the new company was to use it as a device to reduce the amount to be paid by way of bonus to workmen, the Supreme Court upheld the piercing of the veil to look at the real transaction (*The Workmen Employed in Associated Rubber Industries Limited, Bhavnagar v. The Associated Rubber Industries Ltd., Bhavnagar and another*, A.I.R. 1986 SC 1).

**KINDS OF COMPANIES**

The Companies Act, 2013 provides for a variety of companies of which can be promoted and registered under the Act. These companies may be:

(i) limited by shares;

(ii) limited by guarantee; or

(iii) unlimited companies.

Companies may also be classified as:

(a) Private Companies;

(b) Public Companies;

(c) One Person Company

(d) Company with charitable objects, etc. under Section 8 of the Companies Act, 2013;

(e) Small Company

(f) Government companies;

(g) Foreign companies;

(h) Holding companies; and

(i) Subsidiary companies.

(j) Producer Companies.

A brief discussion of each type of company follows hereunder.
A Company Limited by Shares

A company limited by shares may be defined as a “registered company” whether public or private company having the liability of its members limited by its memorandum to the amount, if any, unpaid on the shares respectively held by them. In other words, a member of a company limited by shares is required to pay only the nominal amount of shares held by him and nothing more. If the shares are fully paid-up he has nothing more to pay.

A Company Limited by Guarantee

A company limited by guarantee is a registered company having the liability of its members limited by its memorandum to such an amount as the members may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound up.

A special feature of this type of company is that the liability of members to pay their guarantee amount arises only when the company goes into liquidation and not when it is a going concern.

Clubs, trade associations and societies for promoting different objects are at times incorporated as companies limited by Guarantee to take the advantages of incorporation without running the risk of heavy liabilities.

An Unlimited Company

An unlimited company is a company not having any limit on the liability of its members. Thus, the maximum liability of the members of such a company, in the event of its being wound up, might stretch up to the full extent of their properties to meet the obligations of the company by contributing to its assets. However, the members of an unlimited company are not liable directly to the creditors of the company, as in the case of partners of a firm. The liability of the members is only towards the company and in the event of its being wound up only the liquidator can ask the members to contribute to the assets of the company which will be used in discharging the debts of the company.

A company registered as an unlimited company may subsequently convert itself as a limited company, subject to the condition that any debts, liabilities, obligations or contracts incurred or entered into, by or on behalf of the unlimited company before such conversion are not affected by such changed registration.

Private Company [Section 2(68)]

By virtue of Section 2(68) of Companies Act, 2013 “private company” means a company having a minimum paid up share capital of one lakh rupees or such higher paid-up share capital as may be prescribed, and which by its articles, –

(i) restricts the right to transfer its shares;

(ii) except in case of One Person Company, limits the number of its members to two hundred:

Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this clause, be treated as a single member:

Provided further that –

(A) persons who are in the employment of the company; and

(B) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased, shall not be included in the number of members; and

(iii) prohibits any invitation to the public to subscribe for any securities of the company;
Maximum number of members that a private company can have is 200.

There should be at least two persons to form a private company. A private company can therefore be registered with a minimum of 2 members and cannot have more than 200 members (excluding employee and ex-employee members). It cannot invite the public to subscribe for its shares or debentures nor can its shares be freely transferred.

The words “Private Limited” must be added at the end of its name by a private limited company.

**Public Company [Section 2(71)]**

“Public company” means a company which –

(a) is not a private company;

(b) has a minimum paid-up share capital of five lakh rupees or such higher paid-up capital, as may be prescribed:

Provided that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles;

It is clarified the status of a private company which is a subsidiary of a public company by providing specifically in the proviso that such company shall be deemed to be public company irrespective of its status as private company in its articles.

**Distinction between a Public and a Private Company**

1. **Minimum number**: The minimum number of persons required to form a public company is 7. It is 2 in case of a private company.

2. **Maximum number**: There is no restriction on maximum number of members in a public company, whereas the maximum number cannot exceed 200 in a private company.

3. **Number of directors**: A public company must have at least 3 directors, whereas a private company must have at least 2 directors.

4. **Restriction on invitation to subscribe for shares**: A public company invites the general public to subscribe for the shares in, or the debentures of the company. A private company by its Articles prohibits any such invitation to the public.

5. **Transferability of shares**: In a public company, the shares are freely transferable. In a private company the right to transfer shares is restricted by the Articles.

6. **Special privileges**: A private company enjoys some special privileges. A public company enjoys no such privileges.

**One Person Company (OPC)**

With the implementation of the Companies Act, 2013, a single person could constitute a Company, under the One Person Company (OPC) concept. The introduction of OPC in the legal system is a move that would encourage corporatisation of micro businesses and entrepreneurship.

As per section 2(62) of the Companies Act, 2013, “One Person Company” means a company which has only one person as a member.

The memorandum of One Person Company is required to indicate the name of the other person, with his prior written consent in the prescribed form, who shall, in the event of the subscriber’s death or his incapacity to
contract become the member of the company and the written consent of such person shall be filed with the Registrar at the time of incorporation of the One Person Company along with its memorandum and articles.

Other conditions for One Person Company are as under:

1. Only a natural person who is an Indian citizen and resident in India –
   a. shall be eligible to incorporate a One Person Company;
   b. shall be a nominee for the sole member of a One Person Company.

   It may be noted that “resident in India” means a person who has stayed in India for a period of not less than one hundred and eighty two days during the immediately preceding one calendar year.

2. No person shall be eligible to incorporate more than a One Person Company or become nominee in more than one such company.

3. No minor shall become member or nominee of the One Person Company or can hold share with beneficial interest.

4. Such Company cannot be incorporated or converted into a company under section 8 of Companies Act, 2013 (section 8 deals with Formation of company with charitable objects, etc.)

5. Such Company cannot carry out Non-Banking Financial Investment activities including investment in securities of any body corporates.

6. No such company can convert voluntarily into any kind of company unless two years have expired from the date of incorporation of One Person Company, except threshold limit (paid up share capital) is increased beyond fifty lakh rupees or its average annual turnover during the relevant period exceeds two crore rupees.

**Company with charitable objects**

Section 8 of the Companies Act, 2013 provides that where it is proved to the satisfaction of the Central Government that a person or an association of persons proposed to be registered as a limited company –

a. has in its objects the promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object;

b. intends to apply its profits, if any, or other income in promoting its objects; and

c. intends to prohibit the payment of any dividend to its members,

The Central Government may, by licence issued in such prescribed manner and on such conditions as it deems fit, allow that person or association of persons to be registered as a limited company without the addition to its name of the word “Limited”, or as the case may be, the words “Private Limited”, and thereupon the Registrar shall, on application, in the prescribed form, register such person or association of persons as a company under this section.

2. The company registered under section 8 shall enjoy all the privileges and be subject to all the obligations of limited companies.

3. A firm may be a member of the company registered under this section.

4. A company registered under section 8 shall not alter the provisions of its memorandum or articles except with the previous approval of the Central Government.

5. A company registered under section 8 may convert itself into company of any other kind only after complying with such prescribed conditions.
(6) The Central Government may, by order, revoke the licence granted to a company registered under this section if the company contravenes any of the requirements or any of the conditions subject to which a licence is issued or the affairs of the company are conducted fraudulently or in a manner violative of the objects of the company or prejudicial to public interest, and without prejudice to any other action against the company under this Act, direct the company to convert its status and change its name to add the word “Limited” or the words “Private Limited”, as the case may be, to its name and thereupon the Registrar shall register the company accordingly.

(7) Where a licence is revoked, the Central Government may, by order, if it is satisfied that it is essential in the public interest, direct that the company be wound up under this Act or amalgamated with another company registered under this section.

**Small Company**

Small company is a new form of private company under the Companies Act, 2013. A classification of a private company into a small company is based on its size i.e. paid up capital and turnover. In other words, such companies are small sized private companies.

As per section 2(85) “small company” means a company, other than a public company, –

(i) paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than five crore rupees; or

(ii) turnover of which as per its last profit and loss account does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than twenty crore rupees:

Provided that nothing in this definition shall apply to –

(A) a holding company or a subsidiary company;

(B) a company registered under section 8; or

(C) a company or body corporate governed by any special Act;

**Government Companies**

Section 2(45) of the Companies Act, 2013 defines “Government Company” as any company in which not less than fifty one per cent. of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.

Where the Central Government is a member of a Government company, the Central Government shall cause an annual report on the working and affairs of that company to be prepared within three months of its annual general meeting, and laid before both Houses of Parliament together with a copy of the audit report and comments upon or supplement to the audit report, made by the Comptroller and Auditor-General of India.

Where in addition to the Central Government, any State Government is also a member of a Government company, that State Government shall cause a copy of the annual report prepared within three months of its annual general meeting and laid before the House or both Houses of the State Legislature together with a copy of the audit report and the comments upon or supplement to the audit report, made by the Comptroller and Auditor-General of India.

Where the Central Government is not a member of a Government company, every State Government which is a member of that company, or where only one State Government is a member of the company, that State Government shall cause an annual report on the working and affairs of the company to be prepared and as soon as may be after such preparation, laid before the House or both Houses of the State Legislature together with a
copy of the audit report and comments upon or supplement to the audit report made by the Comptroller and Auditor-General of India.

**Foreign Companies**

As per section 2(42) of the Companies Act, 2013 “foreign company” means any company or body corporate incorporated outside India which —

(a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and

(b) conducts any business activity in India in any other manner.

Where not less than fifty per cent. of the paid-up share capital, whether equity or preference or partly equity and partly preference, of a foreign company is held by one or more citizens of India or by one or more companies or bodies corporate incorporated in India, or by one or more citizens of India and one or more companies or bodies corporate incorporated in India, whether singly or in the aggregate, such company shall comply with the provisions of Chapter XXIII deals with companies incorporated outside India contains Sections 379 to 395 and such other prescribed provisions of the Companies Act, 2013 as may be with regard to the business carried on by it in India as if it were a company incorporated in India.

**Holding company**

As per Section 2(46) of the Companies Act, 2013, holding company, in relation to one or more other companies, means a company of which such companies are subsidiary companies.

**Subsidiary company**

Section 2(87) of the Companies Act, 2013 provides that subsidiary company or subsidiary, in relation to any other company (that is to say the holding company), means a company in which the holding company—

(i) controls the composition of the Board of Directors; or

(ii) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies:

Provided that such class or classes of holding companies, shall not have layers of subsidiaries beyond the prescribed limit. (Proviso to be notified)

For the above purpose, —

(a) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;

(b) the composition of a company’s Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;

(c) the expression “company” includes any body corporate;

It may be noted that according to section 2 (27) of the Companies Act, 2013, control shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.
Producer Company

Section 465(1) of the Companies Act, 2013 provides that the Companies Act, 1956 and the Registration of Companies (Sikkim) Act, 1961 (hereafter in this section referred to as the repealed enactments) shall stand repealed.

However, proviso to section 465(1) provides that the provisions of Part IX A of the Companies Act, 1956 shall be applicable mutatis mutandis to a Producer Company in a manner as if the Companies Act, 1956 has not been repealed until a special Act is enacted for Producer Companies.

In view of the above provision, Producer Companies are still governed by the Companies Act, 1956. Companies (Amendment) Act, 2002 had added a new Part IXA to the main Companies Act, 1956 consisting of 46 new Sections from 581A to 581ZT relating to Producer Companies.

According to the provisions as prescribed under Section 581A(l) of the Companies Act, 1956, a producer company is a body corporate having objects or activities specified in Section 581B and which is registered as such under the provisions of the Act. The membership of producer companies is open to such people who themselves are the primary producers, which is an activity by which some agricultural produce is produced by such primary producers.

PROMOTION AND INCORPORATION OF A COMPANY

Any seven or more persons can form a public company and any two or more persons can form a private company and one person can form One Person Company. However, the company should be formed for a lawful purpose i.e. it should not be in contravention of the general law of the country. Every company public or private has to be registered with the Registrar of Companies (ROC). The ROC is the authority which besides registration of companies, receives documents and forms from companies and registers them, maintains records of the companies and makes this record available for public inspection as well as ensures that companies by and large comply with the provisions of Companies Act, 2013.

The whole process of the company formation may be divided into three distinct stages, namely:

(i) Promotion;

(ii) Incorporation by Registration; and

(iii) Commencement of Business.

Promotion

“Promotion” is the process of conceiving an idea and developing it into a concrete proposition or project to be accomplished by the incorporation and floatation of a company. The person who takes the necessary steps to accomplish these objectives is known as promoter.

Promoters

Section 2 (69) of the Companies Act, 2013 defines the term ‘promoter’ as under:

“Promoter” means a person –

(a) who has been named as such in a prospectus or is identified by the company in the annual return referred to in section 92; or

(b) who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or
(c) in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act.

Provided that sub-clause (c) shall not apply to a person who is acting merely in a professional capacity.

By virtue of above definition, persons in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act are also treated as promoters. However, if a person is merely acting in a professional capacity i.e. giving only professional advice to the Board of directors, he shall not be treated as a promoter.

**Is a director/officer/employee of the issuer a promoter?**

A director/officer/employee who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise is considered as a promoter. As per section 2 (27), control shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

However, a director or officer or employee of the issuer or a person, if acting as such merely in his professional capacity, shall not be deemed as a promoter.

**PROMOTERS’ CONTRACT — RATIFICATION THEREOF**

As regards ratification of promoters’ contracts, the view taken in *Kelner v. Baxter LR* (1886) 2 CP 174 was that the company could not ratify contract made by a promoter before its incorporation. Specific performance of a contract may be enforced against a company in respect of contracts entered into by promoters on behalf of the company, if such a contract is warranted by the terms of incorporation and the company has accepted the contract and communicated the acceptance to the other party. (Section 15 of the Specific Relief Act, 1963).

Section 19 of the same Act provides that the other party can also enforce the contract if the company has adopted it after incorporation and the contract is within the terms of incorporation.

As long as the company does not ratify, as required by the Specific Relief Act, 1963 the position remains the same as under the common law.

**Legal Position of a Promoter**

While the accurate description of a promoter may be difficult, his legal position is quite clear. A promoter is neither an agent of, nor a trustee for, the company because it is not in existence. But he occupies a fiduciary position in relation to the company and therefore requires to make full disclosure of the relevant facts, including any profit made by him.

The corollary which the law deduces from this rule of fiduciary relationship is that a promoter may not make, either directly or indirectly, any profit at the expense of the company, he promotes, without the knowledge and consent of the company, and that, if he does make a secret profit in disregard of this rule, the company can compel him to account for it, and surrender the secret profit. When the promoter defrauds the company, he becomes liable for damages and on his death his estate remains liable if it has benefitted from the deceit or breach of trust, but not otherwise.

**INCORPORATION OF COMPANIES - PROCEDURAL ASPECTS**

**(a) Application for Availability of Name of company**

A company being a legal entity must have a name of its own to establish its separate identity. The name of the
company is a symbol of its independent corporate existence. The first clause in the memorandum of association of the company states the name by which a company is to be known. The company may adopt any suitable name provided it is not undesirable.

According to section 4(2) of the Companies Act, 2013, the name stated in the memorandum shall not –

(a) be identical with or resemble too nearly to the name of an existing company registered under this Act or any previous company law; or

(b) be such that its use by the company –

(i) will constitute an offence under any law for the time being in force; or

(ii) is undesirable in the opinion of the Central Government.

Section 4(3) of the Companies Act, 2013 provides that without prejudice to the provisions of section 4(2), a company shall not be registered with a name which contains—

(a) any word or expression which is likely to give the impression that the company is in any way connected with, or having the patronage of, the Central Government, any State Government, or any local authority, corporation or body constituted by the Central Government or any State Government under any law for the time being in force; or

(b) such word or expression, as may be prescribed, unless the previous approval of the Central Government has been obtained for the use of any such word or expression.

As per section 4(4) a person may make an application, in such form and manner and accompanied by such fee, as may be prescribed, to the Registrar for the reservation of a name set out in the application as—

(a) the name of the proposed company; or

(b) the name to which the company proposes to change its name.

Section 4(5)(i) lays down that upon receipt of an application under sub-section (4), the Registrar may, on the basis of information and documents furnished along with the application, reserve the name for a period of 60 days from the date of the application.

As stated above, section 4(2) provides that the name stated in the memorandum shall not be such that its use by the company, in the opinion of the Central Government, is undesirable. A name which is identical to or too nearly resembles, the name by which a company in existence has been previously registered, will be deemed to be undesirable.

The object is to prevent the use of a name likely to mislead the public. For example, a company is not allowed to use a name which is prohibited under the Emblems and Names (Prevention of Improper Use) Act, 1950, or suggestive of any connection with Government or of State patronage where there is none.

As per Rule 9 of Companies (incorporation) Rules 2014, an application for the reservation of a name shall be made in Form No. INC.1 along with the fee as provided in the Companies (Registration offices and fees) Rules, 2014.

(b) Preparation of Memorandum and Articles of Association

The Memorandum of Association

The Memorandum of Association is a document which sets out the constitution of a company and is therefore the foundation on which the structure of the company is built. It defines the scope of the company’s activities and its relations with the outside world.
The first step in the formation of a company is to prepare a document called the memorandum of association. In fact memorandum is one of the most essential pre-requisites for incorporating any form of company under the Act. This is evidenced in Section 3 of the Act, which provides the mode of incorporation of a company and states that a company may be formed for any lawful purpose by seven or more persons, where the company to be formed is a public company; two or more persons, where the company to be formed is a private company; or one person, where the company to be formed is a One Person Company by subscribing their names or his name to a memorandum and complying with the requirements of this Act in respect of its registration.

To subscribe means to append one's signature or mark a document as an approval or attestation of its contents.

According to Section 2(56) of the Companies Act, 2013 "memorandum" means the memorandum of association of a company as originally framed and altered from time to time in pursuance of any previous company law or this Act.

Section 4 of the Companies Act, 2013 specifies in clear terms the contents of this important document which is the charter of the company. The memorandum of association of a company contains the objects to pursue which the company is formed. It not only shows the objects of formation but also determines the scope of its operations beyond which its actions cannot go. “THE MEMORANDUM OF ASSOCIATION”, observed Palmer, “is a document of great importance in relation to the proposed company”.

Memorandum of Association is the charter of a company. It is a document, which amongst other things, defines the area within which the company can operate.

Section 4(1) states that the memorandum of a company shall state –

(a) the name of the company with the last word “Limited” in the case of a public limited company, or the last words “Private Limited” in the case of a private limited company

(b) the State in which the registered office of the company is to be situated;

(c) the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof;

(d) the liability of members of the company, whether limited or unlimited, and also state,— (i) in the case of a company limited by shares, that liability of its members is limited to the amount unpaid, if any, on the shares held by them; and (ii) in the case of a company limited by guarantee, the amount up to which each member undertakes to contribute – (A) to the assets of the company in the event of its being wound-up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and (B) to the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves;

(e) in the case of a company having a share capital, – (i) the amount of share capital with which the company is to be registered and the division thereof into shares of a fixed amount and the number of shares which the subscribers to the memorandum agree to subscribe which shall not be less than one share; and (ii) the number of shares each subscriber to the memorandum intends to take, indicated opposite his name;

(f) in the case of One Person Company, the name of the person who, in the event of death of the subscriber, shall become the member of the company.

**Article of Association**

According to Section 2(5) of the Companies Act, 2013, ‘articles’ means the articles of association of a company as originally framed or as altered from time to time or applied in pursuance of any previous company law or of this Act. It also includes the regulations contained in Table A in Schedule I of the Act, in so far as they apply to the company.
In terms of section 5(1) of the Companies Act, 2013, the articles of a company shall contain the regulations for management of the company. The articles of association of a company are its bye-laws or rules and regulations that govern the management of its internal affairs and the conduct of its business. The articles play a very important role in the affairs of a company. It deals with the rights of the members of the company inter se. They are subordinate to and are controlled by the memorandum of association. The general functions of the articles have been aptly summed up by Lord Cairns, L.C. in *Ashbury Railway Carriage and Iron Co. Ltd. v. Riche*, (1875) L.R. 7 H.L. 653 as follows:

“The articles play a part that is subsidiary to the memorandum of association. They accept the memorandum of association as the charter of incorporation of the company, and so accepting it, the articles proceed to define the duties, rights and powers of the governing body as between themselves and the company at large, and the mode and form in which business of the company is to be carried on, and the mode and form in which changes in the internal regulations of the company may from time to time be made... The memorandum, is as it were... the area beyond which the action of the company cannot go; inside that area shareholders may make such regulations for the governance of the company as they think fit“.

Thus, the memorandum lays down the scope and powers of the company, and the articles govern the ways in which the objects of the company are to be carried out and can be framed and altered by the members. But they must keep within the limits marked out by the memorandum and the Companies Act.

The articles must be printed, divided into paragraphs, numbered consecutively, stamped adequately, signed by each subscriber to the memorandum and duly witnessed and filed along with the memorandum. The articles must not contain anything illegal or *ultra vires* the memorandum, nor should it be contrary to the provisions of the Companies Act, 2013.

**CONTENTS OF ARTICLES**

The articles set out the rules and regulations framed by the company for its own working. The articles should contain generally the following matters:

1. Exclusion wholly or in part of Table F.
2. Adoption of preliminary contracts.
3. Number and value of shares.
4. Issue of preference shares.
5. Allotment of shares.
6. Calls on shares.
7. Lien on shares.
8. Transfer and transmission of shares.
10. Forfeiture of shares.
11. Alteration of capital.
15. Conversion of shares into stock.
17. Meetings and rules regarding committees.
18. Directors, their appointment and delegations of powers.
20. Issue of Debentures and stocks.
21. Audit committee.
22. Managing director, Whole-time director, Manager, Secretary.
23. Additional directors.
24. Seal.
25. Remuneration of directors.
27. Directors meetings.
29. Dividends and reserves.
30. Accounts and audit.
31. Winding up.
32. Indemnity.
33. Capitalisation of reserves.

Utmost caution must be exercised in the preparation of the articles of association of a company. At the same time, certain provisions of the Act are applicable to the company “notwithstanding anything to the contrary in the articles”. Therefore, the articles must contain provisions in respect of all matters which are required to be contained therein so as not to hamper the working of the company later.

Section 5(1) of the Companies Act, 2013 states that the articles of a company shall contain the regulations for management of the company.

**FILING OF DOCUMENTS WITH REGISTRAR OF COMPANIES**

Section 7(1) of the Companies Act, 2013 states that there shall be filed with the Registrar within whose jurisdiction the registered office of a company is proposed to be situated, the following documents and information for registration, namely: –

**a) Application for Incorporation of Companies**

Rule 12 of Companies (Incorporation) Rules 2014 states that an application for incorporation shall be filed with ROC in form INC-2 (in case of one person company or INC-7 in case of other companies).

**b) Memorandum and Articles of Association of the company duly signed**

Section 7(1)(a) the filing of the memorandum and articles of the company duly signed by all the subscribers to the memorandum in such manner as may be prescribed;

*Rule 13 of Companies (Incorporation) Rules 2014 states that –*

The Memorandum and Articles of Association of the company shall be signed in the following manner, namely:-
(1) The memorandum and articles of association of the company shall be signed by each subscriber to the memorandum, who shall add his name, address, description and occupation, if any, in the presence of at least one witness who shall attest the signature and shall likewise sign and add his name, address, description and occupation, if any and the witness shall state that “I witness to subscriber/subscriber(s), who has/have subscribed and signed in my presence (date and place to be given); further I have verified his or their Identity Details (ID) for their identification and satisfied myself of his/her/their identification particulars as filled in”

(2) Where a subscriber to the memorandum is illiterate, he shall affix his thumb impression or mark which shall be described as such by the person, writing for him, who shall place the name of the subscriber against or below the mark and authenticate it by his own signature and he shall also write against the name of the subscriber, the number of shares taken by him.

(3) Such person shall also read and explain the contents of the memorandum and articles of association to the subscriber and make an endorsement to that effect on the memorandum and articles of association.

(4) Where the subscriber to the memorandum is a body corporate, the memorandum and articles of association shall be signed by director, officer or employee of the body corporate duly authorized in this behalf by a resolution of the board of directors of the body corporate and where the subscriber is a Limited Liability Partnership, it shall be signed by a partner of the Limited Liability Partnership, duly authorized by a resolution approved by all the partners of the Limited Liability Partnership:

Provided that in either case, the person so authorized shall not, at the same time, be a subscriber to the memorandum and articles of Association.

(5) Where subscriber to the memorandum is a foreign national residing outside India-

(a) in a country in any part of the Commonwealth, his signatures and address on the memorandum and articles of association and proof of identity shall be notarized by a Notary (Public) in that part of the Commonwealth.

(b) in a country which is a party to the Hague Apostille Convention, 1961, his signatures and address on the memorandum and articles of association and proof of identity shall be notarized before the Notary (Public) of the country of his origin and be duly apostillised in accordance with the said Hague Convention.

(c) in a country outside the Commonwealth and which is not a party to the Hague Apostille Convention, 1961, his signatures and address on the memorandum and articles of association and proof of identity shall be authenticated by a Diplomatic or Consular Officer empowered in this behalf under section 3 of the Diplomatic and Consular Officers (Oaths and Fees) Act, 1948 (40 of 1948) or, where there is no such officer by any of the officials mentioned in section 6 of the Commissioners of Oaths Act, 1889 (52 and 53 Vic.C.10), or in any Act amending the same;

(d) visited in India and intended to incorporate a company, in such case the incorporation shall be allowed if, he/she is having a valid Business Visa.

Explanation.- For the purposes of this clause, it is hereby clarified that, in case of Person is of Indian Origin or Overseas Citizen of India, requirement of business Visa shall not be applicable.

(c) Declaration from the professional

Section 7(1)(b) of the Companies Act, 2013 requires filing of a declaration in the prescribed form by an advocate, a chartered accountant, cost accountant or company secretary in practice, who is engaged in the formation of the company, and by a person named in the articles as a director, manager or secretary of the company, that all the requirements of this Act and the rules made thereunder in respect of registration and matters precedent or incidental thereto have been complied with;
Rule 14 of The Companies (Incorporation) Rules 2014 states that for the purposes of clause (b) of sub-section (1) of section 7, the declaration by an advocate, a Chartered Accountant, Cost accountant or Company Secretary in practice shall be in Form No. INC.8.

Explanation (i) “chartered accountant” means a chartered accountant as defined in clause (b) of sub-section 1 of section 2 of the Chartered Accountants Act, 1949 (ii) “Cost Accountant” means a cost accountant as defined in clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 and (iii) “company secretary” means a “company secretary” or “secretary” means as defined in clause (c) of sub-section (1) of section 2 of the Company Secretaries Act, 1980.

(d) Affidavit from the subscribers to the Memorandum

Section 7(1)(c) of the Companies Act, 2013 requires the filing of an affidavit from each of the subscribers to the memorandum and from persons named as the first directors, if any, in the articles that he is not convicted of any offence in connection with the promotion, formation or management of any company, or that he has not been found guilty of any fraud or misfeasance or of any breach of duty to any company under this Act or any previous company law during the preceding five years and that all the documents filed with the Registrar for registration of the company contain information that is correct and complete and true to the best of his knowledge and belief;

Rule 15 of The Companies (Incorporation) Rules 2014 states that

For the purposes of clause (c) of sub-section (1) of section 7, the affidavit shall be submitted by each of the subscribers to the memorandum and each of the first directors named in the articles in Form No.INC.9

(e) Furnishing verification of Registered Office

Under Section 12 of the Companies Act, 2013, a company shall, on and from the 15th day of its incorporation and at all times thereafter, have a registered office capable of receiving and acknowledging all communications and notices as may be addressed to it. The company can furnish to the registrar verification of registered office with in 30 days of incorporation in the manner prescribed. As per rule 25(1) of Companies (Incorporation) Rules 2014, the verification of registered office shall be filed in Form no INC 22.

Where the location of the registered office is finalised prior to Incorporation of a company by the promoters, the promoters can also file along with the Memorandum and Articles, the verification of its registered office in Form no INC 22.

(f) Particulars of subscribers

Section 7(1)(e) of the Companies Act, 2013 requires the filing of the particulars of name, including surname or family name, residential address, nationality and such other particulars of every subscriber to the memorandum along with proof of identity, as may be prescribed, and in the case of a subscriber being a body corporate, such particulars as may be prescribed;

Rule 16 of Companies (Incorporation) Rules states that –

Particulars of every subscriber to be filed with the Registrar at the time of incorporation.

1. The following particulars of every subscriber to the memorandum shall be filed with the Registrar –
   
   (a) Name (including surname or family name) and recent Photograph affixed and scan with MOA and AOA:

   (b) Father’s/Mother’s/ name:

   (c) Nationality:
(d) Date of Birth:
(e) Place of Birth (District and State):
(f) Educational qualification:
(g) Occupation:
(h) Income-tax permanent account number: (i) Permanent residential address and also Present address (Time since residing at present address and address of previous residence address(es) if stay of present address is less than one year) similarly the office/business addresses:

(i) Email id ......................... of Subscriber;

(j) Phone No. ......................... of Subscriber;

(k) Fax no. ......................... of Subscriber (optional)

Explanation. – information related to (i) to (l) shall be of the individual subscriber and not of the professional engaged in the incorporation of the company;

(m) Proof of Identity:
   For Indian Nationals:
   – PAN Card (mandatory) and any one of the following
   – Voter’s identity card
   – Passport copy
   – Driving License copy
   – Unique Identification Number (UIN)
   For Foreign nationals and Non Resident Indians
   – Passport
      It was clarified by MCA vide Circular No. 16/2014 that, a declaration from foreign national in the prescribed format shall be furnished as an attachment of INC 7 (Application for Incorporation), in case if he does not have a PAN.

(n) Residential proof such as Bank Statement, Electricity Bill, Telephone / Mobile Bill:
   Provided that Bank statement Electricity bill, Telephone or Mobile bill shall not be more than two months old;

(o) Proof of nationality in case the subscriber is a foreign national.

(p) If the subscriber is already a director or promoter of a company(s), the particulars relating to:
   (i) Name of the company;
   (ii) Corporate Identity Number;
   (iii) Whether interested as a director or promoter;

(q) the specimen signature and latest photograph duly verified by the banker or notary shall be in the prescribed Form No.INC.10.

(2) Where the subscriber to the memorandum is a body corporate, then the following particulars shall be filed with the Registrar –
   (a) Corporate Identity Number of the Company or Registration number of the body corporate, if any
   (b) GLN, if any;
(c) the name of the body corporate

(d) the registered office address or principal place of business;

(e) E-mail Id;

(f) if the body corporate is a company, certified true copy of the board resolution specifying inter alia the authorization to subscribe to the memorandum of association of the proposed company and to make investment in the proposed company, the number of shares proposed to be subscribed by the body corporate, and the name, address and designation of the person authorized to subscribe to the Memorandum;

(g) if the body corporate is a limited liability partnership or partnership firm, certified true copy of the resolution agreed to by all the partners specifying inter alia the authorization to subscribe to the memorandum of association of the proposed company and to make investment in the proposed company, the number of shares proposed to be subscribed in the body corporate, and the name of the partner authorized to subscribe to the Memorandum;

(h) the particulars as specified above for subscribers in terms of clause (e) of sub-section (1) of section 7 for the person subscribing for body corporate;

(i) in case of foreign bodies corporate, the details relating to-

(ii) the copy of certificate of incorporation of the foreign body corporate; and

(iii) the registered office address.

(g) Particulars of first directors along with their consent to act as directors

Section 7(1)(f) of the Companies Act, 2013 requires filing of the particulars of the persons mentioned in the articles as the first directors of the company, their names, including surnames or family names, the Director Identification Number, residential address, nationality and such other particulars including proof of identity as may be prescribed.

Section 7(1)(g) of the Companies Act, 2013 states that the particulars of the interests of the persons mentioned in the articles as the first directors of the company in other firms or bodies corporate along with their consent to act as directors of the company in such form and manner as may be prescribed.

Rule 17 of Companies (Incorporation) Rules 2014 states that –

The particulars of each person mentioned in the articles as first director of the company and his interest in other firms or bodies corporate along with his consent to act as director of the company shall be filed in Form No.DIR.12 along with the fee as provided in the Companies (Registration offices and fees) Rules, 2014.

As per section 152 (3), no person shall be appointed as a director of a company unless he has been allotted the Director Identification Number under section 154. Section 152(4) provides that every person proposed to be appointed as a director by the company in general meeting or otherwise, shall furnish his Director Identification Number. By virtue of section 153, every individual intending to be appointed as director of a company shall make an application for allotment of Director Identification Number in Form no Dir 3. Any individual who intends to be a director of a company will have to mandatorily apply for DIN first. DIN has to be obtained by the directors of the company before commencing the procedure for incorporation of a company.

(h) Power of Attorney

With a view to fulfilling the various formalities that are required for incorporation of a company, the promoters may appoint an attorney empowering him to carry out the instructions/requirements stipulated by the Registrar. This requires execution of a Power of Attorney on a non-judicial stamp paper of a value prescribed in the respective State Stamp Laws.
Section 7(2) of the Companies Act, 2013 states that the Registrar on the basis of documents and information filed under sub-section (1) of section 7, shall register all the documents and information referred to in that sub-section in the register and issue a certificate of incorporation in the prescribed form to the effect that the proposed company is incorporated under this Act.

From the date of incorporation mentioned in the certificate of incorporation, such subscribers to the memorandum and all other persons, as may, from time to time, become members of the company, shall be a body corporate by the name contained in the memorandum, capable of exercising all the functions of an incorporated company under this Act and having perpetual succession and a common seal with power to acquire, hold and dispose of property, both movable and immovable, tangible and intangible, to contract and to sue and be sued, by the said name (Section 9). The subscribers would become the members of the company.

**Conclusive Evidence**

A Certificate of Incorporation given by the Registrar in respect of any association shall be conclusive evidence that all the requirements of the Act have been complied with in respect of registration and matters precedent and incidental thereto, and that the association is a company authorised to be registered and duly registered under the Act. The Certificate of Incorporation is conclusive evidence that everything is in order as regards registration and that the company has come into existence from the earliest moment of the day of incorporation stated therein with rights and liabilities of a natural person, competent to enter into contracts. The validity of the registration cannot be questioned after the issue of the certificate.

In *Moosa v. Ebrahim* ILR (1913) 40 Cal. 1 (P.C.) the Memorandum of Association of a company was signed by two adults and by a guardian of the other 5 subscribers, who were minors. The Registrar, however, registered the company and issued under his hand a Certificate of Incorporation. It was contended that this Certificate of Incorporation should be declared void. Lord Macnaughten said: “Their Lordships will assume that the conditions of registration prescribed by the Indian Companies Act were not duly complied with; that there were no seven subscribers to the Memorandum and that the Registrar ought not to have granted the certificate. But the certificate is conclusive for all purpose. Thus, the certificate prevents anyone from alleging that the company does not exist”.

It is for the purpose of incorporation only that the certificate was made conclusive by the legislature and the certificate cannot legalise the illegal object contained in the Memorandum. Where the object of a company is unlawful, it has been held that the certificate of registration is not conclusive for this purpose, [*Performing Right Society Ltd. v. London Theatre of Varieties* (1992) 2 KB 433].

**Allotment of Corporate identity number**

Section 7(3) of the Companies Act, 2013 states that on and from the date mentioned in the certificate of incorporation issued under sub-section (2), the Registrar shall allot to the company a corporate identity number, which shall be a distinct identity for the company and which shall also be included in the certificate.

**Commencement of Business**

In terms of section 11(1) of the Companies Act, 2013 every company having a share capital shall not commence any business or exercise any borrowing powers unless –

(a) a declaration is filed by a director in such form (Form No. INC 21) and verified in such manner as may be prescribed, with the Registrar that every subscriber to the memorandum has paid the value of the shares agreed to be taken by him and the paid-up share capital of the company is not less than Rs 5 lakh in case
of a public company and not less than Rs. 1 lakh in case of a private company on the date of making of this declaration; and

(b) the company has filed with the Registrar a verification of its registered office as provided in sub-section (2) of section 12.

Rule 24 of Companies (Incorporation) Rules 2014 states that the declaration filed by a director shall be in Form INC 21, duly verified by Practicing Company Secretary, Chartered Accountant or Cost Accountant. In case the Company requiring registration from sectoral regulators/SEBI, the approval of such regulator shall be required.

If, therefore, a public company is wound up before it is entitled to commence business the persons who have rendered services or supplied goods or materials to the company can have no claim against it [In Re. Electrical Manufacturing Co. (1906) 2 Ch. 390].

Section 11 of the Companies Act further provides for penalty and fine. If any default is made in complying with the requirements of this section, the company shall be liable to a penalty which may extend to Rs. 5000 and every officer who is in default shall be punishable with fine which may extend to Rs. 1000 for every day during which the default continues. [Section 11(2)]

Where no declaration by a director has been filed with the Registrar under section 11(1)(a) within a period of one hundred and eighty days of the date of incorporation of the company and the Registrar has reasonable cause to believe that the company is not carrying on any business or operations, he may, without prejudice to the provisions of section 11(2), initiate action for the removal of the name of the company from the register of companies under Chapter XVIII. [Section 11(3)].

The approval of the Registrar of Companies of the declaration filed by a director and verification of registered office filed by the company entitles the company to commence business given in the objects clause of the Memorandum of Association. No business other than those given in the “objects clause” can be commenced without obtaining prior approval of the shareholders by way of special resolution.

How does a company function?

A company is an association of persons, upon which law confers a personality. It is an artificial person capable of doing many things, which a natural person can do, e.g., it can purchase and own property in its own name, it can enter into contracts, it can sue in its own name and can be sued likewise. In spite of this capacity, it has no physical personality of its own. It can think, express and take decisions only through others who are natural persons and who act in the name and upon the authority of the company. They are the agents of the company, known as its directors, who act together to take decisions for and on behalf of the company. However, to protect the interest of shareholders the Act provides that a number of important decisions of management have to be approved by the shareholders.

The decisions of a company are thus taken by its owners who are the shareholders, (only at their meetings and not acting individually) or by its agents viz. the directors, at their meetings or the meetings of their committees constituted for certain specific purposes.

A meeting may be generally defined as a gathering or assembly or coming together of two or more persons for transacting any lawful business. There must be at least two persons to constitute a meeting. In certain exceptional circumstances, even one person may constitute a meeting.

Company meetings: The meetings of shareholders, debenture holders, directors or creditors must be convened and held in accordance with the various provisions of the Companies Act.
LESSON ROUND UP

- Company is referred to an association of persons who took their meals together. A company may be an incorporated company or a “corporation” or an unincorporated company. It is called a body corporate because the persons composing it are made into one body by incorporating it according to the law, and clothing it with legal personality, and, so turn it into a corporation.

- The main characteristics of a company are as follow
  - Corporate Personality
  - Limited Liability
  - Perpetual Succession
  - Transferability of Shares
  - Separate Property
  - Common Seal
  - Capacity to Sue and Be Sued

- Company is a distinguished form of business as compared to other forms.

- The companies are regulated under Companies Act 2013.

- The Companies Act, 2013 provides for a variety of companies of which can be promoted and registered under the Act. These companies may be:
  - limited by shares;
  - limited by guarantee; or
  - unlimited companies.

- Companies may also be classified as:
  (a) Private Companies;
  (b) Public Companies;
  (c) One Person Company
  (d) Company with charitable objects, etc. under Section 8 of the Companies Act, 2013;
  (e) Small Company
  (f) Government companies;
  (g) Foreign companies;
  (h) Holding companies; and
  (i) Subsidiary companies.
  (j) Producer Companies.

GLOSSARY

**Corporate Personality** The distinct status of a business organization that has complied with law for its recognition as a legal entity and that has an independent legal existence from that of its officers, directors, and shareholders.
Limited Liability - Type of investment in which a partner or investor cannot lose more than the amount invested. The investor or partner is not personally responsible for the debts and obligations of the company in the event that these are not fulfilled.

Perpetual Succession - Continuation of an incorporated firm’s existence, unaffected by the death of any of its owners or the transfer of its shares to a new entity.

Common Seal - A metal stamp for stamping the impression of a company’s official signature on documents with the name of the company to show that they have been approved officially.

Foreign Company - Any company or body corporate incorporated outside India which -(a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and (b) conducts any business activity in India in any other manner.

Government Company - Any company in which not less than fifty one per cent. of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.

One Person Company - A company which has only one person as a member.

SELF-TEST QUESTIONS

1. Define the term “company”. What are its characteristics?
2. “The fundamental attribute of corporate personality is that the company is a legal entity distinct from the members”. Comment.
3. Write short notes on:
   (i) Perpetual succession
   (ii) Transferability of shares
   (iii) Limited liability
   (iv) Corporate personality.
4. Discuss the principles of law laid down by the House of Lords in Salomon v. Salomon and Co. Ltd.
5. State in brief the various kinds of companies which can be registered under the Companies Act, 2013.
6. Write short notes on:
   (i) One-Person company
   (ii) Small Company
   (iii) Subsidiary companies
   (iv) Government company
   (v) Common Seal.
7. Define promoter? What is the legal position of a promoter vis-a-vis the company?
8. Enumerate the steps involved in the formation of a limited company.
9. Distinguish between a private company and a public company.
LESSON OUTLINE

- Introduction
- Board of Directors
- Minimum/Maximum Number of Directors
- Number of directorships
- Woman Director
- Independent Directors
- Director elected by Small Shareholders
- Appointment of directors
- Duties of directors
- Power of Board
- Meetings of the Board
- Notice of Board Meetings
- Quorum for Board Meetings
- Key Managerial Personnel
- Managing Director
- Whole Time Director
- Manager
- Chief Executive Officer
- Chief Financial Officer
- Company Secretary
- Appointment of Key Managerial Personnel
- Appointment of Whole-Time Company Secretary
- Functions of Company Secretary
- Role of Secretary in a Company
- Members’ Meetings
- Annual General Meeting
- Extra Ordinary General Meeting
- Notice of Meeting
- Contents of Notice
- Notice through Electronic Mode
- E-Governance
- E-Governance and MCA-21

LEARNING OBJECTIVES

Company has separate legal entity. Its perpetual succession leads it to longer life. The companies acts as artificial person and activities of the company are carried out by the persons. The persons are called as director and key managerial personnel who holds the power to act on behalf of company. The companies work according to the set pattern of process and the process is called meetings. The officers of the company are responsible for its day to day functioning. Company secretary is one of the said officers; who is responsible for the legal compliance of the company. He is the bridge between Board and shareholders.

The objective of this section is to articulate about the board processes and providing information about the officer of the company mainly the directors, key managerial personnel and the company secretary. The appointment, removal, qualification, etc., are important aspects of persons involved in operations of a company. Therefore, it is significant to throw light on these aspects in the backdrop of who are the persons and what process is used in laws for their processes.

There is a veil of corporate personality which protects the individual from any personal liability at all. That is the fundamental principle of our Company Law. - Lord Denning
INTRODUCTION

A company, though a legal entity in the eyes of law, is an artificial person, existing only in contemplation of law. It has no physical existence. It has neither soul nor body of its own. As such, it cannot act in its own person. It can do so only through some human agency. The persons who are in charge of the management of the affairs of a company are termed as directors. They are collectively known as Board of Directors or the Board. The directors are the brain of a company. They occupy a pivotal position in the structure of the company.

The supreme executive authority controlling the management and affairs of a company vests in the team of directors of the company, collectively known as its Board of Directors. At the core of the corporate governance practice is the Board of Directors which oversees how the management serves and protects the long term interests of all the stakeholders of the Company. The institution of board of directors was based on the premise that a group of trustworthy and respectable people should look after the interests of the large number of shareholders who are not directly involved in the management of the company. The position of board of directors is that of trust as the board is entrusted with the responsibility to act in the best interests of the company.

Although the Board comprises individual directors, yet the actions and deeds of directors individually functioning cannot bind the company, unless a particular director has been specifically authorised by a Board resolution to discharge certain responsibilities on behalf of the company.

Section 2 (34) of the Companies Act, 2013 prescribed that “director” means a director appointed to the Board of a company. A director is a person appointed to perform the duties and functions of director of a company in accordance with the provisions of the Companies Act, 2013.

Board of Directors

A company, though a legal entity in the eyes of law, is an artificial person, existing only in contemplation of law. It has no physical existence. It has neither soul nor body of its own. As such, it cannot act in its own person. It can do so only through some human agency. The persons who are in charge of the management of the affairs of a company are termed as directors. They are collectively known as Board of Directors or the Board. The directors are the brain of a company. They occupy a pivotal position in the structure of the company. Directors take the decision regarding the management of a company collectively in their meetings known as Board Meetings or at the meetings of their committees constituted for certain specific purposes.

Section 2 (10) of the Companies Act, 2013 defined that “Board of Directors” or “Board”, in relation to a company, means the collective body of the directors of the company.

Minimum/Maximum Number of Directors

Section 149(1) of the Companies Act, 2013 requires that every company shall have a minimum number of 3 directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company. A company can appoint maximum 15 fifteen directors. A company may appoint more than fifteen directors after passing a special resolution in general meeting and approval of Central Government is not required.

Number of directorships

As per Section 165 of the Companies Act, 2013, maximum number of directorships, including any alternate directorship a person can hold is 20. It has come with a rider that number of directorships in public companies/private companies that are either holding or subsidiary company of a public company shall be limited to 10. Further the members of a company may restrict abovementioned limit by passing a special resolution.
Residence of a director in India

Section 149 (3) of the Companies Act, 2013 has provided for residence of a director in India as a compulsory i.e. every company shall have at least one director who has stayed in India for a total period of not less than 182 days in the previous calendar year.

Woman Director

Every listed company shall appoint at least one woman director and Every other public company having paid up share capital of Rs. 100 crores or more or turnover of Rs. 300 crore or more as on the last date of latest audited financial statements, shall also appoint at least one woman director under Section 149(1) of the Companies Act, 2013.

Independent Directors

Section 2(47) of the Companies Act, 2013 prescribed that “Independent director” means an independent director referred to in sub section (5) of section 149 of the Act. In fact reference should have been made to sub section (6) of 149 as it specified the qualifications of independent director with clarity.

An independent director means a director other than a managing director or a whole-time director or a nominee director who does not have any material or pecuniary relationship with the company/ directors. Section 149(6) of the Act prescribes the criteria for independent directors which are as follows:

(a) Who in the opinion of the Board, is a person of integrity and possesses relevant industrial expertise and experience;

(b) Such individual shall not be a promoter or related to promoter of the company or its holding, subsidiary or associate company;

(c) Such individuals must not have any material or pecuniary relationship during the two immediately preceding financial years or during the current financial year with the company or its promoters/directors/holding/ subsidiary/associate company;

(d) The relatives of such person should not have had any pecuniary relationship with the company or its subsidiaries, amounting to 2% or more of its gross turnover or total income or Rs. 50 lacs or such higher amount as may be prescribed, whichever is less, during the two immediately preceding financial years or in the current financial year;

(e) He must not either directly or any of his relatives:

   (i) hold or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed.

   (ii) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of –

      (A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or

      (B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm;

   (iii) holds together with his relatives two per cent or more of the total voting power of the company; or

   (iv) is a Chief Executive or director, by whatever name called, of any non-profit organisation that receives
25% or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds 2% or more of the total voting power of the company, then also he is not eligible for office of independent director; or

(f) who possesses such other qualifications as prescribed in Rule 5 of the Companies (Appointment and Qualification of Directors) Rules, 2014 as an independent director shall possess appropriate skills, experience and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other disciplines related to the company’s business.

Every listed public company shall have at least one-third of the total number of directors as independent directors (fraction is to be rounded off to one). Central Government has prescribed that public companies with paid up share capital of Rs. 10 crore or more; or turnover of Rs. 100 crore or more; or in aggregate, outstanding loans/ borrowings/ debentures/ deposits/ exceeding Rs. 50 crore or more as on the last date of latest audited financial statements mentioned below shall also have at least 2 directors as independent directors.

Further if there is any intermittent vacancy of an independent director then it shall be filled up by the board of directors within 3 months from the date of such vacancy or not later than immediate next board meeting, whichever is later.

**Director elected by Small Shareholders**

According to section 151 of the Companies Act, 2013 every listed company may have one director elected by such small shareholders. For the purpose of this section, “small shareholder” means a shareholder holding shares of nominal value of not more than twenty thousand rupees or such other sum as may be prescribed.

**Appointment of directors**

**First Director**

The first directors of most of the companies are named in their articles. If they are not so named in the articles of a company, then subscribers to the memorandum who are individuals shall be deemed to be the first directors of the company until the directors are duly appointed.

In the case of a One Person Company, an individual being a member shall be deemed to be its first director until the director(s) are duly appointed by the member in accordance with the provisions of Section 152 of the Companies Act, 2013.

**General provisions relating to appointment of directors**

1. Except as provided in the Act, every director shall be appointed by the company in general meeting.

2. Director Identification Number is compulsory for appointment of director of a company.

3. Every person proposed to be appointed as a director shall furnish his Director Identification Number and a declaration that he is not disqualified to become a director under the Act.

4. A person appointed as a director shall on or before the appointment give his consent to hold the office of director.

5. Articles of the Company may provide the provisions relating to retirement of the all directors. If there is no provision in the article, then not less than two-thirds of the total number of directors of a public company shall be persons whose period of office is liable to determination by retirement by rotation and eligible to be reappointed at annual general meeting.

At the annual general meeting of a public company one-third of such of the directors for the time being as are liable to retire by rotation, or if their number is neither three nor a multiple of three, then, the number nearest to
one-third, shall retire from office. The directors to retire by rotation at every annual general meeting shall be those who have been longest in office since their last appointment.

At the annual general meeting at which a director retires as aforesaid, the company may fill up the vacancy by appointing the retiring director or some other person thereto. If the vacancy of the retiring director is not so filled-up and the meeting has not expressly resolved not to fill the vacancy, the meeting shall stand adjourned till the same day in the next week, at the same time and place, or if that day is a national holiday, till the next succeeding day which is not a holiday, at the same time and place.

If at the adjourned meeting also, the vacancy of the retiring director is not filled up and that meeting also has not expressly resolved not to fill the vacancy, the retiring director shall be deemed to have been re-appointed at the adjourned meeting, unless –

(i) a resolution for the re-appointment of such director has been put to the meeting and lost;
(ii) the retiring director has expressed his unwillingness to be so re-appointed;
(iii) he is not qualified or is disqualified for appointment;
(iv) a resolution, whether special or ordinary, is required for his appointment or re-appointment by virtue of any provisions of this Act; or
(v) appointment of directors to be voted individually is applicable to the case.

Duties of directors

As per Section 166 of the Companies Act, 2013, a director of a company shall:

– Act in accordance with the articles of the company.
– Act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment.
– Exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.
– Not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.
– Not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates and if such director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the company.
– Not assign his office and any assignment so made shall be void.

If a director of the company contravenes the provisions of this section such director shall be punishable with fine which shall not be less than Rs. 1,00,000 but which may extend to Rs. 5,00,000.

Power of Board

Section 179 of the Companies Act, 2013 deals with the powers of the board; all powers to do such acts and things for which the company is authorised is vested with board of directors. But the board can act or do the things for which powers are vested with them and not with general meeting.

The following powers of the Board of directors shall be exercised only by means of resolutions passed at meetings of the Board, namely :-

(1) to make calls on shareholders in respect of money unpaid on their shares;
(2) to authorise buy-back of securities under section 68;
(3) to issue securities, including debentures, whether in or outside India;
(4) to borrow monies;
(5) to invest the funds of the company;
(6) to grant loans or give guarantee or provide security in respect of loans;
(7) to approve financial statement and the Board’s report;
(8) to diversify the business of the company;
(9) to approve amalgamation, merger or reconstruction;
(10) to take over a company or acquire a controlling or substantial stake in another company;
(11) to make political contributions;
(12) to appoint or remove key managerial personnel (KMP);
(13) to take note of appointment(s) or removal(s) of one level below the Key Management Personnel;
(14) to appoint internal auditors and secretarial auditor;
(15) to take note of the disclosure of director’s interest and shareholding;
(16) to buy, sell investments held by the company (other than trade investments), constituting five percent or more of the paid-up share capital and free reserves of the investee company;
(17) to invite or accept or renew public deposits and related matters;
(18) to review or change the terms and conditions of public deposit;
(19) to approve quarterly, half yearly and annual financial statements or financial results as the case may be.

Meetings of the Board

The way we run board meetings says much about how we run the company. Successful companies use board meetings to create and improve key business strategies.

The board of directors of a company is primarily an oversight board. It oversees the management of the company to ensure that the interest of non-controlling shareholders is protected. It also functions as advisory board. Independent directors bring diverse knowledge and expertise in the board room and the CEO uses the knowledge pool in addressing issues being faced by the company. The most important function of a monitoring board is to provide direction to the company. Another very important function of a monitoring board is to set the ‘tone at the top’. It is expected to create the right culture within the company.

Section 173 of the Companies Act, 2013 deals with Meetings of the Board and it provides that the first Board meeting should be held within thirty days of the date of incorporation. In addition to the first meeting to be held within thirty days of the date of incorporation, there shall be minimum of four Board meetings every year and not more one hundred and twenty days shall intervene between two consecutive Board meetings.

In case of One Person Company (OPC), small company and dormant company, at least one Board meeting should be conducted in each half of the calendar year and the gap between two meetings should not be less than Ninety days. Directors may participate in the meeting either in person or through video conferencing or other audio visual means.
Notice of Board Meetings

The Companies Act, 2013 requires that not less than seven days’ notice in writing shall be given to every director at the registered address as available with the company. The notice can be given by hand delivery or by post or by electronic means.

In case the Board meeting is called at shorter notice, at least one independent director shall be present at the meeting. If he is not present, then decision of the meeting shall be circulated to all directors and it shall be final only after ratification of decision by at least one Independent Director.

Quorum for Board Meetings

One third of total strength or two directors, whichever is higher, shall be the quorum for a meeting. If due to resignations or removal of director(s), the number of directors of the company is reduced below the quorum as fixed by the Articles of Association of the company, then, the continuing Directors may act for the purpose of increasing the number of Directors to that required for the quorum or for summoning a general meeting of the Company.

If at any time the number of interested directors exceeds or is equal to two-thirds of the total strength of the Board of directors, the number of directors who are not interested and present at the meeting, being not less than two shall be the quorum during such time.

The meeting shall be adjourned due to want of quorum, unless the articles provide shall be held to the same day at the same time and place in the next week or if the day is National Holiday, the next working day at the same time and place.

Key Managerial Personnel

The executive management of a company is responsible for the day to day management of a company. The companies Act, 2013 has used the term key management personnel to define the executive management. The key management personnel are the point of first contact between the company and its stakeholders. While the Board of Directors are responsible for providing the oversight, it is the key management personnel who are responsible for not just laying down the strategies as well as its implementation. Chapter XIII of the Companies Act, 2013 read with Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 deal with the legal and procedural aspects of appointment of Key Managerial Personnel including Managing Director, Whole-time Director or Manager, managerial remuneration, secretarial audit etc.

The Companies Act, 2013 has for the first time recognized the concept of Key Managerial Personnel. As per section 2(51) of the Companies Act, 2013 “key managerial personnel”, in relation to a company, means—

(i) the Chief Executive Officer or the managing director or the manager;
(ii) the company secretary;
(iii) the whole-time director;
(iv) the Chief Financial Officer; and
(v) such other officer as may be prescribed.

Managing Director

Section 2(54) of the Companies Act, 2013, defines ‘managing director’. It stipulates that a "managing director" means a director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of Directors, is entrusted with substantial powers of management
of the affairs of the company and includes a director occupying the position of managing director, by whatever name called.

The explanation to section 2(54) excludes administrative acts of a routine nature when so authorised by the Board such as the power to affix the common seal of the company to any document or to draw and endorse any cheque on the account of the company in any bank or to draw and endorse any negotiable instrument or to sign any certificate of share or to direct registration of transfer of any share, from the substantial powers of management.

**Whole Time Director**

Section 2 (94) of the Companies Act, 2013 defines “whole-time director” as a director in the whole-time employment of the company.

**Manager**

Section 2(53) of the Companies Act, 2013 defines “manager” as an individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole, of the affairs of a company, and includes a director or any other person occupying the position of a manager, by whatever name called, whether under a contract of service or not.

**Chief Executive Officer**

Section 2(18) of the Companies Act, 2013 defined “Chief Executive Officer” means an officer of a company, who has been designated as such by it.

**Chief Financial Officer**

Section 2(19) of the Companies Act, 2013 defined “Chief Financial Officer” means a person appointed as Chief Financial Officer of a company.

**Company Secretary**

Section 2(24) of the Companies Act, 2013 defines “company secretary” or “secretary” means a company secretary as defined in clause (c) of sub-section (1) of section 2 of the Company Secretaries Act, 1980 who is appointed by a company to perform the functions of a company secretary under this Act;

**Appointment of Key Managerial Personnel**

Section 203 of the Companies Act, 2013 read with Rule 8 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules 2014 mandates the appointment of Key Managerial Personnel and makes it obligatory for a listed company and every other public company having a paid up share capital of rupees ten crores or more, to appoint following whole-time key managerial personnel:

1. managing director, or Chief Executive Officer or manager and in their absence, a whole-time director;
2. company secretary; and
3. Chief Financial Officer:

Every whole-time key managerial personnel of a company shall be appointed by means of a resolution of the Board containing the terms and conditions of the appointment including the remuneration. An individual shall not be appointed or reappointed as the chairperson of the company, as well as the managing director or Chief Executive Officer of the company at the same time unless the articles of such a company provide otherwise; or the company does not carry multiple businesses. However, such class of companies engaged in multiple
businesses and which has appointed one or more Chief Executive Officers for each such business as may be notified by the Central Government are exempted from the above.

A whole-time key managerial personnel shall not hold office in more than one company except in its subsidiary company at the same time. However, he can hold such other directorship with the permission of the Board.

A whole-time key managerial personnel holding office in more than one company at the same time, shall, within a period of six months from such commencement, choose one company, in which he wishes to continue to hold the office of key managerial personnel.

A company may appoint or employ a person as its managing director, if he is the managing director or manager of one, and of not more than one, other company and such appointment or employment is made or approved by a resolution passed at a meeting of the Board with the consent of all the directors present at the meeting and of which meeting, and of the resolution to be moved thereat, specific notice has been given to all the directors then in India.

If the office of any whole-time key managerial personnel is vacated, the resulting vacancy shall be filled-up by the Board at a meeting of the Board within a period of six months from the date of such vacancy.

**Appointment of Whole-Time Company Secretary**

As per Rule 8A of the Companies (Appointment and Remuneration of Managerial Personnel) Rules 2014 provides that a company which has a paid up capital of Five crore rupees or more shall have a whole-time company secretary.

**Functions of Company Secretary**

According to Section 205 of the Companies Act, 2013 the functions of the company secretary shall include,—

(a) to report to the Board about compliance with the provisions of this Act, the rules made thereunder and other laws applicable to the company;

(b) to ensure that the company complies with the applicable secretarial standards;

(c) to discharge such other duties as may be prescribed.

*Explanation.*—For the purpose of this section, the expression “secretarial standards” means secretarial standards issued by the Institute of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980 and approved by the Central Government.

For the purposes of clause (c) of sub-section (1) of section 205, the Central Government has prescribed that the duties of Company Secretary shall also include –

(1) to provide to the directors of the company, collectively and individually, such guidance as they may require, with regard to their duties, responsibilities and powers;

(2) to facilitate the convening of meetings and attend Board, committee and general meetings, and maintain the minutes of these meetings;

(3) to obtain approvals from the Board, general meetings, the Government and such other authorities as required under the provisions of the Act;

(4) to represent before various regulators, Tribunal and other authorities under the Act in connection with discharge of various functions under the Act;

(5) to assist the Board in the conduct of the affairs of the company;

(6) to assist and advise the Board in ensuring good corporate governance and in complying with the corporate governance requirements and best practices; and
(7) to discharge such other duties as may be assigned by the Board from time to time;

(8) such other duties as have been prescribed under the Act and Rules.

Section 205(2) of the Companies Act, 2013 provides that provisions contained in section 204 and section 205 shall not affect the duties and functions of the Board of Directors, chairperson of the company, managing director or whole-time director under this Act, or any other law for the time being in force.

Role of Secretary in a Company

Generally speaking, the role of a secretary is threefold, viz., as a statutory officer/Key Managerial Personnel, as a co-ordinator and as an administrative officer. Similarly, the responsibility of a company secretary extends not only to the company, but also to its shareholders, depositors, creditors, employees, consumers, society and the Government.

Thus a company secretary plays a vital role in company administration. His role can conveniently be studied from three different angles:

(a) as a statutory officer/key managerial personnel;

(b) as a coordinator;

(c) as an administrative officer.

(a) Statutory Officer/Key Managerial Personnel

According to Section 203 of the Companies Act, 2013 read with Rule 8 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules 2014 mandates the appointment of Key Managerial Personnel and makes it obligatory for a listed company and every other public company having a paid up share capital of rupees ten crores or more, to appoint following whole-time key managerial personnel:

(i) managing director, or Chief Executive Officer or manager and in their absence, a whole-time director;

(ii) company secretary; and

(iii) Chief Financial Officer:

As per Rule 8A of the Companies (Appointment and Remuneration of Managerial Personnel) Rules 2014 provides that a company which has a paid up capital of Five crore rupees or more shall have a whole-time company secretary.

Under the Indian Stamp Act, it is the duty of a Secretary to see that the documents such as letter of allotment, share certificate, debentures, mortgages are issued duly stamped. He is the principal officer under Section 2(35) of the Income-tax Act, 1961.

Thus, the responsibility of a secretary as a statutory officer has been expanded by the enactment of various economic legislations, like Industries (Development and Regulation) Act; Foreign Exchange Management Act and Competition Act etc. Accordingly, the numerous provisions which the company is obliged to comply with makes the Secretary’s job onerous and difficult. The duties imposed upon a secretary by various statutes clearly indicates the important place that he occupies in corporate administrative hierarchy.

(b) Co-ordinator

The Company Secretary as a co-ordinator has an important role to play in the administration of a company’s business and affairs. It is for the secretary to ensure effective execution and implementation of the management policies laid out by the Board. The position that the Company Secretary occupies in the administrative set up of the Company makes his function as one of co-ordinator and link between the top management and other levels. He is not only the communicating channel between the Board and the executives but he also co-ordinates the
actions of other executives vis-a-vis the Board. The ambit of his role as a co-ordinator also extends beyond the company and he is the link between the company, its shareholders, society and the Government. Thus, the role of a company secretary as a co-ordinator has two aspects, namely internal and external. The internal role of a co-ordinator extends to the Board including the Chairman and Managing Director, various line and staff functions, the trade unions and the auditors of the company. His role as an external co-ordinator extends to the relationship of the company with shareholders, Government and Society.

Where, the company has a Managing Director, he must seek his guidance and instructions regarding implementation of the policies laid down by the Board and also on matters arising out of the implementation of the decisions. He is also required to keep the chairman and the managing director apprised of changes made in the Government Policies/Acts, obligations under various statues and to give balanced advice on matters which have legal ramifications.

Relationship with other Functionaries

We have seen that the Secretary is responsible for conveying the Board’s decisions on various aspects of the company’s policies to the persons incharge of such functions. He is, in addition, responsible to ensure that the returns and reports received from various operational executives are submitted in time complete in all respects, and do not conflict with the corporate objectives.

Even where different persons are in-charge of other functions, e.g., sales, personnel, etc., it is usually the Secretary who normally communicates with outside agencies, particularly with government and semi-government bodies to ensure that the information given to various agencies do not conflict with each other and are in accordance with the statutory requirements and corporate objectives of the organisation.

Trade Union

Where the Secretary is responsible either directly or through his assistants for industrial relations, he must be very careful with trade union officials whether they belong to recognised unions or not. He must ensure that proper notes are kept of the discussions and negotiations and all decisions arrived at during such negotiations.

Whenever long term settlement with recognised unions is finalised he should see that the agreement embodying these settlements are in accordance with the relevant statutes applicable. It is the responsibility of the Secretary to ensure compliance with the provisions of various labour legislations such as Industrial Disputes Act, 1947, Employees’ Provident Funds and Miscellaneous Provisions Act, 1952, Payment of Bonus Act, 1965, Payment of Gratuity Act, 1972, Payment of Wages Act, 1936, etc. Whilst he must ensure that the employees guilty of misconduct are charge-sheeted and punished but before doing so all formalities, e.g., holding of enquiries, etc., must be scrupulously followed. He should see that industrial labour relations are always cordial and he should ensure that various creative activities of the employees are encouraged wherever possible by grants and subsidies from the company.

Shareholders

The relationship with the shareholders is an important sphere of his co-ordinating role and, therefore, the Secretary will have to maintain proper relationship with the shareholders of the company. He should ensure that there is no delay in the inspection of books and registers required by a shareholder provided all formalities are complied with. He must ensure that extracts of registers demanded by shareholders are furnished to them within the statutory periods.

However, the most important thing for a Secretary is to ensure that all correspondence from shareholders is dealt with promptly, and their queries are answered as far as possible keeping the statutory provisions in mind. As part of public relations he should be able to attend to the shareholders who personally come for information, to furnish documents or details or any other matter as the image of the company will, to a great extent, depend on the relationship of the Secretary with the shareholders.
Government

All information and correspondence with the Government are normally coordinated or routed through the Secretary to ensure uniform reporting. The Secretary has a very important role vis-a-vis the Government. He should endeavour to have information on Government policies and programmes in advance wherever possible to ensure effective implementation. Good relationship with the Government can be developed where the company sincerely tried to implement various statues both in law and spirit.

Community

In recent years the responsibility of a company towards society has become very important since the company has to function within the parameters of the environment of the country. With this in view, a number of companies have undertaken rural development including adoption of villages and have built schools, colleges and hospitals to cater to the needs of society. In respect of companies in consumer goods industry, it is necessary to project that the products and their prices are in consonance with the standards expected by the consumers. Arising out of such social responsibility many companies have also allowed small sectors to manufacture ancillaries and raw materials required by the organisation for promotion of employment opportunities.

(c) Administrative Officer

The principal duty of a secretary as an administrator is to ensure that the activities of a company are in conformity with the company’s policy. In his role as an administrator, the secretary provides the very foundation on which the entire structure of company administration is constructed. The role of company secretary can be subdivided into organisational, financial, office and personnel administration.

Organisational Administration

Since the secretary has an opportunity of looking at the entire organisation with some amount of detachment, he has the scope to advise the top management including the Board of directors on the need to develop a good structure. Since the secretary collects, interprets and assimilates information relating to all aspects of business to aid and assist the board in carrying out its function, he therefore, gets an opportunity to know the strengths and the weaknesses of the functional executives.

In his role as administrator, he has to make a detailed analysis of various activities, decision-making machinery, inter-relations of departments and functions. He has, therefore, to ensure that the organisational structure must always be kept under constant study. The making of such examination and study and the consequent advice and recommendation for making changes is a task which the company secretary has to perform.

Financial Administration

Since various monthly and periodical operating reports and financial statements are routed for consideration of the board through the secretary, he should analytically study these statements. Thus as a secretary to the Board, the Company Secretary has in consultation with the Chief Finance Officer to devise suitable and proper systems of accounting procedure, internal control and internal audit with a view to safeguard the company’s funds. The Company Secretary should have a good knowledge of budgetary control and procedures, accounts and other related matters. He is also expected to be proficient in dealing with matters connected with taxation.

The Company Secretary is generally assisted by Chief Finance Officer in the discharge of his functions relating to financial administration. In many companies, the Secretary is also the Chief Finance Officer. He has to negotiate with banks and financial institutions the terms of finance both for working capital requirements and capital expenditure.

Office Administration

In all big companies, the office administration is carried on by an officer called the Office Manager who generally reports to the Company Secretary. It is the duty of the Secretary to ensure that different departments of the office
are properly staffed, organised, co-ordinated and supervised. He has to review from time to time, the various procedures and systems with a view to making the administration effective. In the discharge of these functions, he is normally assisted by organisation methods section of the organisation. He is also responsible in most organisations for office services including transport. The image of a company depends on the design and office layout from the reception to the records. The Secretary has not only to ensure that these services are maintained and increased but also to ensure that the cost of such services is reviewed from time to time.

**Personnel Administration**

Personnel Administration includes recruitment, training, payment, promotion, retirement, discharge and dismissal of staff. This is a very important and at the same time a difficult task to administer. Whilst in big organisations there may be a separate personnel manager or officer, in smaller companies the Secretary may be called upon to advise and assist the directors on principles and legal points involved in this area of administration.

**Administration - Company’s Properties**

The Secretary has an important role to play in safeguarding the company’s interest in property matters, ensure all properties are properly maintained and insured and keep a suitable register for each property containing relevant information. He should have a good knowledge of relevant rules and by-laws applicable to property. He should also ensure that registration of trade marks, patents, licences is done from time to time and legal action is taken in respect of infringement of such industrial rights.

**Corporate Records**

The secretary is required to maintain certain records in addition to those under the Companies Act. The volume, the method and the procedure will vary with the size and nature of the company. The secretary has also to ensure that the statutory time limits relating to directors and shareholders meetings, payment of dividend and interest, filing of returns under the Companies Act, 2013, Income-tax Act, etc., are adhered to and formalities under stock exchange regulations are complied with. He must also ensure timely renewal of contracts and leases.

**Personnel and Property**

The secretary has to ensure that adequate system of security of personnel based on technical advice are available in the factory and office. He is also responsible for devising and maintenance of systems to safeguard the valuable company records, or information against loss, theft, fire, etc. He is to review from time to time to ensure that the properties of the company are adequately insured. The company secretary should have good knowledge of insurance law and practice.

Whilst the above discussion only gives a brief outline, the duties and responsibilities of the company secretary are subject to continuous change and has, therefore, to be reviewed from time to time to ensure that he effectively contributes in respect of the above matters. He should, therefore, keep himself abreast of legal changes and practice.

**Members’ Meetings**

A company is composed of members, though it has its own entity distinct from members. The members of a company are the persons who, for the time being, constitute the company, as a corporate entity. However, a company, being an artificial person, cannot act on its own. It, therefore, expresses its will or takes its decisions through resolutions passed at validly held Meetings. The primary purpose of a Meeting is to ensure that a company gives reasonable and fair opportunity to those entitled to participate in the Meeting to take decisions as per the prescribed procedures.

The decision making powers of a company are vested in the Members and the Directors and they exercise their respective powers through Resolutions passed by them. General Meetings of the Members provide a platform to express their will in regard to the management of the affairs of the company.
Convening of one such meeting every year is compulsory. Holding of more general meetings is left to the choice of the management or to a given percentage of shareholders to exercise their power to compel the company to convene a meeting. Shareholder Democracy, Class Action Suits and Protection of interest of investors are the essence and attributes of the Companies Act, 2013.

A company is required to hold meetings of the members to take approval of certain business items, as prescribed in the Act. The meetings to be held for seeking approval to ordinary business and special business are called annual general meeting and extraordinary general meeting. In certain cases, a company may have to hold a meeting of the members of a particular class of members.

Members’ Meetings are:
- Annual General Meeting
- Extraordinary General Meeting
- Class Meeting

### Annual General Meeting

Annual general meeting (AGM) is an important annual event where members get an opportunity to discuss the activities of the company. Section 96 of the Companies Act, 2013 provides that every company, other than a one person company is required to hold an annual general meeting every year.

Following are the key provisions regarding the holding of an annual general meeting:

**Holding of annual general meeting**

1. Annual general meeting should be held once every year.
2. First annual general meeting of the company should be held within 9 months from the closing of the first financial year. Hence it shall not be necessary for the company to hold any annual general meeting in the year of its incorporation.
3. Subsequent annual general meeting of the company should be held within 6 months from the closing of the financial year.
4. The gap between two annual general meetings should not exceed 15 months.

**Extension of validity period of AGM**

In case, it is not possible for a company to hold an annual general meeting within the prescribed time, the Registrar may, for any special reason, extend the time within which any annual general meeting shall be held. Such extension can be for a period not exceeding 3 months. No such extension of time can be granted by the Registrar for the holding of the first annual general meeting.

**Time and place for holding an annual general meeting**

An annual general meeting can be called during business hours, that is, between 9 a.m. and 6 p.m. on any day that is not a National Holiday. It should be held either at the registered office of the company or at some other place within the city, town or village in which the registered office of the company is situate. The Central Government is empowered to exempt any company from these provisions, subject to such conditions as it may impose.

“National Holiday” for this purpose means and includes a day declared as National Holiday by the Central Government.

**Default in holding the annual general meeting**

Section 99 of the Companies Act, 2013 provides that if any default is made in complying or holding a meeting of the company, the company and every officer of the company who is in default shall be punishable with fine which
may extend to Rs. 1 lakh and in case of continuing default, with a further fine which may extend to Rs. 5,000/- for
each day during which such default continues. If any default is made in holding the annual general meeting of a
company, any member of the company may make an application to the Tribunal to call or direct the calling of, an
annual general meeting of the company and give such ancillary or consequential directions as the Tribunal
thinks expedient. Such directions may include a direction that one member of the company present in person or
by proxy shall be deemed to constitute a meeting.

Business to be transacted at annual general meeting:

Sub-section (2) of Section 102 of the Companies Act, 2013 provides that all other businesses transacted at an
Annual General Meeting except the following are special business:

(i) the consideration of financial statements and the reports of the Board of Directors and auditors;
(ii) the declaration of any dividend;
(iii) the appointment of directors in place of those retiring;
(iv) the appointment of, and the fixing of the remuneration of, the auditors.

Extra Ordinary General Meeting

All general meetings other than annual general meetings are called extraordinary general meetings. Extraordinary
General Meetings shall called by:

– By Board
– By Board on requisition of shareholders
– By requisitionists
– By Tribunal

All businesses items can be transacted at the extraordinary general meetings are special business. Following
are the key provisions, provided in section 100, regarding calling and holding of an extraordinary general meeting:

(I) By Board

The Board may, whenever it deems fit, call an extraordinary general meeting of the company.

(II) By Board on requisition of shareholders

The Board must call an extraordinary general meeting on receipt of the requisition from the following number of
members:

(a) in the case of a company having a share capital: members who hold, on the date of the receipt of the
    requisition, not less than one-tenth of such of the paid-up share capital of the company as on that date
    carries the right of voting;
(b) in the case of a company not having a share capital: members who have, on the date of receipt of the
    requisition, not less than one-tenth of the total voting power of all the members having on the said date a
    right to vote.

The requisition should set out the matters to be considered at the proposed meeting and the same should be
signed by the requisitionists and sent to the registered office of the company. The Board must, within 21 days
from the date of receipt of a valid requisition, proceed to call a meeting on a day not later than 45 days from the
date of receipt of such requisition.

(III) By requisitionists

If the Board does not within 21 days from the date of receipt of a valid requisition in regard to any matter, proceed
to call a meeting for the consideration of that matter on a day not later than 45 days from the date of receipt of
such requisition, the meeting may be called and held by the requisitionists themselves.

However in such case, the meeting should be held within a period of 3 months from the date of the requisition. Reasonable expenses incurred by the requisitionists in calling such a meeting shall be reimbursed by the company to the requisitionists. The company in turn recover such expenses from any fee or other remuneration under section 197 payable to such of the directors who were in default in calling the meeting. In case, the quorum is not present within half-an-hour from the time appointed for holding a meeting called by requisitionists, the meeting shall stand cancelled.

(IV) By Tribunal

Section 98 of the Companies Act, 2013 provides that if for any reason it is impracticable to call a meeting of a company or to hold or conduct the meeting of the company, the Tribunal may, either suo motu or on the application of any director or member of the company who would be entitled to vote at the meeting:

Order a meeting of the company to be called, held and conducted in such manner as the Tribunal thinks fit; and

Give such ancillary or consequential directions as the Tribunal thinks expedient, including directions modifying or supplementing in relation to the calling, holding and conducting of the meeting, the operation of the provisions of this Act or articles of the company. Such directions may include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting. Meeting held pursuant to such order shall be deemed to be a meeting of the company duly called, held and conducted.

Notice of Meeting

A general meeting of a company may be called by giving not less than 21 clear days’ notice either in writing or through electronic mode. Notice through electronic mode shall be given in such manner as may be prescribed.

Short notice

A general meeting may be called after giving a shorter notice also if consent is given in writing or by electronic mode by not less than 95% of the members entitled to vote at such meeting.

Contents of Notice

Place of meeting

The notice should state the place where the general meeting is scheduled to be held. In case of an annual general meeting, the place of the meeting has to be either the registered office of the company or some other place within the city, town or village in which the registered office of the company is situated. No such restriction applies to an extraordinary general meeting.

Day of meeting

The day and date of the meeting should be clearly stated in the notice. In case of an annual general meeting, the day should be one that is not a National Holiday. An extraordinary general meeting can however be held on any day.

Time of meeting

Exact time of holding the meeting should be given in the notice. An annual general meeting can be called during business hours only, that is, between 9 a.m. and 6 p.m. There is no need to follow such timings in case of an extraordinary general meeting.

Agenda

A statement of the business to be transacted at the general meeting should be given in the notice. In case, the meeting is to transact a special business, a explanatory statement should be attached about such item.
Proxy clause with reasonable prominence

Every notice calling a meeting of a company which has a share capital, or the articles of which provide for voting by proxy at the meeting, should carry with reasonable prominence, a statement that a member entitled to attend and vote is entitled to appoint a proxy, or, where that is allowed, one or more proxies, to attend and vote instead of himself, and that a proxy need not be a member.

Notice through Electronic Mode

A company may give notice through electronic mode. Electronic mode’ means any communication sent by a company through its authorized and secured computer programme which is capable of producing confirmation and keeping record of such communication addressed to the person entitled to receive such communication at the last electronic mail address provided by the member.

Class Meetings

Class meetings are those meetings which are held by holders of a particulars class of shares/ debenture holders/ creditors.

E-GOVERNANCE

With the advent of Information and Communication Technology in all sectors today, Governments across the globe are taking major initiatives to integrate IT in all their processes. These initiatives aimed at electronic governance, embrace policy changes, legal reforms, business process reengineering, change management and infrastructure creation. They are also realizing that public/private partnership is very critical to the success of any e-governance Project and are accordingly entering into partnerships with private IT companies to implement e-governance. It is being felt that IT enablement of various Government to Business processes along with Business Process Reengineering will not only improve efficiency and transparency of the government operations, but will also provide speedy transactions between the government and the businesses.

E-GOVERNANCE AND MCA-21

Electronic Governance is the application of Information Technology to the Government functioning in order to bring about Simple, Moral, Accountable, Responsive and Transparent (SMART) Governance. E-governance is a highly complex process requiring provision of hardware, software, networking and re-engineering of the procedures for better delivery of services.

MCA-21 is an ambitious e-governance initiative of Government of India that builds on the Government’s vision of National e-governance in the country. As part of the Government’s focus on governance norms to meet the expectations arising from globalization, MCA project was launched as a flagship initiative of Ministry of Corporate Affairs (MCA). The project was named MCA 21 as it aimed at repositioning MCA as an organization capable of fulfilling the aspirations of its stakeholders in the 21st Century. Rather than compelling the business community to physically travel to MCA offices, MCA services are made available at the place of their choice, be it their homes or offices. The scope of MCA 21 includes services provided by the Regional Directors (RDs), Offices of Registrar of Companies (ROCs) and the Ministry Headquarters etc. MCA 21 fully automates all processes related to the proactive enforcement and compliance of the legal requirements under the Companies Act, 2013. E-filing facility includes incorporation of new companies, filing annual return and other statutory returns, registration and verification of charges and processing of various approvals/ clearances etc. applied on time. Besides, inspection of company documents, request for certified copies is also facilitated through MCA portal.
A company, though a legal entity in the eyes of law, is an artificial person, existing only in contemplation of law. It has no physical existence. It has neither soul nor body of its own. As such, it cannot act in its own person. It can do so only through some human agency.

The persons who are in charge of the management of the affairs of a company are termed as directors. They are collectively known as Board of Directors or the Board. The directors are the brain of a company.

Section 149(1) of the Companies Act, 2013 requires that every company shall have a minimum number of 3 directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company.

Every company shall have a minimum number of 3 directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company.

As per Section 165 of the Companies Act, 2013, maximum number of directorships, including any alternate directorship a person can hold is 20.

Every listed company shall appoint at least one woman director and every other public company having paid up share capital of Rs. 100 crores or more or turnover of Rs. 300 crore or more as on the last date of latest audited financial statements, shall also appoint at least one woman director.

Every listed company may have one director elected by small shareholders.

The first Board meeting should be held within thirty days of the date of incorporation. In addition to the first meeting to be held within thirty days of the date of incorporation, there shall be minimum of four Board meetings every year and not more one hundred and twenty days shall intervene between two consecutive Board meetings.

Section 203 of the Companies Act, 2013 read with Rule 8 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules 2014 mandates the appointment of Key Managerial Personnel and makes it obligatory for a listed company and every other public company having a paid up share capital of rupees ten crores or more, to appoint following whole-time key managerial personnel:(i) managing director, or Chief Executive Officer or manager and in their absence, a whole-time director;(ii) company secretary; and (iii) Chief Financial Officer:

As per Rule 8A of the Companies (Appointment and Remuneration of Managerial Personnel) Rules 2014 provides that a company which has a paid up capital of Five crore rupees or more shall have a whole-time company secretary.

Annual general meeting (AGM) is an important annual event where members get an opportunity to discuss the activities of the company. Section 96 of the Companies Act, 2013 provides that every company, other than a one person company is required to hold an annual general meeting every year.

All general meetings other than annual general meetings are called extraordinary general meetings. Extraordinary General Meetings shall called by Board; by Board on requisition of shareholders; by requisionists ; by Tribunal.

Electronic Governance is the application of Information Technology to the Government functioning in order to bring about Simple, Moral, Accountable, Responsive and Transparent (SMART) Governance.
## GLOSSARY

<table>
<thead>
<tr>
<th>Term</th>
<th>Description</th>
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</thead>
<tbody>
<tr>
<td>“Board of Directors” or “Board”</td>
<td>The collective body of the directors of the company.</td>
</tr>
<tr>
<td>“Director”</td>
<td>A director appointed to the Board of a company.</td>
</tr>
<tr>
<td>“Independent director”</td>
<td>An independent director referred to in sub section (5) of section 149 of the Companies Act, 2013.</td>
</tr>
<tr>
<td>“Small shareholder”</td>
<td>A shareholder holding shares of nominal value of not more than twenty thousand rupees or such other sum as may be prescribed.</td>
</tr>
<tr>
<td>“Key Managerial Personnel”</td>
<td>Key Managerial Personnel in relation to a company, means— (i) the Chief Executive Officer or the managing director or the manager; (ii) the company secretary; (iii) the whole-time director; (iv) the Chief Financial Officer; and (v) such other officer as may be prescribed.</td>
</tr>
<tr>
<td>“Managing Director”</td>
<td>A director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called.</td>
</tr>
<tr>
<td>Whole-Time Director</td>
<td>A director in the whole-time employment of the company.</td>
</tr>
<tr>
<td>“Manager”</td>
<td>An individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole, of the affairs of a company, and includes a director or any other person occupying the position of a manager, by whatever name called, whether under a contract of service or not.</td>
</tr>
<tr>
<td>“Chief Executive Officer”</td>
<td>An officer of a company, who has been designated as such by it.</td>
</tr>
<tr>
<td>“Company Secretary” or “Secretary”</td>
<td>A company secretary as defined in clause (c) of sub-section (1) of section 2 of the Company Secretaries Act, 1980 who is appointed by a company to perform the functions of a company secretary under this Act.</td>
</tr>
</tbody>
</table>

## SELF-TEST QUESTIONS

1. Define Director and Board of Director.
2. Write short notes on:
   (a) Key Managerial Personnel
   (b) Whole-time Director
   (c) Company Secretary.
3. How are the first directors of a company appointed?
4. Discuss duties of Board of Director of a company.
5. Enumerate the powers to be exercised by the Board only at their meetings.
6. Discuss the function of the Company Secretary.
7. Enumerate briefly the duties of a Company Secretary.
8. What is a statutory meeting? State the contents of Statutory Report.
9. What is an Extraordinary General Meeting? Who can call such a meeting?
FOUNDATION PROGRAMME

BUSINESS MANAGEMENT ETHICS
AND COMMUNICATION

PAPER-2
LEARNING OBJECTIVES

Business ethics reflects the philosophy of business, one of whose aim is to determine the fundamental purpose of a company. Ethics is related to every aspect of our life. In today’s world of scams, frauds, corruptions due to cut-throat competition, it is essential for new entrants to ensure that they adhere to the basic ethical standards.

Business ethics is not only applicable to any particular kind of business but it is applicable to all kind of business.

Business ethics is concerned with the behaviour of a businessman in doing a business.

Business ethics may be defined as a set of moral rules and principles to protect the interest of customers, employers, society, business unit itself and the industry as a whole.

Therefore, the objective of this study lesson is to enable the students to understand the genesis and concept of ethics and also why all business should be done ethically.

Integrity is doing the right thing, even if nobody is watching.
Genesis of Ethics

Ethics is not recent phenomenon. Ethical codes have been prepared along with the development of human civilization. In olden days, people might have found some of their actions was wrong and others right. The question what is right and what is wrong gave birth to ethical and unethical codes.

The word “ethics” is derived from the Greek word ethos (character), and from the Latin word ’mores’ (customs). Derived from the Greek word “ethos”, which means “way of living”, ethics is a branch of philosophy that is concerned with human conduct. It consists in a code of conduct of human beings living in a society. Ethics examines the rational justification for our moral judgments; it studies what is morally right or wrong, just or unjust. Together, they combine to define how individuals choose to interact with one another. In philosophy, ethics defines what is good for the individual and for society and establishes the nature of duties that people owe to themselves and to one another. It aims at individual good as well as social good, the good of mankind as a whole.

Ethics is an attempt to guide human conduct and it is also an attempt to help man in leading good life by applying moral principles. Ethics refers to well based standards of right and wrong that prescribe what humans ought to do, usually in terms of rights, obligations, benefits to society, fairness, or specific virtues. Ethics is related to issues of propriety, rightness and wrongness. What is right is ethical and what is wrong is unethical. The words ‘proper’, ‘fare’ and ‘just’ are also used in place of right ‘and ‘ethical’. If it is ethical, it is right, proper, fair and just.

Ethics is a matter of practical concern. It tries to determine the good and right thing to do; choices regarding right and wrong, good and evil; questions of obligation and value. Ethics is to consider the practice of doing right actions or what we may call the art of living the good life.

It is also defined as the science of the highest good. Mackenzie defines ethics as “the study of what is right or good in human conduct” or the “science of the ideal involved in human life”. So, it is clear that ethics is the study which determines rightness or wrongness of actions.

Applied ethics is the practice of ethics that aims to guide the moral judgment governing the decisions we make in all areas of our lives. Issues of right and wrong are related to one’s values. In the context of ethics, values are our standards of right and wrong.

Background to Ethics

Ethics is the area of philosophy concerned with the evaluation of human conduct. Philosophers generally distinguish between four or five major branches of ethics: meta-ethics, ethics and politics (political philosophy), normative ethics, virtue ethics and practical philosophy.

Meta-ethics is concerned with the meaning of philosophical language and moral propositions. This means that the focus is on the grounds used to justify moral judgments rather than on making moral judgments.

Political ethics consists mostly of an examination of the good society and the origins and forms of political power (government).

Normative ethics is the branch of philosophy concerned with developing theories that determine which human actions are right and wrong. It is evaluative and constructive rather than descriptive (like meta-ethics). Deontological ethics, utilitarian ethics and virtue ethics are all normative.

Virtue ethics is often viewed as a separate branch in itself. Although it is certainly normative as well, virtue ethics is distinguished from other forms of normative ethics because it is concerned with possessing moral traits and living a good life generally as opposed to evaluating actions alone.
Rule-based ethics seeks to evaluate moral considerations against a set of rules that constitute a moral theory, which determines what acceptable behaviour is. These rules may be divided into two main categories, namely consequentialism (also known as teleology) – under which it is claimed that actions should be judged according to their consequences, and deontology – under which the opposing view is assumed, i.e. that rightness or wrongness is a judgment not dependent on consequences but rather on the intrinsic goodness of the action in and of itself.

Practical (or applied) ethics applies ethical principles and theories to practical disciplines - this includes medical ethics, environmental ethics and business ethics. The purpose is to give guidance on a specific issue such as abortion, GM crops, donor consent, protecting client privacy etc.

The History of Business Ethics

Business ethics has only existed as an academic field since the 1970s. During the 1960s, corporations found themselves increasingly under attack over unethical conduct. As a response to this, corporations - most notably in the US - developed social responsibility programmes which usually involved charitable donations and funding of local community projects. This practice was mostly ad hoc and unorganised varying from industry to industry and company to company. Business schools in large universities began to incorporate 'social responsibility' courses into their syllabi around this time but it was mostly focused on the law and management strategy.

Social responsibility has been described as being a pyramid with four types of responsibility involved - economic (on the bottom level), then legal, ethical and finally philanthropic. Ethical issues were dealt with in social issues courses however, and were not considered in their own right until the 1970s when philosophers began to write on the subject of business ethics. Previous to this development, only management professionals, theologians and journalists had been highlighting problems of this nature on a regular basis.

When philosophers became involved they brought ethical theory to bear on the relevant ethical issues and business ethics became a more institutionalised, organised and integral part of education in business. Thereafter annual conferences, case books, journals and text books were more regular and established.

This new aspect of business ethics differentiated it from social issues courses in three ways:

1) Business ethics provided an ethical framework for evaluating business and the corporate world.

2) It allowed critical analysis of business and development of new and different methods. (This also made business ethicists unpopular in certain circles.)

3) Business ethics fused personal and social responsibility together and gave it a theoretical foundation. In this way, business ethics had a somewhat broader remit than its predecessor (the social issues course) and was a good deal more systematic and constructive. Business ethics also recognised that the world of business raised new and unprecedented moral problems not covered by personal systems of morality. Common-sense morality is sufficient to govern judgments about stealing from your employer, cheating customers and tax fraud. It could not provide all the necessary tools for evaluating moral justification of affirmative action, the right to strike and whistle-blowing.

What is Business Ethics?

Business ethics is nothing but the application of ethics in business. Business ethics is the application of general ethical ideas to business behavior. Ethical business behavior facilitates and promotes good to society, improves profitability, fosters business relations and employee productivity. The concept of business ethics has come to mean various things to various people, but generally it's coming to know what it right or wrong in the workplace and doing what's right - this is in regard to effects of products/services and in relationships with stakeholders.

Business ethics is concerned with the behavior of a businessman in doing a business. Unethical practices are creating problems to businessman and business units. The life and growth of a business unit depends upon the
ethics practiced by a businessman. Business ethics are developed by the passage of time and custom. A custom differs from one business to another. If a custom is adopted and accepted by businessman and public, that custom will become an ethic. Business ethics is applicable to every type of business. The social responsibility of a business requires the observing of business ethics. A business man should not ignore the business ethics while assuming social responsibility. Business ethics means the behaviour of a businessman while conducting a business, by observing morality in his business activities.

According to Wheeler Business Ethics is an art and science for maintaining harmonious relationship with society, its various groups and institutions as well as reorganizing the moral responsibility for the rightness and wrongness of business conduct.

According to Rogene. A. Buchholz, Business ethics refers to right or wrong behaviour in business decisions.

Business Ethics or Ethical standards are the principles, practices and philosophies that guide the business people in the day today business decisions. It relates to the behaviour of a businessman in a business situation. They are concerned primarily with the impacts of decisions of the society within and outside the business organizations or other groups who keep interest in the business activities. Business ethics can be said to begin where the law ends. Business ethics is primarily concerned with those issues not covered by the law, or where there is no definite consensus on whether something is right or wrong.

**IMPORTANCE OF BUSINESS ETHICS**

There may be many reasons why business ethics might be regarded as an increasingly important area of study, whether as students interested in evaluating business activities, or as managers seeking to improve their decision-making skills.

It is generally viewed that good business ethics promote good business.

1. The power and influence of business in society is greater than ever before. Business ethics helps us to understand why this is happening, what its implications might be, and how we might address this situation.

2. Business has the potential to provide a major contribution to our societies, in terms of producing the products and services that we want, providing employment, paying taxes, and acting as an engine for economic development and thereby increases the goodwill.

3. Business malpractices have the potential to inflict enormous harm on individuals, on communities and on the environment. Through helping us to understand more about the causes and consequences of these malpractices, business ethics helps to create mutual trust and confidence in relationship.

4. The demands being placed on business to be ethical by its various stakeholders are constantly becoming more complex and more challenging. Business ethics provides the means to appreciate and understand these challenges more clearly, in order that firms can meet these ethical expectations more effectively.

5. Business ethics can help to improve ethical decision making by providing managers with the appropriate knowledge and tools that allow them to correctly identify, diagnose, analyse, and provide solutions to the ethical problems and dilemmas they are confronted with.

6. A business can prosper on the basis of good ethical standards and it helps to retain the business for long years.

7. Business ethics can provide us with the ability to assess the benefits and problems associated with different ways of managing ethics in organizations.

8. In the age of complexity in business fields, competition is increasing day by day. Good ethical standard helps the business to face the challenges.
CHARACTERISTICS OF BUSINESS ETHICS

The following are the important features of business ethics:-

1. Business ethics are the principles, which govern and guide business people to perform business functions and in that sense business ethics is a discipline.
2. It is considered both as a science and an art.
3. It continuously test the rules and moral standards and is dynamic in nature.
4. It is based on theological principles such as sincerity, human welfare, service, good behavior etc.
5. It is based on reality and social customs prevailing in business environment.
6. It studies the activities, decisions and behavior which are related to human beings.
7. It has universal application because business exists all over the world.
8. Many of the ethical principles develop the personal dignity.
9. Business ethics keeps harmony between different roles of businessman, with every citizen, customer, owner and investors.

PRINCIPLES OF BUSINESS ETHICS

The Principles of business ethics developed by well known authorities like Cantt, J. S.Mill, Herbert Spencer, Plato, Thomas Garret, Woodrad, Wilson etc are as follows:

1. **Sacredness of means and ends**: The first and most important principles of business ethics emphasize that the means and techniques adopted to serve the business ends must be sacred and pure. It means that a good end cannot be attained with wrong means, even if it is beneficial to the society.
2. **Not to do any evil**: It is unethical to do a major evil to another or to oneself, whether this evil is a means or an end.
3. **Principle of proportionality**: This principle suggests that one should make proper judgment before doing anything so that others do not suffer from any loss or risk of evils by the conducts of business.
4. **Non co-operation in evils**: It clearly points out that a business should not co-operate with any one for doing any evil acts.
5. **Co-operation with others**: This principles state that business should help others only in that condition when other deserves for help.
6. **Publicity**: According to W. Wilson, anything that is being done or to be done, should be brought to the knowledge of everyone. If everyone knows, none gets opportunity to do an unethical act.
7. **Equivalent price**: According to W. Wilson, the people are entitled to get goods equivalent to the value of money that he will pay.
8. **Universal value**: According to this principle the conduct of business should be done on the basis of universal values.
9. **Human dignity**: As per this principle, man should not be treated as a factor of production and human dignity should be maintained.
10. **Non violence**: If businessman hurts the interests and rights of the society and exploits the consumer by overlooking their interests this is equivalent to violence and unethical act.
ELEMENTS OF BUSINESS ETHICS MANAGEMENT

Everyone who is entrusted to manage ethics in this organization is bound to prepare a sound ethical programme which should include the following components:-

1. Formal code of conduct
2. Ethics committee
3. Ethical communication
4. An Ethic office with Ethical officers
5. Ethics Training Programme
6. A disciplinary system
7. Establishing an ombudsperson.
8. Monitoring

1. Code of conduct

Several organizations that have undertaken to implement ethical behavior at their workplaces have started the process with developing and implementing codes of conduct for their employees. Codes of conduct are statements of organizational values. It comprises of three elements such as a code of ethics, a code of conduct and statement of values. A code of conduct is a written document, inspirational in contents and specifies clearly what is acceptable or unacceptable behavior at workplace and beyond, when the employees represent their organizations outside.

In general the code should reflect the management's desire to incorporate the values and policies of the organization. The statement of values envisages by the management to serve the public and normally addresses the stakeholders groups.

Code of Ethics

Every time a new business is launched anywhere in the world, whether a one man operation or a full blown brick – and- mortar corporate enterprise, the owners must adopt a code of ethics for the business. For small businesses the code is usually unwritten. And sometimes not even discussed and decided upon, but still a code exists. Larger businesses often have written codes of ethics and employees are twined in them and required to adhere to the code. A code of ethics is a buzzword to employees to observe ethical norms and forms the basis for rules of conduct. It is comprehensive enough to cover the entire scheme of organizational ethics expected to be followed by everyone in the company. It usually specifies methods for reporting violations, disciplinary action for violations and a structure of the due process to be followed. School of Distance Education

A code of ethics in business is just as important as a sound marketing plan, a solid financial strategy, and an organized business plan.

A code of ethics must summarize the beliefs and values of the organization. Those beliefs and values should become internalized by all employees and used regularly in all business practices, no matter the type of business. Owners of businesses that routinely engage in unethical practices cannot help but pass those values and principles along to the other people working in the business. Small businesses suffer even more, because unethical behavior and actions are easier for customers to take notice of. Once customers become aware that a business does not have high ethical ideals, they will take their business elsewhere.

Codes of ethics vary among businesses, and also from one country to another. When business grows large enough to expand its operations into other countries, it is critical to hire talent to assist in training existing personnel with regard to the integrity, understanding, responsibility, and cultural norms of the country where the
new operation is located. All employees must be treated equally, and any issues of inequality must be dealt with quickly, fairly, and in a manner that is satisfactory to all.

Today, more than ever before, consumers pay a great deal of attention to corporate governance and proper behavior of businesses and their owners. Because the marketplace is flooded with numerous variations of the same businesses, promises must be fulfilled and the price and quality of products must be equal to what is advertised, or another business will step into deliver. Therefore a code of ethics where unarticulated or formally documented – is vital to ensuring that a business will succeed.

A code of ethics that is both defines and acted upon is part of the business culture of every successful business, and must become the mantra of every business owner. Growing a flourishing business through the use of sound ethical principles will reap not only the benefits of grown and prosperity, but also the satisfaction of being able to sleep soundly at night.

2. Ethics committee

Ethics committee is formed in many organizations. They are wholly devoted at work places. These committees can rise concerns of ethical nature; prepare or update code of conduct, and resolve ethical dilemma in organizations. they formulate ethical policies and develop ethical standards. The committee evaluates the compliance of the organization with these ethical norms. The members of the ethical committee should be selected from those persons who have knowledge in their industry, their code of ethics and community standards. The committee members are also conscious about the corporate culture and ethical concise of the organization. School of Distance Education

The following committees are to be formed :-

(i) Establishing an ethics committee at the board level

The committee would be charged to oversee development and operation of the ethics management programme.

(ii) Establishing an Ethics Management committee

Ethics Management committee would be charged with implementing and administrating an ethics management programme, including administrating and training about policies and procedures, and resolving ethical dilemmas. The committee should be comprised of senior officers.

3. Ethical communication system

The next step is the establishment of an effective ethical communication system. Ethical communication system place an important role in making an ethics programme successful. It should allow employees to make enquiries, get advice if needed or report wrong doing. Ethical communication system is a necessity to educate employees about the organizations ethical standard and policies. It has the following objectives

(i) To communicate the organizations'values and standards of ethical conduct or business to employees.

(ii) To provide information to the employees on the company's policies and procedure regarding ethical conduct of business.

(iii) To help employees to get guidance and resolve questions regarding compliance with the firms standards of conducts and values.

(iv) To set up the means of enquiry such as telephone hotlines, suggestion boxes and email facilities for employees to contact with and get advice from competent authorities.

Along with these means of communication there are other ways, that can be used to communicate an organization's moral standards to its employees. Top management can communicate the ethical standards to
lower level managers and they can communicate it to operational levels. Sometimes the organization publishes newsletters. It can be used to expose company's code or ethics. If an organization has briefing and management meeting, these can be used as a means of communicating values. Certain companies use attractive multi colored posters to publicize their codes and ethics, these posters are placed in most visible places of the organization premises.

4. Ethics office and officers

Ethics offices are to be established to communicate and implement ethics policies among employees of the organization. For this purpose an ethics officer is to be appointed. The ethics officer should develop a reputation for credibility, integrity, honesty and responsibility through establishment of such ethics monitoring bodies.

School of Distance Education

Functions of the ethics officers

1. Ethics officers are responsible for assessing the needs and risks that an organization-wide ethics programme must address.
2. To develop and distribute a code of conduct or ethics
3. To conduct ethical training programme for employees
4. To establish and maintain a confidential service to answer employees questions about ethical issues.
5. To ensure that the organization is in compliance with governmental regulations
6. To monitor and audit ethical conduct
7. To take action on possible violations of the company's code
8. To review and update code in time

5. Ethics Training Programme

To ensure a good ethical behavior in the organization the employees are to be given training. For this purpose a corporate ethical training programme is to be devised. The main objective of an ethical training program is to offer assistance to employees to understand the ethical issues that are likely to arise in their workplace. When new employees are to be recruited, the induction training should be arranged for them.

This training will help to familiarize with the company's ethical code of behavior. Importance of abiding code should be dealt with at the induction meeting. A well developed and proper training programme will help the employees to understand the organizations policies and expectations, important and relevant rules, bye laws and regulations which are to be complied in the organization by the employees. For the success of the training programmes, the senior executive from every department must involve fully in the training programme.

6. Disciplinary system

Code of conduct or ethical behavior codes should be properly enforced in the organization to achieve the organization's objectives. A disciplinary system should be established to deal with ethical violations promptly and severely. If unethical behavior is not properly dealt with, it will threaten the entire social system that supports the ethical behavior of the organization. While enforcing disciplines to ensure ethical conduct, companies should be consistent, i.e., the company should adopt a fair attitude towards every one without any discrimination or bias.

7. Establishing an ombudsperson

The ombudsperson is responsible to help coordinate development of the policies and procedures to institutionalize
moral values in the workplace. This position usually is directly responsible for resolving ethical dilemmas by interpreting policies and procedures. School of Distance Education

8. Monitoring

To become an ethical programme fruitful and successful, an effective monitoring committee is to be formed. It can be monitored through keen observation by ethics officers, internal audits, surveys, investigations and supporting systems.

Advantages of Managing Ethics in Workplace

1. Significant improvement to society

Application of business ethics helps to avoid many evils from the society. It includes child labour, unscrupulous price fixing, harassment of employees, poverty and starvation of employees etc.

2. Cultivate strong team work and productivity

Ethical programme helps to tune employee behavior in accordance with the values preferred by leaders of the organization. It helps to build openness, integrity and a sense of oneness among all. Employees feel strong alignment between their values and those of the organization and they react with strong motivation and performance.

3. Support Employee Growth

Ethics programme help employees to face reality, both good and bad in the organization and themselves. They feel full confidence to admit and deal with whatever comes their way.

4. Insurance policy

Ethical programs help to ensure that policies are legal. Ethical principles are often applied to current, major ethical issues and become legislation. A major intent of well designed personnel policies is to ensure ethical treatment of employees.

5. Avoid Penal action

Ethical programs help to detect issues and violations early so that they can be reported or addressed which helps to avoid subsequent penal actions and lower fines.

6. Helps in Quality Management, Strategic planning and diversity management

CHALLENGES IN BUSINESS ETHICS

Challenges in business ethics commonly include balancing responsibility to shareholders with social responsibility to the community and employees. Decisions that balance corporate profit against compensation to workers might also present challenges related to business ethics, especially during an economic downturn. Other challenges might revolve around philanthropic activities that contribute to the economic good of the community. These challenges might also involve legal compliance with laws and regulations.

Executive pay and the distribution of wealth might prompt discussion about the challenges in business ethics. Some critics say multimillion dollar bonuses and benefit packages for executives should be linked to actual contributions to the company. The ratio of pay between upper-level management, shareholders, and lower-level employees might create challenges for business ethics.

Working conditions and outsourcing represent additional challenges company owners might face. In some firms, executives who successfully increase profits by moving operations overseas might be rewarded, even though it puts people out of work. If employee pay and benefits are cut while executives receive bonuses based
on the savings, it might be classified as an ethical dilemma. Both situations typically bring up challenges in business ethics.

Ethics might also involve attempts to hire employees who share company values regarding the environment and dealing with customers. Challenges in business ethics include identifying and recruiting workers without regard to sex, age, or ethnic background. Once hired, a company operating ethically usually attempts to share power and leadership through training programs. Training might include giving employees tools to solve ethical dilemmas on the job.

In the area of compliance, challenges in business ethics might include going beyond adherence to laws and regulations. For example, a firm might follow environmental law because it is required, but an ethically responsible company might improve the environment because it’s the right thing to do as a corporate citizen. The company operating within a strict code of ethics typically makes decisions that improve the community instead of decisions based solely on profits.

Other issues that crop up as ethical concerns might center on conflicts of interest and corruption. News stories about some large corporations cheating investors in high-profile scandals have often brought business ethics to the forefront. Other instances might involve political contributions in an attempt to sway regulators to relax compliance laws.

Ethical problems and phenomena arise across all the functional areas of companies and at all levels within the company. Ethical issues in different fortes of Business are explained below:

**General business ethics Issues**

- This part of business ethics overlaps with the philosophy of business, one of the aims of which is to determine the fundamental purposes of a company. If a company's main purpose is to maximize the returns to its shareholders, then it could be seen as unethical for a company to consider the interests and rights of anyone else.
- Corporate social responsibility or CSR: an umbrella term under which the ethical rights and duties existing between companies and society is debated.
- Issues regarding the moral rights and duties between a company and its shareholders: fiduciary responsibility, stakeholder concept v. shareholder concept.
- Ethical issues concerning relations between different companies: e.g. hostile take-over, industrial espionage.
- Leadership issues: corporate governance.
- Political contributions made by corporations.
- Law reform, such as the ethical debate over introducing a crime of corporate manslaughter.
- The misuse of corporate ethics policies as marketing instruments.

**Ethics in Compliance**

Compliance is about obeying and adhering to rules and authority. The motivation for being compliant could be to do the right thing out of the fear of being caught rather than a desire to be abiding by the law. An ethical climate in an organization ensures that compliance with law is fuelled by a desire to abide by the laws. Organizations that value high ethics comply with the laws not only in letter but go beyond what is stipulated or expected of them.

**Ethics in Finance**

The ethical issues in finance that companies and employees are confronted with include:
In accounting – window dressing, misleading financial analysis.

Related party transactions not at arm’s length

Insider trading, securities fraud leading to manipulation of the financial markets.

Executive compensation.

Bribery, kickbacks, over billing of expenses, facilitation payments.

Fake reimbursements

**Ethics in Human Resources**

Human resource management (HRM) plays a decisive role in introducing and implementing ethics. Ethics should be a pivotal issue for HR specialists. The ethics of human resource management (HRM) covers those ethical issues arising around the employer-employee relationship, such as the rights and duties owed between employer and employee.

The issues of ethics faced by HRM include:

- Discrimination issues i.e. discrimination on the bases of age, gender, race, religion, disabilities, weight etc.
- Sexual harassment.
- Affirmative Action.
- Issues surrounding the representation of employees and the democratization of the workplace, trade unionization.
- Issues affecting the privacy of the employee: workplace surveillance, drug testing.
- Issues affecting the privacy of the employer: whistle-blowing.
- Issues relating to the fairness of the employment contract and the balance of power between employer and employee.
- Occupational safety and health.

Companies tend to shift economic risks onto the shoulders of their employees. The boom of performance-related pay systems and flexible employment contracts are indicators of these newly established forms of shifting risk.

**Ethics in Marketing**

Marketing ethics is the area of applied ethics which deals with the moral principles behind the operation and regulation of marketing. The ethical issues confronted in this area include:

- Pricing: price fixing, price discrimination, price skimming.
- Anti-competitive practices like manipulation of supply, exclusive dealing arrangements, tying arrangements etc.
- Misleading advertisements
- Content of advertisements.
- Children and marketing.
- Black markets, grey markets.
Ethics of Production

This area of business ethics deals with the duties of a company to ensure that products and production processes do not cause harm. Some of the more acute dilemmas in this area arise out of the fact that there is usually a degree of danger in any product or production process and it is difficult to define a degree of permissibility, or the degree of permissibility may depend on the changing state of preventative technologies or changing social perceptions of acceptable risk.

- Defective, addictive and inherently dangerous products and
- Ethical relations between the company and the environment include pollution, environmental ethics, and carbon emissions trading.
- Ethical problems arising out of new technologies for eg. Genetically modified food
- Product testing ethics.

The most systematic approach to fostering ethical behaviour is to build corporate cultures that link ethical standards and business practices.

Ethical Dilemma

An ethical dilemma is a situation where one is in conflict between moral imperatives. Often rejecting either solution has major consequences. It is also known as ethical paradox or moral dilemma. Ethical dilemma is any situation in which guiding moral principles cannot determine which course of action is right or wrong. To obey one action, would result in transgressing another.

Characteristics of Ethical Dilemmas

1. Choice between equally undesirable alternatives
2. Different courses of action possible
3. Involves value judgments about actions or consequences
4. Data will not help resolve issue
5. Different sources (psychology, theology) offer resolutions
6. Unfavorable outcomes will result
7. Choices have far-reaching effects on persons, relationships and society
8. Resources which must be allocated are finite or limited
9. Can be resolved, not solved
10. There is no “right” and “wrong”

Business ethos principles practiced by Indian Companies:-

Indian companies are guided by certain rules of conduct in the form of ethical and moral standards. Some of the business ethos principles, practiced by Indian companies are listed below:

1. Principle of ‘sacrifice’

An individual is trained by the principle of ‘sacrifice’ through the process of ‘give and take’ policy. A person, who is willing to sacrifice part of his bread or effort, commands a superior place in the organization.
2. Principle of ‘harmony’
An individual is trained in such a way that to avoid conflicts and friction one should be guided by certain set of moral conducts and principles.

3. Principle of ‘non-violence’
This principle protects an organization from strikes and lockouts and unnecessary avoidable conflicts.

4. Principle of ‘reward’
The one who performs well are encouraged to do so. This implies that the activities of individuals need to be monitored and encouragement in the form of ‘rewards’ may cultivate the spirit of higher productivity among groups.

5. Principle of ‘justice’
The one who works hard is ‘rewarded’ and the one who fails to do so is ‘punished’. This is essence the principle of Justice.

6. Principle of ‘taxation’
The one who is taxed more is encouraged to stay fit for a longer period by proper appreciation and encouragement. This principle applies to individuals who are hardworking and productive.

7. Principle of ‘Integrity’
An integrated mind is more productive. Groups are encouraged to stay united in order to reap the benefits of division of labour.

8. Principle of ‘Polygamy’
This is nothing but the wedding of two different cultures by absorption or takeover.

LESSON ROUND UP

- The term "ethics" is derived from the Greek word “ethos” which refers to character or customs or accepted behaviour.
- ‘Code of conduct’ is a set of principles and expectations that are considered binding on any person who is a member of a particular group.
- The alternative names for code of conduct are ‘code of ethics’ or ‘code of practice’.
- Advantages of business ethics - attracting and retaining talent, investor loyalty, customer satisfaction.
- Scope of Ethics in Business is in the areas, like compliance, finance, HR, marketing and production.
- Measures to improve ethical behaviour of business are framed at three levels: at institutional level; government level and societal level.

GLOSSARY

<table>
<thead>
<tr>
<th>Buzzword</th>
<th>Trendy word or phrase.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stature</td>
<td>Degree of development attained; level of achievement.</td>
</tr>
<tr>
<td>Legitimate</td>
<td>According to law; lawful; in accordance with established rules, principles, or standards.</td>
</tr>
<tr>
<td>Infringing</td>
<td>To commit a breach; violate.</td>
</tr>
</tbody>
</table>
### Articulated
Made clear or distinct.

### Veteran
A person who has had long service or experience in an occupation or the like.

### Aberration
The act of departing or deviating from the right, normal, or usual course or deviation from truth or moral rectitude.

### Dilemmas
A situation requiring a choice between equally undesirable alternatives; any difficult or perplexing situation or problem.

### Pivotal
Of vital or critical importance.

### Whistle blowing
The process where a person informs about another misdoings or makes a public disclosure of corruption or wrongdoing.

### Percolate
Grow or spread gradually.

### Errant
Pretense of having virtues, beliefs, principles, etc., that one does not actually possess; One who assumes a false appearance

### Manifest
Evident; obvious; apparent; plain.

### Endeavour
To attempt; try.

### SELF-TEST QUESTIONS

1. State five ethical practices.
2. Write short notes on Ethics in HR and Ethics in Compliance.
3. State any five measures undertaken at institutional level to ensure ethical standards.
4. Discuss in brief the scope of ethics in business.
5. What are the general reasons for unethical business practices in India?
6. Discuss the various measures for improving the ethical behaviour of business houses in India.

### SUGGESTED READINGS

1. The Ground of Professional Ethics – Daryl Koehn
3. Companion to Business Ethics – Edited by Robert E Federick
4. Business Ethics and Business Communications – Ashok K. Nadhani
5. Ethics, Indian Ethos and Management – S. Balachandran, Raja, Nair
LESSON 12: THEORY OF PROBABILITY

RANDOM VARIABLES

By random we mean unpredictable; when the same is applied in case of a random variable, means, we cannot with certainty predict its future value. Even through the entire past history of the variable is known, it is still unpredictable with certainty. If the variable is of the deterministic type, no such uncertainty exists.

However, quite a few random variables do exhibit statistical regularity. Consider a simple experiment of tossing an unbiased coin. We do not know in advance whether the outcome on a particular toss would be a head or tail. But, we know for sure that in a long sequence of tosses, about half of the outcomes would be heads. If this does not happen, we suspect either the coin or the person tossing it is biased. Statistical regularity of averages is an experimentally verifiable phenomenon in many cases involving random quantities. Hence, we are tempted to develop mathematical tools for the analysis and quantitative characterization of random variables.

Random Variable Definition

Although it may look simple at first sight to give a definition of what a random variable is, it proves to be quite difficult in practice. A random variable, usually written $X$, is a variable whose possible values are numerical outcomes of a random experiment. It therefore is a function that associates a unique numerical value with every outcome of an experiment. The value of the random variable will vary from trial to trial as the experiment is repeated. The following paragraphs will cover the details.

Random Experiment: As Random variables are outcomes of a random experiment, it is essential to understand a random experiment as well. Where Random variables are outcomes, a random experiment is a process leading to an uncertain outcome, before the experiment is run. It is usually assumed that the experiment can be repeated indefinitely under essentially
homogeneous conditions. Result of a random experiment is not unique but it can be one of the various possible outcomes. Simple example is tossing an unbiased coin, where outcomes can be head or tail. You keep on tossing the coin a number of times under essential homogeneous conditions, the outcomes would keep on flipping between Head & Tail, without exactly knowing which toss would result in to what.

The outcome of an experiment need not be a number, for example, the outcome in a coin toss experiment can be 'heads' or 'tails'. However, we often want to represent outcomes as numbers. A random variable is a function that associates a unique numerical value with every outcome of an experiment. In the given example, if there are three trials (say); the number of times “Head” appears can be a random variable, which can assume values as, 0, 1, 2, & 3. Because in three trials, you can have minimum zero Heads and maximum three Heads.

**Types of Random Variables**

Classification of random variables is done based on their probability distribution. A random variable has either an associated probability distribution (discrete random variable) or probability density function (continuous random variable). Based on that, there are two types of random variable – Discrete and Continuous.

**Discrete Random Variables**

A discrete random variable is one which may take on only a countable number of distinct values such as 0,1,2,3,4,....... Discrete random variables are usually (but not necessarily) counts. If a random variable can take only a finite number of distinct values, then it must be discrete. Examples of discrete random variables include the number of children in a family, the number of people in an ATM queue, the number of patients in a doctor's surgery, the number of defective light bulbs in a box of ten etc.

The probability distribution of a discrete random variable is a list of probabilities associated with each of its possible values. It is also sometimes called the probability function or the probability mass function.
Suppose a random variable \( X \) may take \( k \) different values, with the probability that \( X = x_i \) defined to be \( P(X = x_i) = p_i \). The probabilities \( p_i \) must satisfy the following:

1: \( 0 \leq p_i \leq 1 \) for each \( i \)

2: \( p_1 + p_2 + \ldots + p_k = 1 \).

Example

1. A coin is tossed ten times. The random variable \( X \) is the number of “Tails” that are noted. \( X \) can only take the values 0, 1, ..., 10, so \( X \) is a discrete random variable. The above two properties hold in this case. For e.g. probability of 8 Tails, \( p_8 \) will definitely fall in the range 0 to 1. And also, the sum of probabilities for all possible values of Tails, \( p_0 + p_1 + p_2 + \ldots + p_{10} = 1 \).

Note in case of ten trials, number of tails can be 0 to 10.

Continuous Random Variables

A continuous random variable is one which takes an infinite number of possible values (usually in a given range). Continuous random variables are usually measurements like, height, weight, the amount of sugar in an orange, time required to finish a task, interest earn etc. For e.g.: life of an individual in a community. A person may die immediately on his birth (life equals to zero years) or after attaining an age of 110 years (say). Within this range, he may die at any age. Therefore the variable “age” can take any value in the range 0 to 110, in this case.

A continuous random variable is not defined at specific values, since the values are infinite and therefore probability at a specific value is almost zero. Instead, it is defined over an interval of values, and is represented by the area under a curve.

Suppose a random variable \( X \) may take all values over an interval of real numbers. Then the probability that \( X \) is in the set of outcomes \( A \), \( P(A) \), is defined to be the area above \( A \) and under a curve. The curve, which represents a function \( p(x) \), must satisfy the following:

1: The curve has no negative values (\( p(x) \geq 0 \) for all \( x \))
A curve meeting these requirements is known as a density curve.

1. A light bulb is burned until it burns out. Suppose the life of bulb ranges between zero hours (minimum) to 100 hours (maximum). The random variable Y is its lifetime in hours. Y can take any positive real value in the range 0 to 100, so Y is a continuous random variable. It is immaterial to calculate probability of Y at a specific point in the specified range; instead we wish to calculate probability between any two end points in the range, like 0-10, 50-70, less than 20, more than 90 etc. At any point in the complete range (0-100), \( p(x) \geq 0 \), and the total area in the probability curve from \( p(x=0) \) to \( p(x=100) \) would be equal to one.

**EXPECTED VALUE**

The expected value (or population mean) of a random variable indicates its average or central value. It is a useful summary value (a number) of the variable's distribution.

Stating the expected value gives a general impression of the behaviour of some random variable without giving full details of its probability distribution (if it is discrete) or its probability density function (if it is continuous).

Two random variables with the same expected value can have very different distributions. There are other useful descriptive measures which affect the shape of the distribution, for example standard deviation.

The expected value of a random variable \( X \) is symbolised by \( E(X) \).

If \( X \) is a discrete random variable with possible values \( x_1, x_2, x_3, ..., x_n \), and \( p(x_i) \) denotes \( P(X = x_i) \), then the expected value of \( X \) is defined by:

\[
\mu = E(X) = \sum x_i p(x_i)
\]
where the elements are summed over all values of the random variable X.

If X is a continuous random variable with probability density function \( f(x) \), then the expected value of X is defined by:

\[
\mu = E(X) = \int x f(x) \, dx
\]

**Example**

Discrete case: When a die is thrown, each of the possible faces 1, 2, 3, 4, 5, 6 (the xi's) has a probability of 1/6 (the p(xi)'s) of showing. The expected value of the face showing is therefore:

\[
\mu = E(X) = (1 \times 1/6) + (2 \times 1/6) + (3 \times 1/6) + (4 \times 1/6) + (5 \times 1/6) + (6 \times 1/6) = 3.5
\]

Notice that, in this case, E(X) is 3.5, which is not a possible value of X.

**Expected Values of Random Variables**

We already looked at finding the mean in the section on averages. Random variables also have means but their means are not calculated by simply adding up the different variables.

The mean of a random variable is more commonly referred to as its Expected Value, i.e. the value you expect to obtain should you carry out some experiment whose outcomes are represented by the random variable.

In Probability theory, the expected value (or expectation, mathematical expectation, EV, mean, ) refers, intuitively, to the value of a random variable one would "expect" to find if one could repeat the random variable process an infinite number of times and take the average of the values obtained. More formally, the expected value is a weighted average of all possible values. In other words, each possible value that the random variable can assume is multiplied by its assigned weight, and the resulting products are then added together to find the expected value. The weights used in computing this average are the probabilities in the case of a discrete random variable, or the values of a probability density function in the case of a continuous random variable.
Example:

A local club plans to invest $10000 to host a baseball game. They expect to sell tickets worth $15000. But if it rains on the day of the game, they won't sell any tickets and the club will lose all the money invested. If the weather forecast for the day of the game is 20% possibility of rain, is this a good investment?

Make a table of probability distribution.

<table>
<thead>
<tr>
<th>Outcome</th>
<th>+$3000</th>
<th>-$12000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Probability</td>
<td>0.80</td>
<td>0.20</td>
</tr>
</tbody>
</table>

Use the weighted average formula.

\[
\text{Expected value} = 5000(0.8) - 12000(0.2) \\
= 4000 - 2400 \\
= 1600
\]

The club can expect a return of $1600. So, it's a good investment, though a bit risky.

In other cases, we are asked to find the values of one or more variables involved in the model for which the experiment has a given expected value.

Example:

A company makes electronic gadgets. One out of every 50 gadgets is faulty, but the company doesn't know which ones are faulty until a buyer complains. Suppose the company makes a $3 profit on the sale of any working gadget, but suffers a loss of $80 for every faulty gadget because they have to repair the unit. Check whether the company can expect a profit in the long term.

Write the probability distribution.

\[
E(X) = \frac{49}{50} \cdot 3 + \frac{1}{50} \cdot (-80) \\
= \frac{147}{50} - \frac{80}{50} \\
= \frac{67}{50} \\
= 1.34
\]
Since the expected value is positive, the company can expect to make a profit. On average, they make a profit of $1.34 per gadget produced.

The intuitive explanation of the expected value above is a consequence of the law of average numbers: the expected value, when it exists, is almost surely the limit of the sample mean as the sample size grows to infinity. More informally, it can be interpreted as the long-run average of the results of many independent repetitions of an experiment (e.g. a dice roll).

Suppose random variable $X$ can take value $x_1$ with probability $p_1$, value $x_2$ with probability $p_2$, and so on, up to value $x_k$ with probability $p_k$. Then the expectation of this random variable $X$ is defined as

$$E[X] = x_1 p_1 + x_2 p_2 + \cdots + x_k p_k .$$

Since all probabilities $p_i$ add up to one ($p_1 + p_2 + \cdots + p_k = 1$), the expected value can be viewed as the weighted average, with $p_i$’s being the weights:

$$E[X] = \frac{x_1 p_1 + x_2 p_2 + \cdots + x_k p_k}{p_1 + p_2 + \cdots + p_k} .$$

If all outcomes $x_i$ are equally likely (that is, $p_1 = p_2 = \cdots = p_k$), then the weighted average turns into the simple average. This is intuitive: the expected value of a random variable is the average of all values it can take; thus the expected value is what one expects to happen on average. If the outcomes $x_i$ are not equally probable, then the simple average must be replaced with the weighted average, which takes into account the fact that some outcomes are more likely than the others. The intuition however remains the same: the expected value of $X$ is what one expects to happen on average.

**Example 1.** Let $X$ represent the outcome of a roll of a six-sided die. More specifically, $X$ will be the number of pips showing on the top face of the die after the toss. The possible values for $X$ are 1, 2, 3, 4, 5, and 6, all equally likely (each having the probability of $1/6$). The expectation of $X$ is

$$E[X] = 1 \cdot \frac{1}{6} + 2 \cdot \frac{1}{6} + 3 \cdot \frac{1}{6} + 4 \cdot \frac{1}{6} + 5 \cdot \frac{1}{6} + 6 \cdot \frac{1}{6} = 3.5 .$$
Let $X$ be a discrete random variable taking values $x_1, x_2, ...$ with probabilities $p_1, p_2, ...$ respectively. Then the expected value of this random variable is the infinite sum

$$E[X] = \sum_{i=1}^{\infty} x_i p_i.$$ 

Given that the random variable $X$ is continuous and has a probability distribution $f(x)$, the expected value of the random variable is given by:

$$E(x) = \int_{-\infty}^{\infty} x f(x) \, dx$$

**Uses and applications**

It is possible to construct an expected value equal to the probability of an event by taking the expectation of an indicator function that is one if the event has occurred and zero otherwise. This relationship can be used to translate properties of expected values into properties of probabilities, e.g. using the law of large numbers to justify estimating probabilities by frequencies.

**PROBABILITY DISTRIBUTION**

A probability distribution is a table or an equation that links each outcome of a statistical experiment with its probability of occurrence. The usefulness of probability theory comes in understanding probability distributions (also called probability functions and probability densities or masses). Probability distributions list or describe probabilities for all possible occurrences of a random variable.

Example: Let us consider a case of tossing a coin two times. This simple statistical experiment can have four possible outcomes: HH, HT, TH, and TT. Now, let the variable $X$ represent the
“number of Heads” that result from this experiment. The variable X can take on the values 0, 1, or 2. Where, a value of X = 0, signifies, none of the trials resulted in Head. A value of X = 2, means both the trials gives Head. Similarly we can interpret for X = 1. In this example, X is a random variable; because its value is determined by the outcome of a statistical experiment.

As stated above, probability distribution is a table or an equation that links each outcome of a statistical experiment with its probability of occurrence. In the experiment described above, the table below, which associates each outcome with its probability, is an example of a probability distribution.

<table>
<thead>
<tr>
<th>Number of heads</th>
<th>Probability</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>0.25</td>
</tr>
<tr>
<td>1</td>
<td>0.50</td>
</tr>
<tr>
<td>2</td>
<td>0.25</td>
</tr>
</tbody>
</table>

These all probabilities are calculated using classical approach. The probability of X = 1, is 0.50 because, two outcomes (out of four) resulted in to one Head (HT, and TH).

**Types of probability distributions:** Broadly there are two types of Probability distribution, Discrete and Continuous. Within these two broad categories, there are many theoretical distributions defined.

**Discrete probability distributions:** It describes a finite set of possible occurrences, for discrete variables.” For example, the number of successful treatments out of 4 patients is discrete, because the random variable represent the number of success can be only 0, 1, 2,3 or 4. The probability of all possible occurrences: P (0 successes), P (1success),.....P (4successes) constitutes the probability distribution for this discrete random variable. The example cited above (tossing a coin twice is also a case of discrete distribution).

Therefore a discrete probability distribution lists each possible value that a random variable can take, along with its probability. It has the following properties:
The probability of each value of the discrete random variable is between 0 and 1,

So \(0 \leq p(x) \leq 1\)

The sum of all the probabilities is 1, so \(\sum p(x) = 1\)

Example: Consider the table below:

<table>
<thead>
<tr>
<th>(X)</th>
<th>-5</th>
<th>6</th>
<th>9</th>
</tr>
</thead>
<tbody>
<tr>
<td>(P(x))</td>
<td>.05</td>
<td>.025</td>
<td>.025</td>
</tr>
</tbody>
</table>

This is a probability distribution, since all of the probabilities are between 0 and 1, and they add to 1.

**Continuous probability distributions:** It describes the probability distribution of a continuous variable. For example, the probability of a given weight (of an infant) can be anything from, say, two Kg to more than 6 Kg (or something like that). Thus, the random variable of weight is continuous, with an infinite number of possible points between any two values.

When moving from discrete to continuous distributions, the random variable will no longer be restricted to integer values, but will now be able to take on any value in some interval of real numbers. Graphically, we will be moving from the discrete bars of a histogram to the curve of a (possibly piecewise) continuous function.
In the discrete case, probabilities were given by a probability distribution function \( P(X=x) \), and graphically displayed by using its value as the height of each bar. We might also observe that each of the bars had width 1, and therefore the height of each bar was equal to its area.

In the continuous case, the function \( f(x) \) is called the **probability density function**, and probabilities are determined by the areas under the curve \( f(x) \). So as we move from the discrete to the continuous case, we need to modify how we interpret the graph, so that we see probabilities as areas. And yet, the mathematics has not changed at all, since probabilities are areas in both cases.
Lesson 9
Introduction to Company Accounts

LESSON OUTLINE

- Basic Concepts of Company Accounts
- Issue of Shares
  - For Cash
  - Under Subscription of Shares
  - Over Subscription of Shares
  - Calls in Advance and Interest on Calls in Advance
  - Calls in Arrears and Interest on Calls in Arrears
  - Issue of shares for consideration other than cash
- Review Questions
- Forfeiture of Shares
- Re-issue of Forfeited Shares
- Forfeiture and Re-issue of Shares allotted on Pro-Rata basis in case of over subscription
- Issue of Debentures
  - For cash
  - For consideration other than Cash
  - As Collateral Security
- Redemption of Preference Shares
  - Out of the profits of the company
  - Out of the proceeds of the fresh issue
  - Out of the profits of the company and proceeds of the fresh issue
- Lesson Round Up
- Glossary
- Self-Test Questions

LEARNING OBJECTIVES

The company form of business organization is formed to overcome the limitations of partnership form of business organization. A company is an association or collection of individual real persons and/or other companies, who provide some form of capital with a common purpose or focus and an aim of gaining profits. Thus, a company can be defined as an “artificial person” created by law, with a discrete legal entity, perpetual succession and a common seal. It is not affected by the death, insanity or insolvency of an individual member.

Company accounting is different from sole proprietorship and partnership accounting. Company being a legal entity, has to maintain proper books of accounts to give a true and fair view of the state of affairs of the company. The books are kept on accrual basis and according to double entry system of accounting. The company has to prepare its balance sheet and profit & loss account from the books of account maintained by it.

In this lesson, we will study some basic concepts of company accounts like shares, share capital, entries for issue of share, debentures, forfeiture and re-issue of shares and redemption of preference shares.

We are not going to see a significant upside until we get a clearer sense of how companies make their money and how it is accounted for.

Charles Pradilla
BASIC CONCEPTS OF COMPANY ACCOUNTS

The company form of business organization is a voluntary association of persons to carry on a business. Normally, it is given a legal status and is subject to certain legal regulations. It is an association of persons who generally contribute money for some common purpose. The money so contributed is the capital of the company. The persons who contribute capital are its members. The proportion of capital to which each member is entitled is called his share, therefore members of a joint stock company are known as shareholders and the capital of the company is known as share capital. The total share capital is divided into a number of units known as ‘shares’. The companies are governed by the Indian Companies Act, 2013.

Meaning of Shares

Share as defined in Section 2(84) of the Companies Act, 2013 means a share in the share capital of a company and it also includes stock. A share is one unit into which the total share capital is divided. It is a fractional part of the share capital and forms the basis of ownership in the company. For example, when a company has a share capital of ₹ 5,00,000 divided into 50,000 shares of ₹ 10 each and a person who has taken 50 shares of that company is said to have a share in the share capital of the company to the tune of ₹ 500. In other words, shares are divisions of the share capital of a company.

KINDS OF SHARE CAPITAL

The share capital of a company limited by shares shall be of two kinds under the Companies Act 2013, namely:

(a) Equity share capital: Equity share capital with reference to any company limited by shares means all share capital which is not preference share capital. Equity share capital can be

(i) with voting rights; or

(ii) with differential rights as to dividend or voting or any other right.

(b) Preference share capital: Preference share capital with reference to any company limited by shares means that part of the issued share capital of the company which carries or would carry a preferential right with respect to—

• payment of dividend, either 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, in the case of a 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 capital shall be deemed to be preference 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, on 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.

### Types of Share Capital in Balance Sheet

**(a) Nominal or Authorized Capital:** It refers to that amount which is stated in the Memorandum of Association as the share capital of the company. The company is registered with this amount of capital. This is the maximum limit of capital which the company is authorized to issue and beyond which the company cannot issue shares unless the capital clause in the Memorandum is altered and the authorized capital is increased.

**(b) Issued Capital:** It refers to that part of the authorized capital of the company which has actually been offered to the public for subscription in cash and the shares allotted to vendors/promoters for consideration other than cash. It sets the limit of the capital available for subscription. The prescribed form of the Balance Sheet requires that under the head "Issued Capital", should be stated (i) the different classes of share capital as also the sub-classes of the preference shares, (ii) the date and terms of redemption or conversion (if any) of any redeemable preference capital, and (iii) any option on un-issued share capital.

**(c) Subscribed Capital:** It refers to that part of the issued capital which has actually been subscribed by the public and subsequently allotted to them by the directors of the company which are fully paid or partially paid.

**(d) Called up Capital:** It is that portion of the subscribed capital which the shareholders are called upon to pay on the shares allotted to them. A company does not necessarily require the full amount at once on the shares subscribed and hence calls up only such portion as it needs. The balance then remaining is known as uncalled capital.

**(e) Paid-up Capital:** It refers to that part of the called up capital which has actually been paid by the shareholders. This is the actual capital of the company which is included in the total of the Balance Sheet. Paid-up capital is equal to the called up capital if all the shareholders have paid the amount called up by the company.

### ISSUE OF SHARES

When a public company desires to raise capital by issuing its shares to the public, it has to invite the public to subscribe for its shares. The invitation is made through a document called the prospectus. The person who intends to subscribe to those shares should make an application for the desired number of shares to the company. Then, the company will allot shares to the applicant.

Allotment means the appropriation of 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. The minimum subscription is 90% of the issued amount.
ISSUE OF SHARES FOR CASH

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. issue price is ₹ 10 and face value is also ₹ 10. When the shares are issued, the company may ask the payment of the shares either in one lump sum or in installments.

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

1) On receipt of application money -
   Bank Dr. (With the amount received on application)
   To Share Application and Allotment A/c

2) On allotment of shares -
   Share Application and Allotment A/c Dr. (With the money received on the number of shares allotted)
   To Share Capital A/c

Note:

(i) When the capital of the company consists of shares of different classes, a separate share application account will be opened for each class of shares, i.e. equity share application account/preference share application account etc.

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

(iii) 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 A/c Dr. (With the application money received now refunded)
   To Bank

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

<table>
<thead>
<tr>
<th>Dr.</th>
<th>Particulars</th>
<th>₹</th>
<th>Cr.</th>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Share Application and Allotment A/c</td>
<td>XXX</td>
<td>By Share Application and Allotment A/c</td>
<td>XXX</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Application money on...... shares @ ₹.................per share)</td>
<td></td>
<td>(Refund of application money on......... shares @ ₹......... per share)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Example: A Ltd. issued 10 lakh equity shares of ₹ 10 each payable in full on application. The company received application for 10 lakh shares. Applications were accepted in full.

**Journal Entries**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Dr.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank</td>
<td>1,00,00,000</td>
<td>1,00,00,000</td>
</tr>
<tr>
<td>To Equity Share Application and Allotment A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Application money on 10 lakh equity shares @ ₹10 per share)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity Share Application and Allotment A/c</td>
<td>1,00,00,000</td>
<td>1,00,00,000</td>
</tr>
<tr>
<td>To Equity Share Capital A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Allotment of 10 lakh equity shares of ₹ 10 each)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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

When shares are not payable in a lump sum, the amount can be called in a number of installments. After allotment, whenever the need arises, the directors may demand further money from the shareholders towards payment of the value of shares taken up by them. Such demands are termed as calls. The different calls are distinguished from each other 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.

- First installment is called ‘application money’
- Second installment is called ‘allotment money’
- Third installment is called ‘first call money’ and
- The last installment is called ‘final call money’.

**JOURNAL ENTRIES**

(i) On receipt of application money

Bank
To Share Application Account (Being the application money received in respect of...... shares @ ₹.........per share)

(ii) On allotment of shares

Share Application Account
To Share Capital Account (Being the application money on allotted shares)
(iii) On refund of application money on rejected applications
Share Application Account Dr. (with the amount actually repaid)
To Bank
(Being application money on ____ shares refunded)

(iv) On making the allotment money (second installment) due
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 @ ₹........ each)

(v) On receipt of allotment money is received the following journal entry is made
Bank Dr. (with the actual amount received as allotment money)
To Share Allotment Account (Being the amount received on........shares @ ₹........ 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 @ ₹..... per share on......shares)

(vii) On receipt of first call money
Bank Dr. (with the amount received on first call)
To Share First Call Account (Being the amount received in respect of first call @ ₹..... 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 @ ₹.... per share on.... shares)

(ix) On receipt of second call money:
Bank Dr. (With the amount actually received on second call)
To Share Second Call Account (Being the amount received in respect of second call @ ₹......... 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 @ ₹............. per share on...........shares)
(xi) On receipt of final call money:
Bank Dr. (with the amount actually...
Introduction to Company Accounts

To Share Final Call Account
(Being the amount received in respect of final call @ ₹.............. per share on.............. shares)

Issue of Shares at Premium

The shares of many successful companies which offer attractive rates of dividend on their existing capitals fetch a higher price than their face value in the market. When shares are issued at a price higher than the 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.

The premium on issue of shares must not be treated as revenue profits. On the contrary, it must be regarded as capital receipt. The Companies Act requires that 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 restrictions on its disposal. 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.

The Securities Premium Account must be shown as “Securities premium reserves” separately in the liabilities side of the balance sheet under the head “Reserves & Surplus”.

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.

<table>
<thead>
<tr>
<th>JOURNAL ENTRY</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>When allotment money becomes due:</strong></td>
</tr>
<tr>
<td>Share Allotment A/c Dr. (with the money due on allotment including premium)</td>
</tr>
<tr>
<td>To Securities Premium A/c (with the premium amount)</td>
</tr>
<tr>
<td>To Share Capital A/c (with the share allotment amount)</td>
</tr>
<tr>
<td>(Being allotment money due on shares issued at premium)</td>
</tr>
</tbody>
</table>

Issue of Shares at A Discount

When shares are issued at a price lower than the face value, they are said to be issued at discount. Thus, the excess of the face value over the issue price is the amount of discount. For example, if a share of ₹ 10 is issued at ₹ 9 then ₹ (10 – 9) = Re. 1 is the discount.
As per 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.

Where a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both.

**REVIEW QUESTIONS**

1. When shares are issued at a price higher than the face value, they are said to be issued at ______.
2. ____ means the appropriation of a certain number of shares to an applicant in response to his application.
3. When shares are issued at a price lower than the face value, they are said to be issued at ________.

**Illustration 1:**

P Ltd. was registered with an authorised capital of ₹1,00,000 divided into 1,00,000 equity shares of ₹10 each out of which 50,000 equity shares were offered to the public for subscription. The shares were payable as under:

- ₹3 per share on application
- ₹2 per share on allotment
- ₹2 per share on 1st call
- ₹3 per share on 2nd and final call

The shares were fully subscribed for and the money was duly received.

Show the journal and cash book entries.

**Solution:**

In the books of P Ltd.

**Journal Entries**

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Debit (₹)</th>
<th>Credit (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Equity Share Application A/c</td>
<td>Dr. 1,50,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Equity Share Allotment A/c</td>
<td>Dr. 1,00,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Equity Share Capital A/c</td>
<td></td>
<td>2,50,000</td>
</tr>
<tr>
<td></td>
<td>(Capitalization of application money @ ₹3 per share and allotment money due on 50,000 equity shares transferred as per Boards resolution dated.....)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Equity Share First Call A/c</td>
<td>Dr. 1,00,000</td>
<td></td>
</tr>
</tbody>
</table>
Lesson 9  Introduction to Company Accounts  269

Lesson 9

Introduction to Company Accounts

To Equity Share Capital A/c 1,00,000
(First call money on 50,000 equity shares @ ₹2 per share due as per Board’s resolution dated.....)

Equity Share Second & Final Call A/c Dr. 1,50,000
To Equity Share Capital A/c 1,50,000
(Second and final call money due on 50,000 Equity Shares @ 3 per share as per Board’s resolution dated.....)

Cash Book (Bank Columns)

<table>
<thead>
<tr>
<th>Dr. Particulars</th>
<th>Debit (₹)</th>
<th>Cr. Particulars</th>
<th>Credit (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Equity Share Application A/c</td>
<td>1,50,000</td>
<td>By Balance c/fd</td>
<td>5,00,000</td>
</tr>
<tr>
<td>To Equity Share Allotment A/c</td>
<td>1,00,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>To Equity Share First Call A/c</td>
<td>1,00,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>To Equity Share Second &amp; Final Call A/c</td>
<td>1,50,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>5,00,000</td>
<td></td>
<td>5,00,000</td>
</tr>
</tbody>
</table>

Illustration 2:
Wonder Ltd. issued 10,000, 12% Preference Shares of ₹ 100 each at a premium of ₹ 10 per share payable as follows:

On Application ₹ 30
On Allotment ₹ 30 (including premium)
On First Call ₹ 25
On Final Call ₹ 25

Applications were received for 12,000 shares and the directors allotted 10,000 shares and rejected applications for 2,000 shares and the money received thereon was refunded.
The allotment money was duly received while the first call money was received on 9,000 shares and the final call money on 8,000 shares.
Show the cash book and journal entries.

Solution:
In the books of Wonder Ltd.

Journal Entries

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Debit (₹)</th>
<th>Credit (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>12% Preference Share Application and Allotment A/c Dr. To 9% Preference Share Capital A/c</td>
<td>6,00,000</td>
<td>5,00,000</td>
</tr>
<tr>
<td></td>
<td>To Securities Premium A/c</td>
<td></td>
<td>1,00,000</td>
</tr>
<tr>
<td></td>
<td>(Capitalisation of application money @ ₹ 30 per share and allotment money due @ ₹ 30 per share shares including ₹ 10 as premium on 10,000, 12% preference as per Board’s resolution dated.....)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Debit (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>12% Preference Share First Call A/c Dr.</td>
<td>2,50,000</td>
</tr>
</tbody>
</table>
To 12% Preference Share Capital A/c 2,50,000
(First call money due @ ₹ 25 per share on 10,000, 12% Preference Shares as per Board’s resolution dated......)

Calls-in-Arrear A/c Dr. 25,000
To 12% Preference Share First Call A/c 25,000
(First call money due on 1,000, 12% Pref. Shares @ ₹ 25 per share transferred to Call-in-Arrear A/c)

12% Preference Share Final Call A/c Dr. 2,50,000
To 12% Preference Share Capital A/c 2,50,000
(Final call money due @ ₹ 25 per share on 10,000, 12% Pref. shares as per Board’s resolution dated...)

Calls-in-Arrear A/c Dr. 50,000
To 12% Preference Share Final Call A/c 50,000
(Final call money due on 2,000, 12% Pref. Shares @ ₹ 25 per share transferred to Calls-in-Arrear A/c)

### Cash Book (Bank Columns)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>To 12% Preference Share Application and Allotment A/c</td>
<td>3,60,000</td>
<td>By 12% Preference Share Application and Allotment A/c</td>
<td>60,000</td>
</tr>
<tr>
<td>(Application money on 12,000, 12% Pref. Shares @ ₹ 30 per share)</td>
<td></td>
<td>(Refund of Application money on 2000, 12% Pref. Shares @ ₹ 30 per share)</td>
<td></td>
</tr>
<tr>
<td>To 12% Preference Share Application and Allotment A/c</td>
<td>3,00,000</td>
<td>By Balance c/d</td>
<td>10,25,000</td>
</tr>
<tr>
<td>(Allotment money @ ₹ 30 per share on 10,000, 12% preference shares)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>To 12% Preference Share First Call A/c</td>
<td>2,25,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(First call money @ ₹ 25 per share on 9,000, 12% Pref. Shares)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>To 12% Preference Share Final Call A/c</td>
<td>2,00,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Final call money @ ₹ 25 per share on 8,000, 12% Pref. shares)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

10,85,000 10,85,000
UNDER-SUBSCRIPTION OF SHARES

In actual practice, it rarely happens that the number of shares applied for is exactly equal to the number of shares offered to public for subscription. If the number of shares applied for is less than the number of shares issued the shares are said to be undersubscribed. When an issue is under-subscribed, entries are made on the basis of number of shares applied for, provided the minimum subscription is raised.

OVER-SUBSCRIPTION OF SHARES

When the number of shares applied for exceeds the number of shares issued, the shares are said to be over-subscribed. In such a situation, the directors allot shares on some reasonable basis because the company can allot only that number of shares which has been actually offered for subscription. Moreover, as per the guidelines issued by SEBI, the company cannot reject out-rightly any application for shares unless it has incomplete information or absence of signature(s) or insufficient application money and so on. In short, the following procedure is adopted:

(i) Total rejection of some applications;
(ii) Acceptance of some applications in full; and
(iii) Allotment to the remaining applicants on pro-rata basis.

The shares should be issued in tradable lot. In case of pro-rata allotment, no applicant for shares is refused and no applicant is allotted the shares in full. Each applicant receives the shares in some proportion. In such cases, the excess amount of application money (i.e. overpaid amount) is not refunded but retained and treated as a payment towards allotment money. The following journal entry is made to transfer excess application money to allotment account.

```
Share Application A/c Dr. (with the excess application
To Share Allotment A/c money)
(Being the surplus application money transferred
to share allotment account)
```

Surplus money exceeding that due on allotment should be refunded to the allottees. However, the company may transfer this to Calls-in-Advance Account if:

(i) Acceptance of calls in advance is permitted by the company’s Articles.
(ii) The consent of the applicant has been 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 the most so much amount as is sufficient to make the allotted shares fully paid up ultimately.

The journal entry will be as follows:

```
Share Application A/c Dr. (with the excess application
To Calls-in-Advance A/c money left over the amount
(Being the surplus application money transferred due on application and
to Calls-in-Advance Account) allotment)
```
CALLS-IN-ADVANCE AND INTEREST ON CALLS-IN-ADVANCE

If authorised by the articles, a company may receive from a shareholder the amount remaining unpaid on shares, even though the amount has not been called up. This is known as calls-in-advance. It is a debt of a company until the calls are made and the amount already paid is adjusted. Calls-in-advance may also arise when 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. Of course, the company can retain only so much as is required to make the allotted shares fully paid ultimately. The calls-in-advance account is ultimately closed by transfer to the relevant call accounts. It is noted that the money received on calls-in-advance does not become part of share capital. It is shown under a separate heading, namely ‘calls-in-advance’ on the liabilities side. No dividend is paid on calls-in-advance.

The amount received as calls-in-advance is a debt of the company, the company is liable to pay interest on the amount of Calls-in-Advance from the date of receipt of the amount till the date when the call is due for payment. Generally the Articles of the company specify the rate at which interest is payable. If the articles do not contain such rate, Table A will be applicable which leaves the matter to the Board of directors subject to a maximum rate of 12% p.a.

It is to be noted that the 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) On receipt of call money in advance:**

<table>
<thead>
<tr>
<th>Account</th>
<th>Dr.</th>
<th>(with the amount of call money received in advance)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank</td>
<td></td>
<td></td>
</tr>
<tr>
<td>To Call-in-Advance A/c</td>
<td></td>
<td>(Being the calls received in advance)</td>
</tr>
</tbody>
</table>

**(ii) As and when calls are made:**

<table>
<thead>
<tr>
<th>Account</th>
<th>Dr.</th>
<th>(with the amount adjusted on relevant call becoming due)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Calls-in-Advance A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td>To Relevant Call A/c</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Note:** 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.

### Accounting Treatment

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

<table>
<thead>
<tr>
<th>Account</th>
<th>Dr.</th>
<th>(with the amount of interest paid)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest on Calls-in-Advance A/c</td>
<td></td>
<td>(Interest on Calls-in-Advance paid @ ......% p.a. on ₹........... for.......... months)</td>
</tr>
<tr>
<td>To Bank</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Account</th>
<th>Dr.</th>
<th>(with the amount of interest payable)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest on Calls-in-Advance A/c</td>
<td></td>
<td>(To Sundry Shareholders A/c)</td>
</tr>
<tr>
<td>When payment is made, Sundry shareholders</td>
<td></td>
<td>.......... Debited and Bank articles.</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Account</th>
<th>Dr.</th>
<th>(with the amount of interest)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit and Loss A/c</td>
<td></td>
<td>(To Interest on Calls-in-Advance A/c)</td>
</tr>
</tbody>
</table>
**Illustration 3:**
Newlook Ltd. issued, 1,00,000 Equity Shares of ₹ 10 each payable as follows:

- **On Application (On 1st March, 2012)** ₹ 4
- **On Allotment (On 1st April, 2012)** ₹ 1
- **On First Call (On 1st August, 2012)** ₹ 3
- **On Final Call (On 1st October, 2012)** ₹ 2

Application were received for 2,60,000 shares. Of these 10,000 shares were in disorder; 40,000 shares in lots of 100 shares; 1,20,000 shares in lots of exceeding 100 but less than 500 shares; 60,000 shares in lots of exceeding 500 but less than 1,000 shares and the balance in lots of exceeding 1,000 shares.

Allotment was made as follows:

- Application for the 10,000 shares in disorder were rejected.

- **Application for 100 shares in full, i.e. 100%** 40,000
- **Application over 100 shares but not exceeding 500 shares - 40%** 48,000
- **Application over 500 shares but not exceeding 1,000 shares - 15%** 9,000
- **Applications over 1,000 shares - 10%** 3,000

Money received in excess on shares partially allotted was retained to the extent possible. Show the cash book and journal entries assuming that all the installments were duly received and interest was paid by the directors on calls-in-advance @ 6.1% per annum on 1st October, 2012.

**Solution:**

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>₹</th>
<th>Date</th>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.3.2012</td>
<td>To Equity Share Application A/c</td>
<td>10,40,000</td>
<td>1.4.2012</td>
<td>By Equity Share Application A/c</td>
<td>2,80,000</td>
</tr>
<tr>
<td></td>
<td>(application money @ ₹ 4 per share)</td>
<td></td>
<td></td>
<td>(refund of application money)</td>
<td></td>
</tr>
<tr>
<td>1.4.2012</td>
<td>To Equity Share Allotment A/c</td>
<td>40,000</td>
<td>1.10.2012</td>
<td>By Interest on Call in Advance A/c</td>
<td>7,200</td>
</tr>
<tr>
<td></td>
<td>(balance of allotment money)</td>
<td></td>
<td></td>
<td>(interest @ 6% on ₹ 1,80,000 for 4</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>months = 3,600 and on ₹ 1,20,000 for 6</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>months - ₹ 3,600)</td>
<td></td>
</tr>
<tr>
<td>1.8.2012</td>
<td>To Equity Share 1st Call A/c</td>
<td>1,20,000</td>
<td>1.10.2012</td>
<td>By Balance c/d</td>
<td>9,92,800</td>
</tr>
<tr>
<td></td>
<td>(balance of share 1st call money)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.10.2012</td>
<td>To Equity Share Final A/c</td>
<td>80,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>12,80,000</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Cash Book (Bank Columns)**

Dr.    Cr.
### Journal Entries

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Dr. (₹)</th>
<th>(Cr. (₹))</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.4.2012</td>
<td>Equity Share Application A/c Dr.</td>
<td>4,00,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Equity Share Capital A/c</td>
<td></td>
<td>4,00,000</td>
</tr>
<tr>
<td></td>
<td>(Being the application money on 1,00,000 shares transferred to share capital account)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.4.2012</td>
<td>Equity Share Allotment A/c Dr.</td>
<td>1,00,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Equity Share Capital A/c</td>
<td></td>
<td>1,00,000</td>
</tr>
<tr>
<td></td>
<td>(Being the allotment money due in respect of 1,00,000 equity shares @ Re. 1 per share)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.4.2012</td>
<td>Share Application A/c Dr.</td>
<td>3,60,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Share Allotment A/c</td>
<td></td>
<td>60,000</td>
</tr>
<tr>
<td></td>
<td>To Calls in Advance A/c</td>
<td></td>
<td>3,00,000</td>
</tr>
<tr>
<td></td>
<td>(Being the transfer of surplus application money received on 60,000 shares)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.8.2012</td>
<td>Equity Share 1st Call A/c Dr.</td>
<td>3,00,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Equity Share Capital A/c</td>
<td></td>
<td>3,00,000</td>
</tr>
<tr>
<td></td>
<td>(Being the 1st call money due on 1,00,000 equity shares @ ₹ 3 per share)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.8.2012</td>
<td>Calls-in-Advance A/c Dr.</td>
<td>1,80,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Equity Share 1st Call A/c</td>
<td></td>
<td>1,80,000</td>
</tr>
<tr>
<td></td>
<td>(Being the amount transferred from calls in advance account)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.10.2012</td>
<td>Equity Share Final Call A/c Dr.</td>
<td>2,00,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Equity Share Capital A/c</td>
<td></td>
<td>2,00,000</td>
</tr>
<tr>
<td></td>
<td>(Being the final call money due on 1,00,000 equity share @ ₹ 2 per share)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.10.2012</td>
<td>Calls-in-Advance A/c Dr.</td>
<td>1,20,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Equity Share Final Call A/c</td>
<td></td>
<td>1,20,000</td>
</tr>
<tr>
<td></td>
<td>(Being the amount transferred from calls-in-advance account)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Working Note

**Statement showing the adjustment of Application Money and Calls in Advance Money**

<table>
<thead>
<tr>
<th>Shares applied</th>
<th>Shares allotted</th>
<th>Amount received on applications</th>
<th>Amount due on applications</th>
<th>Balance of application money</th>
<th>Amount due on allotment</th>
<th>Amount received on allotment</th>
<th>Surplus to be transferred to calls-in-advance</th>
</tr>
</thead>
<tbody>
<tr>
<td>10,000</td>
<td>Nil</td>
<td>₹40,000</td>
<td>Nil</td>
<td>Nil</td>
<td>40,000</td>
<td>40,000</td>
<td>Nil</td>
</tr>
<tr>
<td>40,000</td>
<td>40,000</td>
<td>1,60,000</td>
<td>1,60,000</td>
<td>Nil</td>
<td>40,000</td>
<td>40,000</td>
<td>Nil</td>
</tr>
<tr>
<td>1,20,000</td>
<td>48,000</td>
<td>4,80,000</td>
<td>1,92,000</td>
<td>2,88,000</td>
<td>48,000</td>
<td>Nil</td>
<td>2,40,000</td>
</tr>
<tr>
<td>60,000</td>
<td>9,000</td>
<td>2,40,000</td>
<td>36,000</td>
<td>2,04,000</td>
<td>9,000</td>
<td>Nil</td>
<td>45,000</td>
</tr>
<tr>
<td>30,000</td>
<td>3,000</td>
<td>1,20,000</td>
<td>12,000</td>
<td>1,08,000</td>
<td>3,000</td>
<td>Nil</td>
<td>15,000</td>
</tr>
<tr>
<td><strong>2,60,000</strong></td>
<td><strong>1,00,000</strong></td>
<td><strong>10,40,000</strong></td>
<td><strong>4,00,000</strong></td>
<td><strong>6,00,000</strong></td>
<td><strong>1,00,000</strong></td>
<td><strong>40,000</strong></td>
<td><strong>3,00,000</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Amount to be refunded</th>
<th>Amount due to 1st call</th>
<th>Calls-in-Advance to be adjusted against 1st call</th>
<th>Amount payable on 1st call</th>
<th>Surplus remaining in calls in advance</th>
<th>Amount due on final call</th>
<th>Calls-in-advance to be adjusted against final call</th>
<th>Amount payable on final call</th>
</tr>
</thead>
<tbody>
<tr>
<td>₹</td>
<td>₹</td>
<td>₹</td>
<td>₹</td>
<td>₹</td>
<td>₹</td>
<td>₹</td>
<td>₹</td>
</tr>
<tr>
<td>40,000</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td>Nil</td>
<td>1,20,000</td>
<td>Nil</td>
<td>1,20,000</td>
<td>Nil</td>
<td>80,000</td>
<td>Nil</td>
<td>80,000</td>
</tr>
<tr>
<td>Nil</td>
<td>1,44,000</td>
<td>1,44,000</td>
<td>Nil</td>
<td>96,000</td>
<td>96,000</td>
<td>96,000</td>
<td>Nil</td>
</tr>
<tr>
<td>1,50,000</td>
<td>27,000</td>
<td>27,000</td>
<td>Nil</td>
<td>18,000</td>
<td>18,000</td>
<td>18,000</td>
<td>Nil</td>
</tr>
<tr>
<td>90,000</td>
<td>9,000</td>
<td>9,000</td>
<td>Nil</td>
<td>6,000</td>
<td>6,000</td>
<td>6,000</td>
<td>Nil</td>
</tr>
<tr>
<td><strong>2,80,000</strong></td>
<td><strong>3,00,000</strong></td>
<td><strong>1,80,000</strong></td>
<td><strong>1,20,000</strong></td>
<td><strong>1,20,000</strong></td>
<td><strong>2,00,000</strong></td>
<td><strong>1,20,000</strong></td>
<td><strong>80,000</strong></td>
</tr>
</tbody>
</table>

### Calls in Arrear and Interest on Calls in Arrear

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 sending the call money within the appointed date, the amount thus failed is called Calls-in-Arrear.

The interest on Calls-in-Arrear is recoverable according to the provisions in this regard in Articles of the company. But if the Articles are silent, Table ‘F’ 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.
On 1st January, 2012, New Ventures Ltd. issued 1,00,000 equity shares of ₹10 each payable as follows:

<table>
<thead>
<tr>
<th>Event</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>On application</td>
<td>₹3</td>
</tr>
<tr>
<td>On allotment</td>
<td>₹2</td>
</tr>
<tr>
<td>On 1st Call (Payable</td>
<td>₹2</td>
</tr>
<tr>
<td>date of allotment)</td>
<td></td>
</tr>
<tr>
<td>On Final Call (Payable</td>
<td>₹3</td>
</tr>
<tr>
<td>date of 1st call)</td>
<td></td>
</tr>
</tbody>
</table>

Applications were received on 15th January, 2012 for 1,20,000 shares and allotment was made on 1st February, 2012. Applicants for 50,000 shares were allotted in full, those for 60,000 shares were allotted 50,000 shares and applications for 10,000 shares were rejected.

Balance of amount due on allotment was received on 15th February. The calls were duly made on 1st March, 2012 and 1st April, 2012 respectively. One shareholder did not pay the 1st call money on 3,000 shares which he paid with the final call together with interest at 5% p.a. Another shareholder holding 2,000 share did not pay the final call money till end of the accounting year which ended on 31st March, 2013. Show the Cash Book and Journal Entries.
### Solution:

#### Journal Entries

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Dr. (₹)</th>
<th>Cr. (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.2.2012</td>
<td>Equity Share Application A/c</td>
<td>Dr. 3,00,000</td>
<td>3,00,000</td>
</tr>
<tr>
<td></td>
<td>To Equity Share Capital A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Being the transfer of application money on 1,00,000 shares @ ₹ 3 per share transferred to share capital account)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.2.2012</td>
<td>Equity Share Allotment A/c</td>
<td>Dr. 2,00,000</td>
<td>2,00,000</td>
</tr>
<tr>
<td></td>
<td>To Equity Share Capital A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Being the amount due on allotment of 10,00,000 shares @ ₹ 1 per share)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.2.2012</td>
<td>Equity Share Application A/c</td>
<td>Dr. 30,000</td>
<td>30,000</td>
</tr>
<tr>
<td></td>
<td>To Share Allotment A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Being the transfer of excess application money)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.3.2012</td>
<td>Equity Share Ist Call A/c</td>
<td>Dr. 2,00,000</td>
<td>2,00,000</td>
</tr>
<tr>
<td></td>
<td>To Equity Share Capital A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Being the Ist call amount due on 1,00,000 shares @ ₹ 2 per share)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.4.2012</td>
<td>Calls-in-Arrear A/c</td>
<td>Dr. 6,000</td>
<td>6,000</td>
</tr>
<tr>
<td></td>
<td>To Equity Share Ist Call A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Being the transfer of Ist call money on 3,000 equity shares @ ₹ 2 per share)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.4.2012</td>
<td>Equity Share Final Call A/c</td>
<td>Dr. 3,00,000</td>
<td>3,00,000</td>
</tr>
<tr>
<td></td>
<td>To Equity Share Capital A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Being the final call amount due on 1,00,000 shares @ ₹ 3 per share)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.5.2012</td>
<td>Calls-in-Arrear A/c</td>
<td>Dr. 6,000</td>
<td>6,000</td>
</tr>
<tr>
<td></td>
<td>To Equity Share Final Call A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Being the transfer of final call money on 2,000 equity shares @ ₹3 per share)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>31.3.2013</td>
<td>Sundry Shareholders A/c</td>
<td>Dr. 200</td>
<td>200</td>
</tr>
<tr>
<td></td>
<td>To Interest on Calls-in-Arrears A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Being the interest due on ₹ 6,000 @5% for eight months)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Dr. Cash Book (Bank Column) Cr.

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>₹</th>
<th>Date</th>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>15.1.2012</td>
<td>To Equity Share Application A/c (application money @ ₹ 3 per share 2,20,000 shares)</td>
<td>3,60,000</td>
<td>1.2.2012</td>
<td>By Equity Share Application A/c (refund of application money @ ₹ 3 per share on 10,000 shares rejected)</td>
<td>30,000</td>
</tr>
<tr>
<td>15.2.2012</td>
<td>To Equity Share Allotment A/c (balance of allotment money on ₹ 1,00,000 shares)</td>
<td>1,70,000</td>
<td>1.5.2012</td>
<td>By Balance c/d</td>
<td>9,94,025</td>
</tr>
<tr>
<td>1.4.2012</td>
<td>To Equity Share 1st Call A/c (1st call money on 97,000 shares)</td>
<td>1,94,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.5.2012</td>
<td>To Equity Share Final A/c (final call money on 98,000 shares)</td>
<td>2,94,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.5.2012</td>
<td>To Calls-in-Arrear A/c (arrears of 1st call money @ ₹ 2 per share on 3,000 shares)</td>
<td>6,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.5.2012</td>
<td>To Interest on Calls-in-Arrear A/c (interest on ₹ 6,000 for one month @ 5% p.a.)</td>
<td>25</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**ISSUE OF SHARES FOR CONSIDERATION OTHER THAN CASH**

A company may also issue shares for consideration other than cash to vendors who sell some assets to the company or to the promoters for their services. When shares are so issued, the Companies Act requires that the same must be clearly stated in the balance sheet and must be distinguished from the issue made for cash.

**ISSUE OF SHARES TO VENDORS**

A company may purchase assets from the vendors and instead of paying the vendors cash, may settle the purchase price by issuing fully paid shares of the company. This type of issue of shares to the vendors is called issue of shares for consideration other than cash.
Illustration 5:
Rocket Ltd. purchased the business of Comet Ltd. for ₹ 2,70,000 payable in fully paid shares. Rocket Ltd. allotted equity shares of ₹ 10 each fully paid in satisfaction of the claim by Comet Ltd. Show the necessary journal entries in the books of Rocket Ltd. assuming that:

(a) Such shares are issued at par,
(b) Such shares are issued at premium of 20% and

Solution:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Dr. (₹)</th>
<th>Cr. (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sundry Assets Dr.</td>
<td>2,70,000</td>
<td>2,70,000</td>
</tr>
<tr>
<td>To Comet Ltd.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Purchase of assets from Comet Ltd. as per agreement dated.....)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) When assets are acquired from the vendors -</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vendors Dr.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>To Share Capital A/c</td>
<td>2,70,000</td>
<td></td>
</tr>
<tr>
<td>(Allotment of 27,000 equity shares of ₹ 10 each fully paid -</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(b) If shares are issued at par</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Comet Ltd. Dr.</td>
<td>2,70,000</td>
<td></td>
</tr>
<tr>
<td>To Equity Share Capital A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Allotment of 27,000 equity shares of ₹ 10 each to vendors as fully paid-</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(ii) When fully paid shares are issued to vendors at par -</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vendors Dr.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>To Share Capital A/c</td>
<td>2,70,000</td>
<td></td>
</tr>
<tr>
<td>To Securities Premium A/c</td>
<td>45,000</td>
<td></td>
</tr>
<tr>
<td>(Allotment of 22,500 equity shares of ₹ 10 each at a premium of ₹2 per share to vendors as fully paid -</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Working Notes:

1. When shares are issued at a premium of 20%

\[
\text{Issue price per share} = \text{₹} \left( 10 + \frac{20}{100} \right) = \text{₹} 12
\]

\[
\therefore \text{No. of shares to be allotted} = \frac{\text{₹} 2,70,000}{\text{₹} 12} = \text{₹} 22,500
\]

ISSUE OF SHARES TO PROMOTERS

A company may allot fully paid shares to promoters or any other party for the services rendered by them by way of furnishing technical information, engineering services, plant layout, drawing and designing, etc. without payment. This type of issue of shares to promoters is called issue of shares for consideration other than cash. As the amount paid to promoters for services rendered by them is supposed to be utilised by the company over a long period of time, such expenditure should be treated as capital expenditure and debited to Goodwill Account. The accounting entry in such a case will be as follows:

<table>
<thead>
<tr>
<th>Goodwill A/c</th>
<th>Dr. (with the nominal value of the shares allotted.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Share Capital A/c</td>
<td></td>
</tr>
</tbody>
</table>

Illustration 6:

Bright Ltd. was registered with a share capital of \( \text{₹} 10,00,000 \) in equity shares of \( \text{₹} 10 \) each. The company acquired factory building worth \( \text{₹} 1,00,000 \) and plant and machinery worth \( \text{₹} 80,000 \) from Delite Ltd. and issued 18,000 equity shares of \( \text{₹} 10 \) each to the vendors as fully paid-up. The directors also decided to allot 2,000 equity shares credited as full paid to the promoters for their services. Further capital was issued to the public for cash to the extent of \( \text{₹} 3,00,000 \) payable in full with the application. All the shares were taken up by the public and fully paid for. Show the necessary journal entries and the balance sheet.

Solution:

| Journal Entries |
|-----------------|-----------------|
| **Particulars** | **Dr. (₹)** | **Cr. (₹)** |
| Factory Building A/c | Dr. 1,00,000 | |
| Plant and Machinery A/c | Dr. 80,000 | |
| To Delite Ltd. | | 1,80,000 |
| (Purchase of assets from Delite Ltd. as per agreement dated.....) | | |
| Delite Ltd. | Dr. 1,80,000 | |
| To Equity Share Capital A/c | | 1,80,000 |
| (Allotment of 18,000 equity shares of ₹ 10 each to vendors as fully paid-up for consideration other than cash as per Board’s resolutions dated.....). | | |
| Goodwill A/c | Dr. 20,000 | |
| To Equity Share Capital A/c | | 20,000 |
| (Allotment of 2,000 equity shares of ₹ 10 each to promoters as fully paid-up for consideration other than cash as per Board’s Resolution dated.....) | | |
| Bank | Dr. 3,00,000 | |
| To Equity Share Application and Allotment A/c | | 3,00,000 |
(Application money on 30,000 equity shares ₹ 10 each per share)

<table>
<thead>
<tr>
<th>Account</th>
<th>Dr.</th>
<th>To</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity Share Application and Allotment A/c</td>
<td>3,00,000</td>
<td>3,00,000</td>
</tr>
<tr>
<td>To Equity Share Capital A/c</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(Allotment of 30,000 equity shares of ₹ 10 each as fully paid as per Board’s resolution dated.....)

### Balance Sheet of Bright Ltd., as at.....

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Note No.</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>I Equity and Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shareholders’ Funds</td>
<td>1</td>
<td>5,00,000</td>
</tr>
<tr>
<td>Share Capital</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>5,00,000</td>
</tr>
<tr>
<td><strong>II Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-current Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tangible Assets</td>
<td>2</td>
<td>1,80,000</td>
</tr>
<tr>
<td>Intangible Assets</td>
<td>3</td>
<td>20,000</td>
</tr>
<tr>
<td><strong>Current Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and Cash Equivalents</td>
<td>4</td>
<td>3,00,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>5,00,000</td>
</tr>
</tbody>
</table>

**Notes:**

1. **Share Capital**
   - Authorised
     - 1,00,000 Equity Shares of ₹ 10 each
     - 10,00,000
   - Issued, Subscribed and Paid-up:
     - 50,000 Equity Shares of ₹ 10 each, fully paid-up
     - 5,00,000
     - (Of the above shares, 20,000 equity shares have been issued to vendors and promoters for consideration other than cash)

2. **Tangible Assets**
   - Factory Building
     - 1,00,000
   - Plant and Machinery
     - 80,000
     - 1,80,000

3. **Intangible Assets**
   - Goodwill
     - 20,000

4. **Cash and Cash Equivalent**
   - Balance with Bank
     - 3,00,000
If 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 membership by way of penalty for non-payment of allotment and/or any call money.

The Companies Act does not contain any specific provisions regarding forfeiture. The directors must follow certain procedure for forfeiting the shares. They have to give notice to the defaulting shareholder calling upon him to pay the amount due from him together with interest before a specified date (not being earlier than the expiry of fourteen days from the date of service of the notice). This notice must also state that if the shareholder fails to pay the amount along with interest due within the specified date, the shares will be forfeited. If the payment is not received within the specified time, the directors meet to consider the forfeiture and they can proceed to forfeit the shares. The directors must pass a resolution for forfeiting the shares at a duly constituted meeting of the Board of Directors and the defaulting shareholder should be informed about the forfeiture of his shares.

The effect of forfeiture of shares is that the defaulting shareholder loses all his rights in the shares and ceases to be a member. 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 the rights of membership. However, the directors have the right to cancel such forfeiture before the forfeiture shares are re-issued.

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.

**Forfeiture of Shares Issued at Par**

**JOURNAL ENTRIES**

1. Where the unpaid calls have already been transferred to Calls-in-Arrear A/c and the respective call accounts have been closed:

<table>
<thead>
<tr>
<th>Account</th>
<th>Dr.</th>
<th>(with the amount of called up value of shares forfeited i.e., no. of shares forfeited x the called up value per share.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share Capital A/c</td>
<td>To Shares Forfeited A/c</td>
<td>with the amount already paid-up by the shareholders on the shares forfeited.</td>
</tr>
<tr>
<td></td>
<td>To Calls-in-Arrear A/c</td>
<td>(with the amount of unpaid calls.)</td>
</tr>
</tbody>
</table>

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:

<table>
<thead>
<tr>
<th>Account</th>
<th>Dr.</th>
<th>(with the amount of called up value of shares forfeited i.e., no. of shares forfeited x the called up value per share.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share Capital A/c</td>
<td>To Shares Forfeited A/c</td>
<td>(with the amount already paid up by the shareholders on the shares forfeited.)</td>
</tr>
<tr>
<td>To Share Allotment A/c</td>
<td>(with the amount failed on allotment, if any.)</td>
<td></td>
</tr>
<tr>
<td>To Share First Call A/c</td>
<td>(with the amount failed on first call, if any.)</td>
<td></td>
</tr>
<tr>
<td>To Share Final Call A/c</td>
<td>(with the amount failed on final call, if any.)</td>
<td></td>
</tr>
</tbody>
</table>
**Forfeiture of Shares Issued at a Premium**

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

In this case the credit already given to the ‘Securities Premium A/c’ will be cancelled at the time of forfeiture of the shares by debiting “Securities Premium A/c”.

<table>
<thead>
<tr>
<th>JOURNAL ENTRIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>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).</td>
</tr>
<tr>
<td>Securities Premium A/c Dr. (with the amount of premium money remaining unpaid on shares forfeited.)</td>
</tr>
<tr>
<td>To Shares Forfeited A/c (with the amount already paid by the shareholders on the shares forfeited.)</td>
</tr>
<tr>
<td>To Calls-in-Arrear A/c (with the amount unpaid on calls.)</td>
</tr>
</tbody>
</table>

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

In this case Securities Premium Account is already credited at the time of making call will not be cancelled at the time of forfeiture of the shares. In such a case, the accounting entry on forfeiture will be the same as the one passed in case of shares issued at par.

**RE-ISSUE OF FORFEITED SHARES**

The Board of Directors can sell/ reissue or dispose of forfeited shares on such terms as it thinks 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 par, at a premium or even at a discount.

**Re-Issue of Forfeited Shares - At Par**

the 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.

<table>
<thead>
<tr>
<th>JOURNAL ENTRIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. On re-issue of shares:</td>
</tr>
<tr>
<td>Bank Dr. (with the amount received on reissue i.e. no. of shares re-issued x amount received per share.)</td>
</tr>
<tr>
<td>To Share Capital A/c</td>
</tr>
</tbody>
</table>
2. On transfer of Shares Forfeited Account to Capital Reserve Account:

<table>
<thead>
<tr>
<th>Share Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shares Forfeited A/c</td>
<td>(with the forfeited amount on shares re-issued)</td>
<td></td>
</tr>
<tr>
<td>To Capital Reserve A/c</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**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. In such a case also, 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:

<table>
<thead>
<tr>
<th>Bank</th>
<th>Dr.</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>(with the total amount received on re-issue.)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>To Share Capital A/c</td>
<td>(with nominal value or paid-up value of shares.)</td>
<td></td>
</tr>
<tr>
<td>To Securities Premium A/c</td>
<td>(with the premium amount received.)</td>
<td></td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Share Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shares Forfeited A/c</td>
<td>(with the forfeited amount on shares re-issued)</td>
<td></td>
</tr>
<tr>
<td>To Capital Reserve A/c</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Re-Issue of Forfeited Shares - At a Discount**

If forfeited shares are re-issued at a discount, the amount of discount can, in no case, exceed the amount credited to Shares Forfeited Account. Discount thus allowed on re-issue has to be debited to Shares Forfeited Account. If the discount allowed on re-issue is less than the forfeited amount, there will be a surplus left in the Shares Forfeited Account which will be treated as net gain on forfeiture. As this gain is in the nature of capital profits, it should be transferred to Capital Reserve Account. Capital Reserve Account will appear on the liabilities side of the balance sheet under the head “Reserves and Surplus”.

**JOURNAL ENTRIES**

1. On re-issue of shares:

<table>
<thead>
<tr>
<th>Bank</th>
<th>Dr.</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>(with the amount received on re-issue.)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shares Forfeited A/c</td>
<td>Dr.</td>
<td>(with the discount allowed on re-issue.)</td>
</tr>
<tr>
<td>To Share Capital A/c</td>
<td></td>
<td>(with the total.)</td>
</tr>
</tbody>
</table>

2. On transfer of balance in Shares Forfeited Account, if any, to Capital Reserve Account:

<table>
<thead>
<tr>
<th>Share Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shares Forfeited A/c</td>
<td>Dr.</td>
<td>(with the net gain, if any, on shares re-issued.)</td>
</tr>
<tr>
<td>To Capital Reserve A/c</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Important Note:** In case only a part of the forfeited shares are re-issued, only the proportionate amount representing the net gain on the shares re-issued should be transferred to Capital Reserve Account and the balance representing the amount received on forfeited shares not yet re-issued should be left in the Shares Forfeited Account itself. This amount should be shown as addition to the paid up capital on the liabilities side of the balance sheet.
Illustration 7:

X Ltd. forfeited 1,000 equity shares of ₹ 10 each issued at par for non-payment of the first call of ₹ 2 per share and the final call of ₹ 3 per share. Give journal entry for the forfeiture.

**Solution:**

In the books of X Ltd.

<table>
<thead>
<tr>
<th>Journal Entries</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Date</strong></td>
</tr>
<tr>
<td>---</td>
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<td></td>
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<tr>
<td>Alternatively:</td>
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<td></td>
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<tr>
<td></td>
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<tr>
<td></td>
</tr>
</tbody>
</table>

Illustration 8:

X Ltd. forfeited 1,500 equity shares of ₹ 10 each, issued at a premium of ₹ 5 per share for non-payment of allotment money of ₹ 8 per share (including share premium ₹ 5 per share) the first call @ ₹ 2 per share and the final call @ ₹ 3 per share. Give the journal entry for the forfeiture.

**Solution**

In the books of X Ltd.

<table>
<thead>
<tr>
<th>Journal Entries</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Date</strong></td>
</tr>
<tr>
<td>---</td>
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<tr>
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</tr>
</tbody>
</table>

* Shown by way of explanation.
Illustration 9:

X Ltd. forfeited 1,500 equity shares of ₹ 10 each issued at a premium of ₹ 5 per share payable with the allotment money, for non-payment of the first call money of ₹ 2 per share and the final call money of ₹ 3 per share. Give journal entries.

Solution:

In the books of X Ltd.

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Debit (₹)</th>
<th>Credit (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Equity Share Capital A/c (1,500 x ₹10)*</td>
<td>15,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Shares Forfeited A/c (1,500 x ₹5)*</td>
<td>7,500</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Equity Share First Call A/c</td>
<td>3,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Equity Share Final Call A/c</td>
<td>4,500</td>
<td></td>
</tr>
</tbody>
</table>

(Forfeiture of 1,500 equity shares of ₹ 10 each for non-payment of the first call money @ ₹ 2 per share and the final call money @ ₹ 3 per share as per Board’s resolution dated...)

Note: As the premium has already been received on these shares, Securities Premium Account will not be debited.

Illustration 10:

Give journal entries for the forfeiture and re-issue of shares in the following cases:

(a) P Ltd. forfeited 300 shares of ₹ 10 each, fully called up for non-payment of final call @ ₹ 4 per share. These shares were subsequently re-issued by the company @ ₹ 10 per share as fully paid-up.

(b) Q Ltd. forfeited 300 shares of ₹ 10 each, fully called up for non-payment of final call @ ₹ 4 per share. These shares were subsequently re-issued by the company @ ₹ 12 per share as fully paid-up.

(c) R Ltd. forfeited 200 shares of ₹ 10 each, ₹ 8 per share being called up on which a shareholder paid application and allotment money @ ₹ 5 per share but did not pay the first call money @ ₹ 3 per share. Of these forfeited shares, 150 shares were subsequently re-issued by the company as fully paid-up @ ₹ 8 per share.

(d) S Ltd. forfeited 100 shares of ₹ 10 each, ₹ 8 per share having been called up, which were issued at a discount of 10% for non-payment of first call money @ ₹ 3 per share. Of these forfeited shares, 80 shares were subsequently re-issued by the company @ ₹ 5 as ₹ 8 paid-up.
Solution:

(a) In the books of P Ltd.

Journal Entries

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Debit (₹)</th>
<th>Credit (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Share Capital A/c (300 x ₹10)</td>
<td>Dr. 3,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Shares Forfeited A/c (300 x ₹ 6)</td>
<td></td>
<td>1,800</td>
</tr>
<tr>
<td></td>
<td>To Share Final Call A/c (300 x ₹ 4)</td>
<td></td>
<td>1,200</td>
</tr>
<tr>
<td></td>
<td>(Forfeiture of 300 shares of ₹ 10 each for non-payment of the final call money @ ₹ 4 per share as per Board’s resolution dated...)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Bank</td>
<td>Dr. 3,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Share Capital A/c (300 x ₹10)</td>
<td></td>
<td>3,000</td>
</tr>
<tr>
<td></td>
<td>(Re-issue of 300 forfeited shares of ₹ 10 each fully paid-up as per Board’s resolution dated...)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Shares Forfeited A/c</td>
<td>Dr. 1,800</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Capital Reserve A/c</td>
<td></td>
<td>1,800</td>
</tr>
<tr>
<td></td>
<td>(Transfer of profit on re-issue of forfeited shares to Capital Reserve A/c)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(b) In the books of Q Ltd.

Journal Entries

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Debit (₹)</th>
<th>Credit (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Share Capital A/c (300 x ₹10)</td>
<td>Dr. 3,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Shares Forfeited A/c (300 x ₹ 6)</td>
<td></td>
<td>1,800</td>
</tr>
<tr>
<td></td>
<td>To Share Final Call A/c (300 x ₹ 4)</td>
<td></td>
<td>1,200</td>
</tr>
<tr>
<td></td>
<td>(Forfeiture of 300 shares of ₹ 10 each for non-payment of the final call money @ ₹ 4 per share as per Board’s resolution dated...)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Bank (300 x ₹12)</td>
<td>Dr. 3,600</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Share Capital A/c (300 x ₹10)</td>
<td></td>
<td>3,000</td>
</tr>
<tr>
<td></td>
<td>To Securities premium A/c (300 x ₹ 2)</td>
<td></td>
<td>600</td>
</tr>
<tr>
<td></td>
<td>(Re-issue of 300 forfeited shares of ₹ 10 each at a premium of ₹ 2 per share as per Board’s resolution dated...)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Shares Forfeited A/c</td>
<td>Dr. 1,800</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Capital Reserve A/c</td>
<td></td>
<td>1,800</td>
</tr>
<tr>
<td></td>
<td>(Transfer of profit on re-issue of forfeited shares to Capital Reserve A/c)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### (c) In the books of R Ltd.

**Journal Entries**

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Debit (₹)</th>
<th>Credit (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Share Capital A/c (200 x ₹8)</td>
<td>Dr. 1,600</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Shares Forfeited A/c (200 x ₹5)</td>
<td></td>
<td>1,000</td>
</tr>
<tr>
<td></td>
<td>To Share First Call A/c (200 x ₹3)</td>
<td></td>
<td>600</td>
</tr>
<tr>
<td></td>
<td>(Forfeiture of 200 shares of ₹ 10 each, ₹ 8 being called up for non-payment of the first call money @ ₹ 3 per share as per Board’s resolution dated...)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Bank (150 x ₹8)</td>
<td>Dr. 1,200</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Shares Forfeited A/c (150 x ₹2)</td>
<td></td>
<td>300</td>
</tr>
<tr>
<td></td>
<td>To Share Capital A/c (150 x ₹10)</td>
<td></td>
<td>1,500</td>
</tr>
<tr>
<td></td>
<td>(Re-issue of 150 forfeited shares of ₹ 10 each fully paid-up @ ₹ 8 per share as per Board’s resolution dated...)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Debit (₹)</th>
<th>Credit (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Shares Forfeited A/c</td>
<td>Dr. 450</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Capital Reserve A/c</td>
<td></td>
<td>450</td>
</tr>
<tr>
<td></td>
<td>(Transfer of capital profit proportionate to forfeited shares re-issued i.e. on 150 shares to Capital Reserve A/c)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### (d) In the books of S Ltd.

**Journal Entries**

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Debit (₹)</th>
<th>Credit (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Share Capital A/c (100 x ₹8)</td>
<td>Dr. 800</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Shares Forfeited A/c (100 x ₹4)</td>
<td></td>
<td>400</td>
</tr>
<tr>
<td></td>
<td>To Discount on issue of shares (100 x ₹1)</td>
<td></td>
<td>100</td>
</tr>
<tr>
<td></td>
<td>To Share First Call A/c (100 x ₹3)</td>
<td></td>
<td>300</td>
</tr>
<tr>
<td></td>
<td>(Forfeiture of 100 shares of ₹ 10 each, ₹ 8 being called up, issued at a discount of Re. 1 per share for non-payment of first call @ ₹ 8 per share as per Board’s resolution dated...)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Bank</td>
<td>Dr. 400</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Discount on Issue of Shares A/c</td>
<td>Dr. 80</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Share Forfeited A/c</td>
<td>Dr. 160</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Share Capital A/c (300 x ₹10)</td>
<td></td>
<td>640</td>
</tr>
<tr>
<td></td>
<td>(Re-issue of 80 forfeited shares of ₹ 10 each, ₹ 8 being called up originally issued at a discount of 10% for ₹ 5 per share credited as ₹ 8 per share as per Board’s resolutions dated...)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Shares Forfeited A/c</td>
<td>Dr. 160</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Capital Reserve A/c</td>
<td></td>
<td>160</td>
</tr>
<tr>
<td></td>
<td>(Transfer of capital profit proportionate to forfeited shares re-issued, i.e., on 80 shares to Capital Reserve A/c)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
REVIEW QUESTIONS

1. A company forfeited 1,000 shares of ₹10 each held by Mr. X for non payment of allotment money of ₹4 per share. Called up value is ₹9 what will be total amount debited to share capital?

2. A company forfeited 2000 shares of ₹10 each for non payment of final call of ₹2 per share. What will be the amount of share forfeiture account?

FORFEITURE AND RE-ISSUE OF SHARES ALLOTTED ON PRO-RATA BASIS IN CASE OF OVER-SUBSCRIPTION

In case, the shares of a Company are over-subscribed, it is not possible for the company to satisfy the demand of all the applicants. In such a case allotment may be made on pro-rata basis, i.e., proportionately. For example, 10,000 shares are allotted pro-rata 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 adjusted subsequently against allotment money and/or call money.

If such shares are subsequently forfeited for non-payment of allotment money and/or call money, the entries will be 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.

Illustration 11:

A limited company issued a prospectus inviting applications for 2,000 shares of ₹10 each at a premium of ₹2 per share payable as follows:

<table>
<thead>
<tr>
<th></th>
<th>--</th>
<th>₹2</th>
</tr>
</thead>
<tbody>
<tr>
<td>On Application</td>
<td></td>
<td>₹2</td>
</tr>
<tr>
<td>On Allotment</td>
<td></td>
<td>₹5 (including premium)</td>
</tr>
<tr>
<td>On First Call</td>
<td></td>
<td>₹3</td>
</tr>
<tr>
<td>On Second and Final Call</td>
<td></td>
<td>₹2</td>
</tr>
</tbody>
</table>

Applications were received for 3,000 shares and allotment was made pro-rata to the applicants of 2,400 shares. Money overpaid on applications was employed on account of sum due on allotment.

Ramesh, to whom 40 shares were allotted, failed to pay the allotment money and on his subsequent failure to pay the first call, his shares were forfeited. Mohan, the holder of 60 shares failed to pay the two calls and his shares were forfeited after the second and final call.

Of the shares forfeited, 80 shares were sold to Krishna credited as fully paid for ₹9 per share, the whole of Ramesh’s share being included. Show journal and cash book entries and the Balance Sheet.

Solution:

Working Notes:

1. Ratio between allotment of shares and application for shares = 2,000: 2,400 = 5: 6,

2. Ramesh was allotted 40 shares.

   Therefore, Ramesh must have applied for 40 x 6/5 = 48 shares.

3. Ramesh must have paid excess application money on (48 - 40) = 8
Excess applications @ ₹ 2 per share, i.e., 8 x ₹ 2 = ₹ 16 retained by the company for adjustment against allotment money.

4. Allotment money due from Ramesh on 40 shares @ ₹ 5 per share = 40 x ₹ 5 = ₹ 200.

5. As the allotment money was failed by Ramesh against which excess money paid on application was adjusted, the net amount failed by Ramesh on Allotment = ₹ (200 - 16) = ₹ 184.

6. As Mohan paid the allotment money and the excess amount paid by him along with the application had already been adjusted, pro rata allotment in this case has no significance.

7. Amount to be transferred to Capital Reserve A/c from Shares Forfeited A/c has to be determined as follows:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount forfeited on 40 shares held by Ramesh (48 x ₹ 2)</td>
<td>96</td>
</tr>
<tr>
<td>Amount forfeited on 60 shares held by Mohan (60 x ₹ 5)</td>
<td>300</td>
</tr>
<tr>
<td>Total amount credited to Shares Forfeited A/c</td>
<td>396</td>
</tr>
</tbody>
</table>

Less: Amount on 20 forfeited shares held by Mohan which are not yet re-issued (20 x ₹ 5) | 100 |

Less: Discount allowed @ ₹ 1 on 80 shares (80 x ₹ 1) | 80 |

Net gain on 80 forfeited shares which are reissued to be transferred to Capital Reserve | 216 |

**Dr. Cash Book (Bank Column) Cr.**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Share application A/c (Application money on 3000 shares @ ₹ 2 per share)</td>
<td>6,000</td>
</tr>
<tr>
<td>By Share Application A/c (Refund of application money on 600 shares rejected @ ₹ 2 per share)</td>
<td>1,200</td>
</tr>
</tbody>
</table>

To Shares Allotment A/c (Balance of allotment money on 2,000 shares less amount failed by Ramesh) | 9,016 |
| By Balance c/d | 24,036 |

To Share First Call A/c (First call money on 1900 shares, i.e., 2000 shares - (40 + 60) shares @ ₹ 3 per share) | 5,700 |

To Shares Final call A/c (Final call money on 1900 shares, i.e., 1960 shares less 60 shares held by Mohan who failed @ ₹ 2 per share) | 3,700 |

To Share Capital A/c (Amount received on re-issue of 80 forfeited shares @ ₹ 9 per share) | 720 |

To Balance b/d | 25,236 |

25,236
### Journal Entries

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Dr. (₹)</th>
<th>Cr. (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share Application A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td>To Share Capital A/c</td>
<td>4,000</td>
<td></td>
</tr>
<tr>
<td><strong>(Transfer of application money to share capital account as per Board’s resolution dated...)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share Allotment A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td>To Share Capital A/c</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>To Securities Premium A/c</td>
<td></td>
<td>6,000</td>
</tr>
<tr>
<td><strong>(Allotment of 2000 shares to the applicants for 2400 shares pro-rata and allotment money due @ ₹ 5 per share including premium of ₹ 2 per share as per Board’s resolution dated...)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share Application A/c</td>
<td></td>
<td>800</td>
</tr>
<tr>
<td>To Share Allotment A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>(Surplus application money adjusted towards share allotment account)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share First Call A/c</td>
<td></td>
<td>6,000</td>
</tr>
<tr>
<td>To Share Capital A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>(First call money due on 2000 shares @ ₹ 3 per share as per Board’s resolution dated...)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share Capital A/c</td>
<td></td>
<td>320</td>
</tr>
<tr>
<td>Securities Premium A/c</td>
<td></td>
<td>80</td>
</tr>
<tr>
<td>To Shares Forfeited A/c</td>
<td></td>
<td>96</td>
</tr>
<tr>
<td>To Share Allotment A/c</td>
<td></td>
<td>184</td>
</tr>
<tr>
<td>To Share First Call A/c</td>
<td></td>
<td>120</td>
</tr>
<tr>
<td><strong>(Forfeiture of 40 shares held by Ramesh for non-payment of allotment of money @ ₹ 5 per share including premium @ ₹ 2 per share and first call money @ ₹ 3 per share as per Board’s resolution dated...)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share Final Call A/c</td>
<td></td>
<td>3,920</td>
</tr>
<tr>
<td>To Share Capital A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>(Share final call due on 1960 shares (i.e., 2000 shares-Ramesh’s 40 shares forfeited) @ ₹ 2 per share as per Board’s resolution dated...)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share Capital A/c</td>
<td></td>
<td>600</td>
</tr>
<tr>
<td>To Shares Forfeited A/c</td>
<td></td>
<td>300</td>
</tr>
<tr>
<td>To Share First Call A/c</td>
<td></td>
<td>180</td>
</tr>
<tr>
<td>To Share Final Call A/c</td>
<td></td>
<td>120</td>
</tr>
<tr>
<td><strong>(Forfeited of 60 shares held by Mohan for non-payment of first call money @ ₹ 3 per share and final call money @ ₹ 2 per share as per Board’s resolution dated...)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shares Forfeited A/c</td>
<td></td>
<td>80</td>
</tr>
<tr>
<td>To Share Capital A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>(Discount allowed on re-issue of 80 forfeited share @ Re. 1 per Board’s resolution dated...)</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Balance Sheet of.....Ltd. as at.....

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Note No.</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>I Equity and Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shareholders’ Funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share Capital</td>
<td>1</td>
<td>19,900</td>
</tr>
<tr>
<td>Reserves and Surplus</td>
<td>2</td>
<td>4,136</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>24,036</td>
</tr>
<tr>
<td><strong>II Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and Cash Equivalents</td>
<td>3</td>
<td>24,036</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>24,036</td>
</tr>
</tbody>
</table>

Notes:

1. **Share Capital**
   - Authorised
   - Issued:
     - 2,000 Equity Shares of ₹ 10 each
       - 20,000
     - Subscribed and Paid-up:
       - 1,980 Equity Shares of ₹ 10 each, fully paid-up
       - 19,800
     - *Add*: Shares Forfeited
       - 100
       - 19,900

2. **Reserves and Surplus**
   - Capital Reserve Account
     - 216
   - Securities Premium Account
     - 3,920
     - 4,136

3. **Cash and Cash Equivalent**
   - Balance with Bank
     - 24,036

**ISSUE OF DEBENTURES**

**Meaning of Debentures**

Besides raising capital by the issue of shares, a company may supplement its capital by borrowings. Such borrowings may take the form of both short-term and long-term borrowings. Short-term borrowings by way of promissory notes, bills of exchange, bank overdrafts, cash credits, public deposits, etc., are needed by a company to provide for its working capital while long-term borrowings by way of loan on mortgage of property, term loans from financial institutions, public deposits for a long period, issue of debentures, etc., are needed by a company for financing expenditure of a capital nature. Loan capital of a company refers to the long-term borrowings of which issue of debentures is the most important and common method adopted by companies. Debentures are part of loan capital and the company is liable to pay interest thereon whether it earns profit or not.

**Issue of Debentures**

The procedure for issuing debentures by a company is very much similar to that of an issue of shares.
Applications for debentures are invited from the public through the prospectus and the applicants are asked to pay the application money along with the applications. The company may ask for payment of the whole of the amount along with the application itself or in installments.

### Issue of Debentures for Cash

When debentures are issued for cash, the amount to be collected on them may be payable in a lump sum or in installments. Where payable in installments, debenture application account is opened on receipt of applications. Then there are debenture allotment account and debenture calls account.

### Issue of Debentures at Par

Debentures are said to be issued at par when the debenture-holder is required to pay an amount equal to the nominal or face value of the debentures e.g. the issue of ₹ 1,000 debenture for ₹ 1,000.

### (a) If the full amount is payable along with the application:

1. On receipt of application money:
   
   - Bank To Debentures Application and Allotment A/c
   - Dr. (with the money received on application)

2. On allotment:
   
   - Debenture Application and (with the money received on
### Allotment A/c
**Dr.** debentures allotted
To Debentures A/c

### (b) If the amount is payable in installments

1. On receipt of application money:
   - Bank **Dr.** (with the money received on application)
   - To Debentures Application A/c

2. On Allotment:
   - Debenture Application A/c **Dr.** (with the application money due on debentures)
   - Debenture Allotment A/c **Dr.** (with the allotment money due on debentures)
   - To Debentures A/c (with application and allotment money on debentures allotted)

3. On refund of application money:
   - Debenture Application A/c **Dr.** (with the excess application money refunded)
   - To Bank

4. On receipt of allotment money:
   - Bank **Dr.** (with the money received on allotment)
   - To Debenture Allotment A/c

5. On making calls:
   - Debenture Calls A/c **Dr.** (with the money due on respective calls)
   - To Debenture A/c

6. On receipt of call money:
   - Bank **Dr.** (with the money received on respective calls)
   - To Debenture Calls A/c

### Note:
- All cash transactions are generally passed through the Cash Book.
- It is customary to prefix the rate of interest payable on debentures with the debenture account.
- The company cannot allot more debentures than issued. The excess application money may be retained by the company against the allotment money due. But the excess application money received on debentures rejected has to be refunded to the applicants.

### Issue of Debentures at a Premium

If the debentures are issued at a price higher than the nominal value of the debentures, the debentures are said to be issued at a premium. The excess of issue price over the nominal value is regarded as the premium amount. In such a case, the Debentures Account should be credited only with the nominal value of the debentures and the premium should be credited to “Securities Premium Reserves.”
### Issue of Debentures at a Discount

If the debentures are issued at a price lower than the nominal value of the debentures, the debentures are said to be issued at a discount. The difference between the nominal value and the issue price is regarded as the discount. Such discount being a capital loss must be shown specifically as a deduction of general Reserve on the liabilities side of the balance sheet under the heading ‘Reserves and Surplus’. If there are no Reserves, the discussion on issue of debentures is to be shown as a negative item under the heading ‘Reserves and Surplus’. Such discount on issue of debentures may either be written off against revenue profits or capital profits of the company. When debentures are issued at a discount, the Debentures Account should be credited with the nominal value of the debentures and the discount allowed on issue of debentures, being a capital loss, should be debited to “Discount on Issue of Debentures Account”.

<table>
<thead>
<tr>
<th>Account</th>
<th>Dr.</th>
<th>With...</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debenture Application A/c</td>
<td>(with the money due on application)</td>
<td></td>
</tr>
<tr>
<td>Debenture Allotment A/c</td>
<td>(with allotment money including premium)</td>
<td></td>
</tr>
<tr>
<td>To Debentures A/c</td>
<td>(with the nominal value of the debentures)</td>
<td></td>
</tr>
<tr>
<td>To Securities Premium A/c</td>
<td>(with the premium money)</td>
<td></td>
</tr>
</tbody>
</table>

### Illustration 12:

X Ltd. made an issue of 10,000 12% Debentures of ₹ 100 each, payable as follows:

- ₹ 25 on Application
- ₹ 25 on Allotment
- ₹ 50 on First and Final Call.

Applications were received for 12,000 debentures and the directors allotted 10,000 debentures rejecting applications for 2,000 debentures. The money received on applications for 2,000 debentures rejected was duly refunded. The call was made and the moneys were duly received.

Show the necessary cash book and journal entries to record the above transactions and above the relevant items in the balance sheet of the company.
### Cash Book (Bank Columns)

<table>
<thead>
<tr>
<th>Dr. Particulars</th>
<th>₹</th>
<th>Cr. Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>To 12% Debenture Application</td>
<td>3,00,000</td>
<td>By 12% Debenture Application A/c</td>
<td>50,000</td>
</tr>
<tr>
<td>(Application money on 12,000 12% Debenture @ ₹ 25 per debenture)</td>
<td></td>
<td>(Refund of Application money on 2,000, 12% Debenture @ ₹ 25 per debenture)</td>
<td></td>
</tr>
<tr>
<td>To 12% Debenture Allotment</td>
<td>2,50,000</td>
<td>By Balance c/d</td>
<td>10,00,000</td>
</tr>
<tr>
<td>(Allotment money on 10,000 12% Debenture @ ₹ 25 per debenture)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>To 12% Debenture First and Final Call A/c</td>
<td>5,00,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(First and final call money on 10,000 debentures @ ₹ 80 per debenture)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>10,50,000</strong></td>
<td><strong>10,50,000</strong></td>
<td></td>
</tr>
</tbody>
</table>

**In the books of X Ltd.**

**Journal Entries**

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Debit (₹)</th>
<th>Credit (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>12% Debenture Application A/c</td>
<td>Dr. 2,50,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>12% Debenture Allotment A/c</td>
<td>Dr. 2,50,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To 12% Debentures A/c</td>
<td></td>
<td>5,00,000</td>
</tr>
<tr>
<td></td>
<td>(Being capitalization of application money @ ₹ 25 per debenture and allotment money due on 10,000 debentures as per Boards resolution dated....)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>12% Debenture First and Final Call A/c</td>
<td>Dr. 5,00,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To 12% Debentures A/c</td>
<td></td>
<td>5,00,000</td>
</tr>
<tr>
<td></td>
<td>(First and final call money due on 10,000, 12% debentures @ ₹ 50 per debenture as per board’s resolution dated...)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Particulars**

<table>
<thead>
<tr>
<th>Note No.</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>I Equity and Liabilities</td>
<td></td>
</tr>
<tr>
<td>Non-current Liabilities</td>
<td></td>
</tr>
<tr>
<td>Long-term Borrowings</td>
<td>1</td>
</tr>
<tr>
<td>Total</td>
<td>10,00,000</td>
</tr>
</tbody>
</table>

| II Assets | |
| Current Assets | |
| Cash and Cash Equivalents | 3 | 10,00,000 |
| Total | 10,00,000 |
Notes:

1. Long-term Borrowings
   12% Debentures 10,00,000

2. Cash and Cash Equivalent
   Balance with Bank 10,00,000

Illustration 13:
B Ltd. issued 2,000, 13% Debentures of ₹ 100 each at ₹ 110 payable as follows:
   On Application ₹ 25
   On Allotment ₹ 35 (including premium)
   On First and Final Call ₹ 50

The debentures were fully subscribed and the moneys were duly received. Prepare cash book, pass the necessary journal entries and about the relevant portions of the balance sheet of the company.

Solution:

Cash Book (Bank Columns)

<table>
<thead>
<tr>
<th>Dr. Particulars</th>
<th>₹</th>
<th>Cr. Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>To 13% Debenture Application A/c</td>
<td>50,000</td>
<td>By Balance c/d</td>
<td>2,20,000</td>
</tr>
<tr>
<td>(Application money on 2,000 debentures @ ₹ 25 per each)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>To 13% Debenture Allotment A/c</td>
<td>70,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Allotment money on 2,000 debentures @ ₹ 35 per debenture including premium of ₹ 10 each)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>To 13% Debenture First and Final Call A/c</td>
<td>1,00,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(First and final call money on 2,000 debentures @ ₹ 50 per debenture)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>2,20,000</td>
<td></td>
<td>2,20,000</td>
</tr>
</tbody>
</table>

In the books of B Ltd.

Journal Entries

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Debit (₹)</th>
<th>Credit (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>13% Debenture Application A/c</td>
<td>Dr. 50,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>13% Debenture Allotment A/c</td>
<td>Dr. 70,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To 12% Debentures A/c</td>
<td></td>
<td>1,00,000</td>
</tr>
<tr>
<td></td>
<td>To Securities Premium A/c</td>
<td></td>
<td>20,000</td>
</tr>
<tr>
<td></td>
<td>(Being capitalization of application money @ ₹ 25 per debenture and allotment money due on 2,000 debentures @ ₹ 35 including premium of ₹ 10 each as per Boards resolution dated.....)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>13% Debenture First and Final Call A/c</td>
<td>Dr. 1,00,000</td>
<td></td>
</tr>
</tbody>
</table>
To 13% Debentures A/c 1,00,000
(First and final call money due on 10,000, 12% debentures @ ₹ 50 per debenture as per board’s resolution dated...)

Balance Sheet of B Ltd. as at...

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Note No.</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>I  Equity and Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shareholders’ Funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reserves and Surplus</td>
<td>1</td>
<td>20,000</td>
</tr>
<tr>
<td><strong>II  Non-current Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long-term Borrowings</td>
<td>2</td>
<td>2,00,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>2,20,000</td>
</tr>
<tr>
<td><strong>II  Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Current Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and Cash Equivalents</td>
<td>3</td>
<td>2,20,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>2,20,000</td>
</tr>
</tbody>
</table>

**Notes:**
1. **Reserves and Surplus**
   Securities Premium 20,000
2. **Long-term Borrowings**
   13% Secured Debentures 2,00,000
3. **Cash and Cash Equivalents**
   Balance with Bank 2,20,000

**Illustration 14:**

W Ltd. issued 2,000, 14% Debentures of ₹ 100 each at discount of 5%, the discount being adjustable on allotment. The debentures were payable as follows:

- On Application - ₹ 25
- On Allotment - ₹ 20
- On First and Final Call - ₹ 50

The debentures were fully subscribed and the moneys were duly received. Show the cash book and journal entries and prepare the balance sheet of the company.
### Solution:

In the books of W Ltd.

<table>
<thead>
<tr>
<th>Dr. Particulars</th>
<th>₹</th>
<th>Cr. Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>To 14% Debenture Application A/c</td>
<td>50,000</td>
<td>By Balance c/d</td>
<td>1,90,000</td>
</tr>
<tr>
<td>(Application money on 2,000 debentures @ ₹ 25 per each)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>To 14% Debenture Allotment A/c</td>
<td>40,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Allotment money on 2,000 debentures @ ₹ 20 each)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>To 14% Debenture First and Final Call A/c</td>
<td>1,00,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(First and final call money on 2,000 debentures @ ₹ 50 per debenture)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>1,90,000</strong></td>
<td></td>
<td><strong>1,90,000</strong></td>
<td></td>
</tr>
</tbody>
</table>

### Journal Entries

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Debit (₹)</th>
<th>Credit (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>14% Debenture Application A/c</td>
<td>Dr. 50,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>14% Debenture Allotment A/c</td>
<td>Dr. 40,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Discount on issue of debentures A/c</td>
<td>Dr. 10,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To 12% Debentures A/c</td>
<td></td>
<td>1,00,000</td>
</tr>
<tr>
<td></td>
<td>(Being capitalization of application money @ ₹ 25 per debenture and allotment money due on 2,000 debentures @ ₹ 20 after adjusting discount of ₹ 5 each as per Board's resolution dated.....)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>14% Debenture First and Final Call A/c</td>
<td>Dr. 1,00,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To 13% Debentures A/c</td>
<td></td>
<td>1,00,000</td>
</tr>
<tr>
<td></td>
<td>(First and final call money due on 2,000, debentures @ ₹ 50 per debenture as per board's resolution dated...)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Balance Sheet (Relevant Items Only)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Note No.</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>I  Equity and Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shareholders' Funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reserves and Surplus</td>
<td>1</td>
<td>(10,000)</td>
</tr>
<tr>
<td><strong>Non-current Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long-term Borrowings</td>
<td>2</td>
<td>2,00,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>1,90,000</td>
</tr>
<tr>
<td><strong>II  Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and Cash Equivalents</td>
<td>3</td>
<td>1,90,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>1,90,000</td>
</tr>
</tbody>
</table>

Notes:

1. Reserves and Surplus
   - Discount on Issue of Debentures (10,000)
2. Long-term Borrowings
   - 13% Debentures 2,00,000
3. Cash and Cash Equivalents
   - Balance with Bank 1,90,000

DEBENTURES ISSUED FOR CONSIDERATION OTHER THAN CASH

The company may allot debentures to the vendors for acquiring some assets as payment for purchase consideration. This issue of debentures to vendors is known as issue of debentures for consideration other than cash.

Journal Entries

(1) For acquisition of assets:
   - Sundry Assets (Individually) A/c Dr. (with the value of assets)
   - To Vendors (with the purchase price)

(2) (a) On allotment of debentures (at par)
   - Vendors Dr. (with the value of debentures)
   - To Debentures A/c

(b) On allotment of debentures (at premium)
   - Vendors A/c Dr. (with the purchase price)
   - To Debentures A/c (with the nominal value)
   - To Securities Premium A/c (with the amount of premium)

(c) On allotment of debentures (at discount)
   - Vendors A/c Dr. (with the amount of purchase)
   - Discount on Issue of Debentures A/c Dr. (with the amount of discount)
   - To Debentures A/c (with the nominal value)
   - To Debentures A/c (with the nominal value)
   - To Debentures A/c (with the nominal value)
Notes:

(i) If the value of debentures allotted is more than the agreed purchase price, the difference is debited to Goodwill Account.

(ii) Similarly, if the value of debentures allotted is less than the agreed purchase price, credited to Capital Reserve Account.

Illustration 15:

Optimist Ltd. purchased building worth Rs.1,20,000 and plant and machinery worth Rs. 1,00,000 from Depressed Ltd. for an agreed purchase consideration of Rs. 2,00,000 to be satisfied by the issue of 2,000, 12% Debentures of Rs. 100 each. Show the necessary journal entries in the books of Optimist Ltd.

Solution:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Dr. (₹)</th>
<th>Cr. (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Building A/c</td>
<td>Dr.</td>
<td>1,20,000</td>
</tr>
<tr>
<td>Plant and Machinery A/c</td>
<td>Dr.</td>
<td>1,00,000</td>
</tr>
<tr>
<td>To Depressed Ltd.</td>
<td></td>
<td>2,00,000</td>
</tr>
<tr>
<td>To Capital Reserve A/c</td>
<td></td>
<td>20,000</td>
</tr>
<tr>
<td>(Purchase of sundry assets and transfer of capital profits as per agreement with the vendor dated...)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depressed Ltd.</td>
<td>Dr.</td>
<td>2,00,000</td>
</tr>
<tr>
<td>To 12% Debentures A/c</td>
<td></td>
<td>2,00,000</td>
</tr>
<tr>
<td>(Being 2,000, 12% Debentures of Rs. 100 each allotted to vendors for consideration other than cash as per Board’s resolution dated...)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

DEBENTURES ISSUED AS COLLATERAL SECURITY

The term ‘Collateral Security’ implies additional security given for a loan. Where a company obtains a loan from a bank or insurance company, it may issue its own debentures to the lender as collateral security against the loan in addition to any other security that may be offered. In such a case, the lender has the absolute right over the debentures until and unless the loan is repaid. On repayment of the loan, however, the lender is legally bound to release the debentures forthwith. But in case the loan is not repaid by the company on the due date or in the event of any other breach of agreement, the lender has the right to retain these debentures and to realise them. The holder of such debentures is entitled to interest only on the amount of loan, but not on the debentures. Such an issue of debentures is known as “Debentures issued as Collateral Security”. There are two alternative ways by which debentures issued as collateral security can be dealt with:

(1) No accounting entry is required to be shown in the books of account at the time of issue of such debentures for the simple reason that the loan against which the debentures are issued as collateral security has already been credited, the debit being given to Bank. But the existence of such debentures issued as collateral security has to be mentioned by way of a note on the Balance Sheet under the specific loan account.

(2) If it is desired that such an issue of debentures as collateral security is to be recorded in the books of account, the accounting entries will be as follows:
Note: The net effect of the above two entries is nil. Both the Debentures Suspense Account and the Debentures Account are cancelled on repayment of the loan. As such, this method is rarely followed in practice.

Illustration 16:

Z Ltd. secured an long-term loan of Rs. 50,000 from the bank by issuing 600, 12% Debentures of Rs. 100 each as collateral security. Show relevant items in the Balance Sheet of the Company under both the methods.

Solution:

(First Method):

Balance Sheet (relevant items only)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Note No.</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity and Liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-current Liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long-term Borrowings</td>
<td>1</td>
<td>50,000</td>
</tr>
</tbody>
</table>

Note:

1. Long-term Borrowings

   Long term Secured Loan
   (Secured by the issue of ……
   12% Debentures of ₹ 100 each as collateral securities)

Solution (Second Method):

Journal Entries

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Dr.(₹)</th>
<th>Cr.(₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debentures Suspense A/c</td>
<td>60,000</td>
<td></td>
</tr>
<tr>
<td>To Debentures A/c</td>
<td></td>
<td>60,000</td>
</tr>
</tbody>
</table>

(Issue of 600, 12% Debentures of Rs. 100 each as collateral security for a bank overdraft of Rs. 50,000 as per Board’s resolution dated…..)
Balance Sheet (relevant items only)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Note No.</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>I Equity and Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Non-current Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long-term Borrowings</td>
<td>1</td>
<td>50,000</td>
</tr>
</tbody>
</table>

Note:
1. **Long-term Borrowings**

   Long term Secured Loan
   (Secured by the issue of .......
   12% Debentures of ₹ 100 each as collateral securities) 60,000

   Less: 12% De Debentures Accounts (60,000) Nil


**ISSUE OF PREFERENCE SHARES**

A company limited by shares may, if so authorised by its articles, issue preference shares which are 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, can issue any preference shares which are irredeemable.

A company may issue preference shares for a period exceeding 20 years but not exceeding 30 years for infrastructure projects (Specified in Schedule VI). However, it is subject to redemption of 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 proposed to be redeemed out of the profits of the company, a sum equal to the nominal amount of the shares to be redeemed, shall be transferred to a reserve called the Capital Redemption Reserve Account out of the profits of the company and the 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 applied by the company, in paying up 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 under 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 2013 Act, 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.

For the companies whose financial statements need not comply with the accounting standards as prescribed 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 out of the profits of the company which would otherwise be available for dividend

If the redeemable preference shares are redeemed out of the profits of the company which would otherwise be available for dividend, the “Capital Redemption Reserve Account” has to be created which will represent the redeemable preference shares in the balance sheet after the redemption. This capital redemption reserve should be equal to the amount of Preference Shares to be redeemed. The profits available for dividend have to be transferred to Capital Redemption Reserve Account.

<table>
<thead>
<tr>
<th>JOURNAL ENTRIES</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. Transfer profits available for dividend to Capital Redemption Reserve Account:</strong></td>
</tr>
<tr>
<td>General Reserve Account Dr. (as the case may be)</td>
</tr>
<tr>
<td>Profit and Loss Appropriation A/c Dr.</td>
</tr>
<tr>
<td>Dividend Equalization Account Dr.</td>
</tr>
<tr>
<td>To Capital Redemption Reserve A/c (with the nominal value of the shares to be redeemed)</td>
</tr>
<tr>
<td><strong>2. If current assets are realized to provide cash for redemption of preference shares:</strong></td>
</tr>
<tr>
<td>Bank Dr.</td>
</tr>
<tr>
<td>To Respective Assets Account (with the realized value of assets)</td>
</tr>
<tr>
<td><strong>3. On transfer of redeemable preference share capital to be redeemed to Preference Shareholders Account:</strong></td>
</tr>
<tr>
<td>Redeemable Preference Share Capital A/c Dr. (with the nominal value of the shares to be redeemed)</td>
</tr>
<tr>
<td>To Preference Shareholders A/c</td>
</tr>
<tr>
<td><strong>4. If preference shares are redeemed at premium:</strong></td>
</tr>
<tr>
<td>Redeemable Preference Share Capital A/c Dr.</td>
</tr>
<tr>
<td>Premium on Redemption of Preference Shares A/c Dr. (with the amount of premium payable)</td>
</tr>
<tr>
<td>To Preference Shareholders A/c</td>
</tr>
<tr>
<td><strong>5. For providing premium on redemption of preference shares:</strong></td>
</tr>
<tr>
<td>Securities Premium Account Dr. (with the amount of premium paid on redemption of preference shares)</td>
</tr>
<tr>
<td>or Profit and Loss A/c Dr.</td>
</tr>
<tr>
<td>To Premium on Redemption of Preference Shares Account</td>
</tr>
<tr>
<td><strong>6. On redemption of preference shares:</strong></td>
</tr>
<tr>
<td>Preference Shareholders Account Dr. (with the amount paid)</td>
</tr>
<tr>
<td>To Bank</td>
</tr>
</tbody>
</table>

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:

If the redeemable preference shares are redeemed out of the proceeds of fresh issue of shares, the new Share Capital Account raised by fresh issue will take the place of the Redeemable Preference Share Capital
Account after the 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 given in previous case.

**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:**

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 equity or preference, the Capital Redemption Reserve Account and the new Share Capital Account taken together will replace the Redeemable Preference Share Capital redeemed. Thus in such a case, Redeemable Preference Share Capital redeemed = Capital Redemption Reserve Account + New Share Capital Account (Equity or Preference).

Here, all the entries shown under (1) and (2) have to be passed. But there are certain common entries which can be combined together.

**Illustration 17:**

Vanities Ltd. had an issue 1,000, 12% redeemable preference shares of ₹ 100 each, repayable at a premium of 10%. These shares are to be redeemed now 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 Account.

**Solution:**

In the books of Vanities Ltd.

<table>
<thead>
<tr>
<th>Journal Entries</th>
<th>Dr. (₹)</th>
<th>Cr. (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Reserve Account</td>
<td>Dr. 1,00,000</td>
<td></td>
</tr>
<tr>
<td>To Capital Redemption Reserve A/c (Transfer of reserves to Capital Redemption Reserve Account on redemption of redeemable preference shares)</td>
<td>1,00,000</td>
<td></td>
</tr>
<tr>
<td>12% Redeemable Preference Share Capital A/c</td>
<td>Dr. 1,00,000</td>
<td></td>
</tr>
<tr>
<td>Premium on Redemption of Preference Shares A/c</td>
<td>Dr. 10,000</td>
<td>1,10,000</td>
</tr>
<tr>
<td>To 12% Preference Shareholders A/c (Amount payable to 12% preference shareholders on redemption of 12% preference shares at a premium of 10%)</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>Securities Premium A/c</td>
<td>Dr. 10,000</td>
<td></td>
</tr>
<tr>
<td>To Premium on Redemption of Preference Share A/c (Application of Securities Premium Account to write off premium on redemption of preference shares)</td>
<td></td>
<td>10,000</td>
</tr>
<tr>
<td>12% Preference Shareholders A/c</td>
<td>Dr. 1,10,000</td>
<td></td>
</tr>
<tr>
<td>To Bank (Amount due to 12% preference shareholders on redemption paid)</td>
<td>1,10,000</td>
<td></td>
</tr>
</tbody>
</table>
Note: Capital Redemption Reserve Account replaces the 12% Redeemable Preference Shares Capital Account and the capital structure of the company remains unchanged.

Illustration 18:
Sure and Fast Ltd. has part of its share capital in 12% redeemable preference shares of ₹ 100 each, repayable at a premium of 5%. The shares have now become due for redemption. It is decided that the whole amount will be redeemed out of a fresh issue of 20,000 equity shares of ₹ 10 each at ₹ 11 each. The whole amount is received in cash and the 12% preference shares are redeemed. Show the necessary journal entries in the books of the company.

Solution:

In the books of Sure and Fast Ltd.

<table>
<thead>
<tr>
<th>Journal Entries</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Particulars</strong></td>
</tr>
<tr>
<td>Bank Dr. To Equity Share Application and Allotment A/c (Application money on 20,000 equity shares @ ₹ 11 per share including a premium of Re. 1 per share)</td>
</tr>
<tr>
<td>Equity Share Application and Allotment A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (Allotment of 20,000 equity shares ₹ 10 each issued at a premium of ₹ 1 per share as per Board’s Resolution dated....)</td>
</tr>
<tr>
<td>12% Redeemable Preference Share Capital A/c Dr. Premium on Redemption of Preference Share A/c Dr. To 12% Preference Shareholders A/c (Amount due to 12% preference shareholders on redemption of 8% preference shares at a premium of 5%)</td>
</tr>
<tr>
<td>Securities Premium A/c Dr. To Premium on Redemption of Preference Shares A/c (Application of Securities Premium Account to write off Premium on Redemption of Preference Shares)</td>
</tr>
<tr>
<td>12% Preference Shareholders A/c Dr. To Bank (Payment of amount due to 12% preference shareholders on redemption)</td>
</tr>
</tbody>
</table>

Note: Equity Share Capital Account replaces the 12% Redeemable Preference Share Capital Account and the capital structure of the company remains unchanged.
Illustration 19:

The following is the balance sheet of Oscar India Ltd. as on 31st March 2011:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Note No.</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>I Equity and Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shareholders’ Funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share Capital</td>
<td>1</td>
<td>5,48000</td>
</tr>
<tr>
<td>Reserves and Surplus</td>
<td>2</td>
<td>1,65,000</td>
</tr>
<tr>
<td><strong>Current Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade Payable</td>
<td>3</td>
<td>1,27,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>8,40,000</td>
</tr>
<tr>
<td><strong>II Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-Current Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Assets</td>
<td></td>
<td>6,00,000</td>
</tr>
<tr>
<td><strong>Current Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment</td>
<td></td>
<td>50,000</td>
</tr>
<tr>
<td>Inventories</td>
<td></td>
<td>1,10,000</td>
</tr>
<tr>
<td>Cash and Cash Equivalents</td>
<td></td>
<td>80,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>8,40,000</td>
</tr>
</tbody>
</table>

Notes:

1. **Share Capital**
   - Authorised
     - Issued, subscribed and paid-up:
       - 30,000 Equity Shares of ₹ 10 each fully paid-up: 3,00,000
       - 2,500 Preference share of ₹ 100 each fully called-up: 2,50,000
       - Less: Final Call on 100 preference shares @ ₹ 20 per share unpaid: 2,000

2. **Reserves and Surplus**
   - Securities Premium: 15,000
   - Surplus: 1,50,000

3. **Trade Payable**
   - Trade Creditors: 1,10,000
   - Outstanding Expenses: 17,000

4. **Cash and Cash Equivalent**
   - Balance with Bank: 80,000

On 30th June, 2012, the Board of Directors decided to redeem the preference shares at a premium of 10% and to sell the investments at its market price of ₹ 40,000. They also decided to issue sufficient number of equity shares of ₹ 10 each at a premium of Re. 1 per share, required after utilizing the profit and loss account leaving a balance of ₹ 50,000. Premium on redemption is required to be set off against securities premium account.
Repayments on redemption were made in full except to one shareholder holding 50 shares only due to his leaving India for good.

You are required to show the journal entries and the balance sheet of the company after redemption. Assumption made should be shown in the working.

**Solution:**

In the books of Oscar Ltd.

<table>
<thead>
<tr>
<th>Journal Entries</th>
<th>Dr. (₹)</th>
<th>Cr. (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank Dr.</td>
<td>40,000</td>
<td></td>
</tr>
<tr>
<td>Profit and Loss A/c Dr.</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>To Investments</td>
<td>50,000</td>
<td></td>
</tr>
<tr>
<td>(Being the sale of investments at a loss of ₹ 10,000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank Dr.</td>
<td>1,65,000</td>
<td></td>
</tr>
<tr>
<td>To Share Capital A/c</td>
<td>1,50,000</td>
<td></td>
</tr>
<tr>
<td>To Securities Premium A/c</td>
<td>15,000</td>
<td></td>
</tr>
<tr>
<td>(Being the issue of required number of equity shares at a premium of 10%)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Preference Share Capital A/c Dr.</td>
<td>2,40,000</td>
<td></td>
</tr>
<tr>
<td>Premium on Redemption A/c Dr.</td>
<td>24,000</td>
<td></td>
</tr>
<tr>
<td>To Preference Shareholders A/c</td>
<td>2,64,000</td>
<td></td>
</tr>
<tr>
<td>(Being the transfer of the amount due to preference shareholders on redemption)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Securities Premium A/c Dr.</td>
<td>24,000</td>
<td>24,000</td>
</tr>
<tr>
<td>To Premium on Redemption A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Being the transfer of securities premium account to write off premium on redemption of preference shares account)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Profit and Loss A/c Dr.</td>
<td>90,000</td>
<td>90,000</td>
</tr>
<tr>
<td>To Capital Redemption Reserve A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Being the transfer of profit used for redemption of preference shares to capital redemption reserve account)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Preference Shareholders A/c Dr.</td>
<td>2,58,500</td>
<td>2,58,500</td>
</tr>
<tr>
<td>To Bank</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Being the payment to preference shareholders except to a holder of 50 shares)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Balance Sheet of Oscar India Ltd. as on 1st July, 2011
(After redemption)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Note No.</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>I  Equity and Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shareholders’ Funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share Capital</td>
<td>1</td>
<td>4,58,000</td>
</tr>
<tr>
<td>Reserves and Surplus</td>
<td>2</td>
<td>1,46,000</td>
</tr>
<tr>
<td><strong>Current Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade Payable</td>
<td>3</td>
<td>1,27,000</td>
</tr>
<tr>
<td>Preference shareholders</td>
<td></td>
<td>5,500</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>1,40,000</td>
</tr>
<tr>
<td><strong>II  Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-Current Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Assets</td>
<td></td>
<td>6,00,000</td>
</tr>
<tr>
<td><strong>Current Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventories</td>
<td></td>
<td>1,10,000</td>
</tr>
<tr>
<td>Cash and Cash Equivalents</td>
<td>4</td>
<td>26,500</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>84,000</td>
</tr>
</tbody>
</table>

Notes:

1. **Share Capital**
   - Authorised
   - Issued, subscribed and paid-up:
     - 45,000 Equity Shares of ₹ 10 each fully paid-up: ₹ 4,50,000
     - In preference share of ₹ 100 each fully called-up: 10,000
     - Less: Final Call @ ₹20 per share unpaid: 2,000
     - ₹ 4,58,000

2. **Reserves and Surplus**
   - Capital Redemption Reserve: ₹ 90,000
   - Securities Premium: ₹ 6,000
   - Surplus: ₹ 50,000
   - ₹ 1,46,000

3. **Trade Payable**
   - Trade Creditors: ₹ 1,10,000
   - Outstanding Expenses: ₹ 17,000
   - ₹ 1,27,000

4. **Cash and Cash Equivalent**
   - Balance with Bank: ₹ 26,500

**Working Notes:**

Calculation of required number of fresh issue of equity shares:

- Balance of Profit and Loss A/c: ₹ 1,50,000
FP-FA&A

Less: Loss on Sale of Investment 10,000
Balance required 50,000 60,000
Profit available for redemption 90,000
Amount required for redemption 2,40,000
Amount available from Profit and Loss A/c 90,000
New issue required 15,000 shares 1,50,000

Dr. Bank Account Cr.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Balance b/d</td>
<td>90,000</td>
<td>By Preference Share-</td>
<td>2,58,500</td>
</tr>
<tr>
<td>To Investment</td>
<td>40,000</td>
<td>holders A/c</td>
<td>36,500</td>
</tr>
<tr>
<td>To Share Capital A/c</td>
<td>1,50,000</td>
<td>By Balance b/d</td>
<td></td>
</tr>
<tr>
<td>To Securities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Premium A/c</td>
<td>15,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>2,95,000</td>
<td></td>
<td>2,95,000</td>
</tr>
</tbody>
</table>

Illustration 22:
The Balance Sheet of Producers Ltd. as at 31st March, 2013 is as follows:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Note No.</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>I Equity and Liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shareholders’ Funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share Capital</td>
<td>1</td>
<td>3,50,000</td>
</tr>
<tr>
<td>Reserves and Surplus</td>
<td>2</td>
<td>64,000</td>
</tr>
<tr>
<td>Current Liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade Payable</td>
<td>3</td>
<td>72,000</td>
</tr>
<tr>
<td>Short-term premium</td>
<td>4</td>
<td>39,500</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>5,26,000</td>
</tr>
<tr>
<td>II Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-Current Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Assets</td>
<td>5</td>
<td>2,80,000</td>
</tr>
<tr>
<td>Current Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short-term Investment</td>
<td></td>
<td>60,000</td>
</tr>
<tr>
<td>Inventories</td>
<td></td>
<td>1,30,500</td>
</tr>
<tr>
<td>Trade Receivables</td>
<td></td>
<td>50,550</td>
</tr>
<tr>
<td>Cash and Cash Equivalents</td>
<td>6</td>
<td>4,950</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>5 26,000</td>
</tr>
</tbody>
</table>

Notes:

1. Share Capital
   Authorised
      Issued, subscribed and paid-up:
      40,000 Equity Shares of ₹ 10 each fully paid-up 4,00,000
      10,000 10% Preference share of ₹ 100 each 1,00,000
      5,00,000

      Issued, subscribed and paid-up:
      25,000 Equity Shares of ₹ 10 each, fully paid-up 2,50,000
In order to redeem its preference shares, the company issued 5,000 equity shares of ₹ 10 each at a premium of 10% and sold all of its investment for ₹ 70,800. Preference shares were redeemed at a premium of 10%. Show the necessary journal entries in the books of the company and prepare the balance sheet of the company immediately after redemption of preference shares.

**Solution:**

**In the books of Producers Ltd.**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Dr. (₹)</th>
<th>Cr. (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank</td>
<td>Dr. 55,000</td>
<td>55,000</td>
</tr>
<tr>
<td>To Equity Share Application and Allotment Account</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Application money received on 5,000 equity shares of ₹ 10 issued at a premium of 10%)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity Share Application and Allotment A/c</td>
<td>Dr. 55,000</td>
<td></td>
</tr>
<tr>
<td>To Equity Share Capital A/c</td>
<td>50,000</td>
<td></td>
</tr>
<tr>
<td>To Securities Premium A/c</td>
<td>5,000</td>
<td></td>
</tr>
</tbody>
</table>
FP-FA&A

Profit and Loss A/c Dr. To Capital Redemption Reserve A/c
(Transfer of the balance of the nominal value of preference shares to be redeemed not covered by fresh issue, i.e., ₹ 1,00,000 - ₹ 50,000 on redemption to Capital Redemption Reserve A/c)

Bank Dr.
To Investments A/c
To Profit and Loss A/c
(Sale of Investments at a profit and transfer of profit on sale to Profit and Loss A/c)

10% Redeemable Preference Share Capital A/c Dr.
Premium on Redemption of Preference Shares A/c Dr.
To 10% Preference Shareholders A/c
(Amount due to 10% preference shareholders on redemption)

Securities Premium A/c Dr.
To Premium on Redemption of Preference Shares A/c
(Application of securities premium to write off premium on redemption of preference shares)

10% Preference Shareholders A/c Dr.
To Bank
(Amount due to 10% Preference Shareholders on redemption of their shares paid)

Balance Sheet of Producers Ltd. as at 31st March, 2013
(After redemption preference shares)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Note No.</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>I Equity and Liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shareholders' Funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share Capital</td>
<td>1</td>
<td>3,00,000</td>
</tr>
<tr>
<td>Reserves and Surplus</td>
<td>2</td>
<td>69,800</td>
</tr>
<tr>
<td>Current Liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade Payable</td>
<td>3</td>
<td>72,000</td>
</tr>
<tr>
<td>Short-term premium</td>
<td>4</td>
<td>39,500</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>4,81,800</td>
</tr>
<tr>
<td>II Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-Current Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tangible assets</td>
<td>5</td>
<td>2,80,000</td>
</tr>
<tr>
<td>Current Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventories</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade Receivables</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and Cash Equivalents</td>
<td>6</td>
<td>20,750</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>4,81,800</td>
</tr>
</tbody>
</table>
Notes:

1. **Share Capital**

   Authorised
   - Issued, subscribed and paid-up:
     - 40,000 Equity Shares of ₹ 10 each: ₹ 4,00,000
     - 10,000 10% Preference share of ₹ 10 each: ₹ 1,00,000
     - 5,00,000

   Issued, subscribed and paid-up:
   - 30,000 Equity Shares of ₹ 10 each, fully paid-up: ₹ 3,00,000

2. **Reserves and Surplus**

   - Capital Redemption Reserve: ₹ 50,000
   - Securities Premium: ₹ 5,000
   - Surplus: ₹ 14,800
     - Total: ₹ 69,800

3. **Trade Payable**

   - Supplies of Goods: ₹ 66,000
   - Outstanding Expenses: ₹ 6,500
     - Total: ₹ 72,500

4. **Short-term Premium**

   - Provision for Income Tax: ₹ 18,000
   - Staff Provision Fund: ₹ 21,500
     - Total: ₹ 39,500

5. **Tangible Assets**

   - Plant and Machinery: ₹ 2,40,000
   - Staff Provision Fund: ₹ 40,000
     - Total: ₹ 2,80,000

6. **Cash and Cash Equivalent**

   - Balance with Bank: ₹ 20,700
   - Cash on hand: ₹ 50
     - Total: ₹ 20,750

**Working Notes:**

(i) **Dr.**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
<th>Particulars</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Balance b/fd</td>
<td>4,900</td>
<td>By 8% Preference Shareholders A/c</td>
<td>1,10,000</td>
</tr>
<tr>
<td>To Equity Share Application</td>
<td>55,000</td>
<td>By Balance c/d</td>
<td>20,700</td>
</tr>
<tr>
<td>and Allotment A/c</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>To Investment A/c</td>
<td>60,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>To Profit and Loss A/c</td>
<td>10,800</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1,30,700</td>
<td></td>
<td>1,30,700</td>
</tr>
<tr>
<td>Particulars</td>
<td>₹</td>
<td>Particulars</td>
<td>₹</td>
</tr>
<tr>
<td>------------------------------------------------</td>
<td>----</td>
<td>------------------------------------------------</td>
<td>----</td>
</tr>
<tr>
<td>To Premium on Redemption of</td>
<td></td>
<td>By Balance b/fd</td>
<td>10,000</td>
</tr>
<tr>
<td>Preference Shares Account</td>
<td>10,000</td>
<td>By Equity Share Application</td>
<td></td>
</tr>
<tr>
<td>To Balance c/d</td>
<td>5,000</td>
<td>and Allotment A/c</td>
<td>5,000</td>
</tr>
<tr>
<td></td>
<td>15,000</td>
<td></td>
<td>15,000</td>
</tr>
</tbody>
</table>

(ii) Dr. Profit and Loss A/c

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Capital Redemption Reserve A/c</td>
<td></td>
<td>By Balance b/fd</td>
<td>54,000</td>
</tr>
<tr>
<td></td>
<td>50,000</td>
<td>By Bank (Profit on sale of investments)</td>
<td></td>
</tr>
<tr>
<td>To Balance c/d</td>
<td>14,800</td>
<td></td>
<td>10,800</td>
</tr>
<tr>
<td></td>
<td>64,800</td>
<td></td>
<td>64,800</td>
</tr>
</tbody>
</table>

Note: Equity Share Capital issued of ₹ 50,000 and Capital Redemption Reserve Account ₹ 50,000 jointly replace 8% Redeemable Preference Share Capital of ₹ 1,00,000. Hence, the capital structure of the company remains unchanged.

LESSON ROUND UP

- There are two basic types of share capital which can be issued by a company under the Companies Act, 2013 i.e. (a) preference shares and (b) equity shares.
- Preference shares are those which carry preferential rights as to the payment of dividend at a fixed rate; and the return of capital on winding up of the company.
- An equity share is one which is not a preference share. Equity shares are risk bearing shares.
- Share capital of a company can be categorized as: Nominal or Authorised Capital; Issued Capital; Subscribed Capital; Called up Capital and Paid-up Capital.
- Shares of a company may be issued at par, at a premium or at a discount.
- When shares are issued at a price higher than the face value, they are said to be issued at a premium.
- When shares are issued at a price lower than the face value, they are said to be issued at a discount.
- Forfeiture of shares may be said to be the compulsory termination of membership by way of penalty for non-payment of allotment and/or any call money.
- The forfeited shares may be re-issued at par, at a premium or even at a discount. If forfeited shares are re-issued at a discount, the amount of discount can, in no case, exceed the amount credited to Shares Forfeited Account.
- A company limited by shares may, if authorised by its articles, issue preference shares, which are, or at the option of the company liable to be redeemed. They have to be redeemed within 20 years of the date of issue.
- Debentures may be issued at par, or at a premium, or at a discount.
Debentures may be issued by a company for cash, for consideration other than cash, or as a collateral security.

The issue of debentures to vendors is known as issue of debentures for consideration other than cash.

A company may issue debentures on any specific condition as to its redemption such as: issued at par and redeemable at par, issued at a discount redeemable at par, issued at a premium and redeemable at par, issued at par and redeemable at a premium, issued at a discount, but redeemable at a premium.

When a company issues debentures it undertakes to pay interest thereon at a fixed percentage. The payment of interest on the debt is obligatory on the part of the company issuing them irrespective of the fact whether the company earns profit or not and the interest payable on debentures is a charge against the profits of the company.

Discount on issue of debentures is a capital loss of the company and it is required to be shown on the liabilities side of the Balance Sheet under the heading “Redemption and Surplus” until it is written off.

When a company issues debenture at par or at a discount which are redeemable at a premium, the premium payable on redemption of the debentures is treated as a capital loss.

The preference shares can be redeemed out of profits or out of the proceeds of fresh issue of equity or preference shares or a combination of both. The preference shares can be redeemed at a premium also.

If the redeemable preference shares are redeemed out of the profits of the company which would otherwise be available for dividend, the “Capital Redemption Reserve Account” has to be credited which will represent the redeemable preference shares in the balance sheet after the redemption.

If the redeemable preference shares are redeemed out of the proceeds of a fresh issue of shares, the new Share Capital Account raised by fresh issue takes the place of the Redeemable Preference Share Capital Account after the redemption.

**GLOSSARY**

<table>
<thead>
<tr>
<th>Shares</th>
<th>The total share capital is divided into a number of units known as ‘shares’.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Authorized Capital</td>
<td>The Company is registered with this amount of capital.</td>
</tr>
<tr>
<td>Issued Capital</td>
<td>That part of the authorized capital of the company which has actually been offered to the public for subscription in cash.</td>
</tr>
<tr>
<td>Subscribed Capital</td>
<td>It refers to that part of the issued capital which has actually been subscribed by the public and subsequently allotted to them.</td>
</tr>
<tr>
<td>Called Up Capital</td>
<td>It is that portion of the subscribed capital which the shareholders are called upon to pay on the shares allotted to them.</td>
</tr>
<tr>
<td>Paid Up Capital</td>
<td>It refers to that part of the called up capital which has actually been paid by the shareholders.</td>
</tr>
<tr>
<td>Forfeiture</td>
<td>The compulsory termination of membership by way of penalty for non-payment of allotment and/or any call money.</td>
</tr>
</tbody>
</table>
SELF TEST QUESTIONS

Theory Questions

1. What do you mean by shares? What are the types of shares?
2. Explain types of share capital in a company.
3. Briefly describe issue of shares at a premium.
5. What are debentures? What are the type of debentures?
6. Explain various methods of redemption of preference shares.

Practical Questions

1. The authorised capital of a company is 1,00,000 shares of ₹ 10 each. On April 10, 2012, 50,000 shares are issued for subscription at a premium of ₹ 2 per share. The share money is payable as follows: ₹ 5 (including the premium of ₹ 2) with application, ₹ 3 on allotment; ₹ 2 on first call and ₹ 2 on second call. The subscription list closes on May 11, 2012 and directors proceed to allotment on May 18, 2012. The shares are fully subscribed and the application money (including the premium) is received in full. The allotment money is received by June 30, 2012, except as regards 500 shares. It is expected that the allotment money on these 500 shares will not be received and hence shares are forfeited. The first call and second call money is received by September 30, 2012 and December 31, 2012 respectively, barring the second call money on 200 shares which is not received hence the shares are forfeited. Show the cash book and the structure of the share capital in the balance sheet.

2. X Ltd. forfeited 100 shares of ₹ 10 each for non-payment of the final call of ₹ 2; the shares were re-issued @ ₹ 9 per share. How much was credited to shares forfeited account and what amount was transferred to capital reserve?

[Ans.: ₹ 800; ₹ 700]

3. Z Ltd. forfeited 150 shares of ₹ 10, issued at a premium of ₹ 2, for non-payment of the final call of ₹ 3. Of these 100 shares were re-issued @ ₹ 11 per share. How much would be transferred to capital reserve?

[Ans.: ₹ 700]

4. Redemption of 100,000 preference shares of ₹ 10 each was carried out by utilisation of reserves and by issue of 40,000 equity shares of ₹10 each at ₹12.5. How much should be credited to capital redemption reserve account?

[Ans.: ₹ 6,00,000]

In the above case, the redemption was carried out of reserves and out of the issue of 4,000 shares of ₹10 each @ ₹ 9.5. What is the amount of capital redemption reserve account that is required?

[Ans.: ₹ 6,20,000]

5. A company having free reserves of ₹ 30,000 want to redeem rupees one lakh preference shares. Calculate the face value of fresh issue of shares of ₹ 10 each to be made at a premium of 10%.

[Ans.: ₹ 70,000]

6. Bhalla and Co. Ltd. has an authorised equity capital of ₹ 20 lakhs divided into shares of ₹ 10 each. The paid-up capital was ₹ 12,50,000. Besides this, the company had 9% preference shares of ₹ 10
each for ₹ 2,50,000. Balance on other accounts were - Securities Premium ₹ 18,000; Profit and Loss Account ₹ 72,000 and General Reserve ₹ 3,40,000. Included in Sundry Assets were investments of the face value of ₹ 30,000 carried in the books at a cost of ₹ 34,000. The company decided to redeem the preference shares at 10% premium, partly by the issue of equity shares of the face value of ₹ 1,20,000 at a premium of 10%. Investments were sold at 105% of their face value. All preference shareholders were paid off except 3 holding 2500 shares. Give the necessary journal entries bearing in mind that the Directors wanted a minimum reduction in free reserves, while effecting the above transactions. Working should form part of your answer.

[Ans.: Amount paid to preference shareholders: ₹ 2,72,250]

7. Krishna Ltd issued 10,000 12% Debentures of ₹ 10 each at a discount of 6%. Applications were received for 7,500 debentures. Journalise the transactions assuming all money has been received.
These days the focus of the government is on self regulation by the business community. Society also wants less intervention of the government in the functioning of the business. Therefore various laws and legislation provide for the appointment of independent auditor. The appointment of auditor, his rights, duties and functions are governed by the legislations under which he is appointed. The emphasis of all these regulation is that the auditor should be independent. In this chapter we have highlighted the provisions of Companies Act, 2013 relating to the auditor and his reports.

At the end of this Lesson you will learn who is an auditor, how auditor can be appointed, what are the qualification, rights and duties of the auditor, meaning of auditors report and how and when auditors will qualify his opinion.

Laws continue to be enacted, and the regulatory environment has become more complex due to unacceptable conduct remediation. Consequently, entities continue to be compelled to demonstrate compliance with legal mandates through documented assurance assessments.

Robert E. Davis
WHO IS AN AUDITOR

A person who conducts an audit is an auditor. An auditor is a professional that accumulates and evaluates evidence to report whether the company complies with the established set of procedures or standards. An auditor may function as an employee or an independent professional. When the auditor works for the organization, he or she is usually referred to as an internal auditor. The internal auditor often conducts periodic audits that may encompass several areas on a rotating basis. As an example, the internal auditor may focus on the manufacturing process during one quarter of the year, while devoting a second quarter to evaluating the financial record keeping of the company. Often, the internal auditor will set up a schedule to ensure that audits are conducted on each critical portion of the company at least once per calendar. So many acts require the organizations to get their accounts audited by an independent external agency. This independent external agency is known as External auditor of the organization. The external auditor has to check the accounts of the organization, and their compliances to various rules and regulations. The idea behind using an external auditor is that the audit will be free of bias and not influenced by office politics or internal relationships that exist among the employees of the company. No connection to the company is permitted, as it may be construed as biasing the auditor’s report. To be fair and equitable, an external auditor should familiarize himself with the nature of the business he is auditing prior to starting the job.

APPOINTMENT OF AUDITOR

Section 139 of the Companies Act 2013 contains provisions regarding the appointment of the auditor. As per this section the auditor of any company can be appointed by the shareholders however in some cases the auditor can be appointed by the directors or the central government.

The provisions with regard to the appointment of an auditor can be divided into three categories:

- First auditor
- Subsequent auditor
- Filling of casual vacancy

Appointment of First Auditor

Section 139(6) of the Companies Act, 2013 provides that the first auditor or auditors are to be appointed by the Board of directors within 30 days from the date of the registration of the company. The auditor so appointed shall hold office till the conclusion of first Annual General Meeting (AGM). Company is not required to send any intimation of appointment of first auditor to the Registrar of companies.

In case the Board of directors fails to appoint the first auditors within 30 days of its registration, the company shall within ninety days at an extraordinary general meeting appoint auditor and such auditor shall hold office till the conclusion of the first annual general meeting

Subsequent Appointment of Auditor

Section 139(1) provides that every company must appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting and the manner and procedure of selection of auditors by the members of the company at such meeting shall be such as may be prescribed however the company shall place the matter relating to such appointment for ratification by members at every annual general meeting:

It is provided that before such appointment is made, the written consent of the auditor to such appointment, and a certificate from him or it that the appointment, if made, shall be in accordance with the prescribed conditions is require to obtain from the auditor. The auditor will also certify that he satisfies the criteria provided in section 141.
The company shall inform the auditor concerned of his or its appointment, and also file a notice of such appointment with the Registrar within fifteen days of the meeting in which the auditor is appointed.

**Filling of Casual Vacancy**

Sub-section (8) of Section 139 provides that the casual vacancy in the office of auditor may be filled by the Board within thirty days of such vacancy. But where the vacancy is caused by resignation of auditor, the appointment of auditor shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.

“Casual Vacancy” means vacancy created by the auditor ceasing to act after being validly appointed and acceptance of appointment. For example, vacancy arises due to resignation, death or disqualification of auditor etc.

**Qualification of Auditor**

Section 141 (1) and Section 141(2) of Companies Act, 2013 contains provision as regards to qualifications of auditors. As per section 141(1) of the Companies Act, 2013, a person shall be eligible for appointment as an auditor of a company only if he is a chartered accountant. A firm whereof majority of partners practising in India are qualified for appointment as aforesaid may be appointed by its firm name to be auditor of a company. Where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm.

**Disqualification of Auditor**

Section 141(3), of the companies act, 2013 defines disqualification of the auditor in a negative sense. As per this section none of the following shall be qualified for appointment as auditor of a company:

The following persons shall not be eligible for appointment as an auditor of a company, namely:—

(a) a body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;

(b) an officer or employee of the company;

(c) a person who is a partner, or who is in the employment, of an officer or employee of the company;

(d) a person who, or his relative or partner –

   (i) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company: Provided that the relative may hold security or interest in the company of face value not exceeding Rs. One lakhs;

   (ii) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of Rs. 5 Lakhs; or

   (iii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of rupees one lakhs ;

(e) a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed;

(f) a person whose relative is a director or is in the employment of the company as a director or key managerial personnel;
(g) a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies;

(h) a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;

(i) any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialised services as provided in section 144.

As per Section 141(4) of the Companies Act, where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in section 141(3) after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office.

**AUDITOR NOT TO RENDER CERTAIN SERVICES**

As per Section 144 of the Companies Act, 2013, An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company, namely :–

(a) Accounting and book keeping services;

(b) Internal audit;

(c) Design and implementation of any financial information system;

(d) Actuarial services;

(e) Investment advisory services;

(f) Investment banking services;

(g) Rendering of outsourced financial services;

(h) Management services; and

(i) Any other kind of services as may be prescribed:

Provided that an auditor or audit firm who or which has been performing any non-audit services on or before the commencement of this Act shall comply with the provisions of this section before the closure of the first financial year after the date of such commencement.

**RIGHT AND DUTIES OF AUDITOR**

As per section 143(1) of the Companies Act, 2013, Every auditor of a company shall have a right of access at all times to the books of account and vouchers of the company, whether kept at the registered office of the company or at any other place and shall be entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties as auditor.

The various rights and powers enjoyed by the auditors under the Companies Act, 2013 are as follows:

(i) Right to Access to Books, Accounts and Vouchers: The auditor of a company shall have right of access, at all times, to the books, accounts and vouchers of the company, whether kept at the head office of the company or elsewhere.

(ii) Right to obtain Information and Explanation: The auditor shall be entitled to require from the officers of the company such information and explanation as he thinks necessary for the performance of his duties as auditor. The Article of Association of a company cannot preclude the auditor team from availing
himself of all information which is material to enable him to make his report and from fulfilling his statutory
duties to the shareholders. In case the information is not supplied to the auditor, he can report the same
to the members.

(iii) Right to Sign the Audit Report: Only the person appointed as auditor of the company, or where a firm is
so appointed, only a partner in the firm practicing in India, may sign the auditor’s report, or sign or
authenticate any other document of the company required by the law to be signed or authenticated by
the auditor.

(iv) Right to Receive Notice of and Attend General Meeting: The auditors have the right to attend any
general meeting and to receive any notice and other communications relating thereto which members
are entitled to receive and to be heard at any general meeting on any part of the business which
concerns them as auditors.

(v) Right to visit Branch Office and right of Access to Books: Where the accounts of any branch office are
audited by a person other than the company's auditor, the company’s auditor
(a) shall be entitled to visit the branch office, if he deems it necessary to do so for the performance of
his duties as auditor; and

(b) Shall have a right of access at all times to the books and accounts and vouchers of the company
maintained at the branch office.

(vi) Right to Receive Remuneration: The auditor shall have the right to receive remuneration for auditing the
accounts of the company.

**DUTIES OF AUDITOR**

The duties of an auditor are many and varied. He must examine the original books of account, kept by the
company to discover any inaccuracies or omissions therein, to examine the company’s balance sheet and profit
and loss account, and report on the original books of account and the annual accounts to the members.

Section 143(1) of the Companies Act requires an auditor to inquire:

(a) Whether loans and advances made by the company on the basis of security have been properly secured
and whether the terms on which they have been made are prejudicial to the interests of the company or
its members;

(b) Whether transactions of the company which are represented merely by book entries are prejudicial to
the interests of the company;

(c) where the company not being an investment company or a banking company, whether so much of the
assets of the company as consist of shares, debentures and other securities have been sold at a price
less than that at which they were purchased by the company;

(d) Whether loans and advances made by the company have been shown as deposits;

(e) Whether personal expenses have been charged to revenue account;

(f) Where it is stated in the books and documents of the company that any shares have been allotted for
cash, whether cash has actually been received in respect of such allotment, and if no cash has actually
been so received, whether the position as stated in the account books and the balance sheet is correct,
regular and not misleading

Auditor will report on these points only if he has a special comment to make otherwise will not make any comment.

The auditor should also ensure the adherence of Auditing Standards as specified by the Institute of Chartered
Accountants of India.
AUDITORS REPORT

Under Section 143(2) of the Companies Act, 2013, the auditor shall make a report to the members of the company on the accounts examined by him and on every financial statements which are required by or under this Act to be laid before the company in general meeting and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of the Act or any rules made thereunder or under any order made under sub-section (11) and to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.

The auditor's report shall also state under Section 143(3) of Companies Act, 2013 –

(a) Whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;

(b) Whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;

(c) Whether the report on the accounts of any branch office of the company audited under sub-section (8) by a person other than the company’s auditor has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;

(d) Whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;

(e) Whether, in his opinion, the financial statements comply with the accounting standards;

(f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;

(g) Whether any director is disqualified from being appointed as a director under sub-section (2) of section 164;

(h) Any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;

(i) Whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls;

(j) The auditor’s report shall also include their views and comments on the following matters, namely:-

(a) Whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;

(b) Whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;

(c) Whether there has been any delay in transferring amounts, required to be transferred, to the Investor, Education and Protection Fund by the company.

As per Section 143(4) of the Companies Act, 2013, where any of the above matters is answered in the negative or with a qualification, the auditor’s report must state the reason for the same.
Auditor’s report is the expert’s opinion expressed by the auditor as to the fairness of financial statements.

The audit report is the end product of every audit. It is the medium through which an auditor expresses his opinion on the financial statements. Audit report is an important part of audit process since it summarize the results of the examination work conducted by the auditor. The report shows the scope of the work done and the responsibility assumed by the auditor regarding the fairness or otherwise of the financial statements. The auditor draws appropriate conclusions by examining the various statements and accounts, which he conveys through the audit report. It is a formal communication by the auditor to the shareholders throwing light on the state of affairs of the company. Audit report is addressed to the members of the company and is considered at the Annual General meeting of the company. Audit reports should be so drafted that they remain simple and intelligible to a common man. The audit report should be explicit so as to provide greater information and protection to the interest of shareholders and others.

**Essentials of Audit Report**

(i) **Title:** An auditor report must have appropriate title, such as “Auditor’s Report”. It is helpful for the reader to identify the auditor’s report. It is easy to distinguish it from other reports. The management can issue any report about the business performance. The title to the report is essential.

(ii) **Addressee:** The addressee may be shareholder or board of director of a company. The auditor can audit financial statements of any business unit as per agreement. The report should be appropriately addressed as required by engagement letter and legal requirements. The report is usually addresses to the shareholders or the board of directors.

(iii) **Identification:** The audit report should identify the financial statement that have audited. The financial statement may include trading profit and loss accounts, balance sheet and statement of changes in financial position and sources and application of cash flow statement. The report should include the name of the entity. Moreover the data and period covered by the financial statement are also stated in it.

(iv) **Reference to Auditing Standards:** The audit report should indicate the auditing standard or practice followed in conducting the audit. The international auditing guidelines need assurance that the audit has been conducted as per set standards.

(v) **Opinion:** The auditor’s report should clearly state the auditor’s opinion on the presentation in the financial statement of the entity’s financial position and the result of its operations. The statement give a true and fair view is an auditor’s opinion. This opinion is usually based on national standard or international accounting standards.

(vi) **Signature:** The audit report should be signed in the name of the audit firm, the personal name of the auditor or both as appropriate.

(vii) **Auditor’s Address:** The address of auditor is stated in the audit report. The name of city is stated in the report for information of the readers.

(viii) **Date of Report:** The auditor’s report shall be dated not earlier than the date on which the auditor has obtained sufficient appropriate audit evidence and date on which accounts are approved by the management.

**AUDITORS OPINION**

In financial accounting, an auditor’s opinion is the published outcome an auditor’s review of a company’s or organizations financial statements. The auditor’s opinion does not pass judgment on the organization’s financial position or financial performance or otherwise interpret the financial data.

In the audit opinion, the auditor states that he or she has examined the client’s financial statements for the year
ended in accordance with the generally accepted accounting principles including tests of the accounting records and other necessary auditing procedures. The auditor then indicates whether in his or her opinion the client's financial statements present fairly the financial position, results of operations, and changes in financial position for the year-ended in conformity with Accounting Principles applied on a consistent basis. The Auditor's opinion may be of the following types:

- Unqualified opinion
- Adverse opinion
- Qualified opinion, and
- Disclaimer of opinion

**Unqualified Opinion**

Where the auditor does not have any reservation, objection regarding the information under audit, then he issues an unqualified opinion. This opinion signifies that the auditor accepts the accounting treatment given to the various transactions and the profit and loss account shows the true and fair view of the transaction entered by the organization during the period and the balance sheet shows the true and fair view of the state of affairs of the organization at that point of time. It is also known as “Clean report”

**Adverse or Negative Opinion**

Where as a result of the examination of the books of accounts, the auditor concludes that he does not agree with the true and fair view of financial statements under audit, he express adverse opinion or negative opinion. The adverse opinion is appropriate in circumstances where the auditor has reservation on matters such as the accounting policies selected and their application, adequacy of disclosures made and where the auditor considers that the impact of reservation or qualification is so material and pervasive that the financial statements as a whole do not give a true and fair view.

Where auditor expresses an adverse opinion, he should also state in his report the reason for the same, so that the readers can assess their significance and effect.

**Qualified Opinion**

In a situation where neither the unqualified, nor adverse opinion is appropriate the auditor gives the qualified opinion. This is a situation where the auditor has some reservation about the financial statements which though significant but not that significant so as to warrant adverse opinion and auditor agrees to a large extent with the true and fair view of the financial statement then he gives qualified opinion. As per this opinion subject to certain reservation or qualification stated, the auditor agrees with the proposition stated in the financial statements.

Where auditor expresses a qualified opinion, he should also state in his report the reason for the same, so that the readers can assess their significance and effect. The words “Subject to” are written to show qualification. If the qualification are quantifiable (measurable) then the auditor has to quantify it. And if these are not quantifiable, Auditor has to clearly state that quantification is not possible.

**Disclaimer of Opinion**

The above three are the opinions which the auditor expresses but the disclaimer of opinion is a situation when auditor is not in a position to give his opinion. Where there is a situation where auditor is not in a position to collect sufficient appropriate audit evidence which enables him to draw his conclusion then it is proper for the auditor to disclaim an opinion due to lack of sufficient appropriate audit evidence.

Where auditor expresses a disclaimer of opinion, he should also state in his report the reason for the same, so that the readers can assess their significance and effect.
An auditor is a professional that accumulates and evaluates evidence to report whether the company complies with the established set of procedures or standards. When the auditor works for the organization, he or she is usually referred to as an internal auditor. Where as independent external agency is known as External auditor of the organization.

The provisions with regard to the appointment of an auditor can be divided into three categories:

- First auditor - By the Board of directors within one month of the date of the registration of the company.
- Subsequent Auditor - every company must appoint an auditor or auditors at each annual general meeting.
- Filling of Casual Vacancy - casual vacancy in the office of auditor may be filled by the Board. But where the vacancy is caused by resignation of auditor, such vacancy shall only be filled by the company in general meeting.
- Power of the Central Government to Appoint Auditors - If no auditors are appointed or re-appointed at the annual general meeting, the Central Government may appoint a person to fill the vacancy.
- Qualification of Auditor - Only a Chartered Accountant in practice within the meaning of Chartered Accountants Act, 1949 can act as an auditor of a limited company. A firm whereof all the partners are practicing Chartered Accountants can be appointed by its firm name as auditor in such case any partner may act in the name of the firm.
- Disqualification of Auditors - None of the following shall be qualified for appointment as auditor of a company: A body corporate; An officer or employee of the company (‘officer’ includes director, manager or secretary); A person who is a partner or who is in the employment, of an officer or employee of the company; A person who is indebted to the company for more than Rs. 1,000/- or who has guaranteed the repayment of any debt of more than Rs. 1,000/- due to the company by a third person; A person holding any security of that company after a period of one year from the date of commencement of the Companies (Amendment) Act, 2000 i.e. 13 December, 2000; A person who is disqualified for appointment as auditor of the company’s subsidiary or holding company, or a subsidiary of its holding company; Statutory auditor cannot act as internal auditor of the company.

- Right and powers of Auditors - Right to access to books, accounts and vouchers; Right to obtain information and explanation; Right to sign the audit report; Right to receive notice of and attend General Meeting; Right to receive remuneration; Right to visit branch office and right of access to books.
- Duties of Auditors - An auditor to inquire: whether loans and advances made by the company are properly secured and the terms on which they have been made are not prejudicial to the company; book entries transactions are not prejudicial to the interests of the company; in case of non-investment or a banking company, whether shares, debentures and other securities have been sold at a price less than its purchase price; whether loans and advances made by the company have been shown as deposits; no personal expenses has been charged to profits; whether cash has actually been received in respect of any shares shown in the books to have been allotted for cash; Whether the books are not misleading.

- Auditors Report- The report must expressly state: Whether, in his opinion the accounts give the information required by the Act and in required manner; Whether the balance sheet and profit and loss account gives a true and fair view; Whether he has obtained all the information and explanations required; Whether, in his opinion, proper books of account as required by law have been kept by the company, and proper returns for the purposes of his audit have been received from the branches not visited by him; Whether the company’s balance sheet and profit and loss account are in agreement with the books; Whether in his opinion, the profit and loss account and balance sheet comply with the...
AS; Auditor’s observation or comments; Whether any director is disqualified from appointment; reason for negative answers.

- Essentials of Audit Report- Title; Addressee; Identification; Reference to Auditing Standards; Opinion; Signature; Auditor’s Address; Date of Report.

- Types of auditor opinion- Unqualified opinion; Adverse or Negative Opinion; Qualified Opinion; Disclaimer of opinion.

**SELF-TEST QUESTIONS**

1. Who can be appointed as the auditor of a company?
2. How the first auditor of the company is appointed?
3. What is a casual vacancy? What are the rules regarding appointment for the casual vacancy on account of resignation?
4. What are the powers of the company auditor?
5. Can a company restrict the rights of its statutory auditor?

**SUGGESTED READINGS**

1. Fundamentals of Auditing – By Kamal Gupta
2. Auditing: principles and practice - By Ravinder Kumar, Virender Sharma
3. An Insight into Auditing- By Dr. B. K. Basu