CORPORATE ACCOUNTING

As per The Companies Act, 2013 including Rules 2014 and 2015

M Hanif | A Mukherjee

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Second Edition

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Preface to the Second Edition

In the last few years, there have been enormous changes in accounting procedures and disclosures of companies. The Companies Act, 2013 has been implemented, and the different accounts are to be prepared as per the provisions of the Accounting Standards. Many Universities have revised their respective syllabi to accommodate the changes brought in by The Companies Act, 2013 and the Accounting Standards.

In this edition, chapters related to Company Accounts have been thoroughly revised as per the provision of The Companies Act, 2013, Companies Rules 2014 and 2015 and the regulations prescribed by SEBI. Special importance has been given to the following chapters.

1. Company Final Accounts
2. Redemption of Preference Shares
3. Buy Back of Shares
4. Employees Stock Option Scheme/Plan
5. Redemption of Debentures
6. Accounting for Bonus and Rights Issue
7. Company: Introduction and Issue of Shares
8. Issue of Debentures
9. Amalgamation
10. Holding Company
11. Capital Reduction/Internal Reconstruction

This book has been designed keeping in mind the model syllabus of UGC, (i.e, CBCS) and is suitable for undergraduate and postgraduate students. Latest question papers from various universities have been solved for the benefit of the students.

Mr. S. Rangarajan bore us his hand in more ways than one in the production of the title. Much of the attractiveness and layout of this title is due to his untiring efforts.

A number of colleagues, friends and students helped us in the preparation of this book. We thank each and every one of them.

We are overwhelmed to receive invaluable suggestions and feedback from students, faculties and subject experts from different colleges and institutions across India. We have put our best to incorporate modifications wherever required and attempted to address most of the received inputs in this edition. We seek to receive many more suggestions and feedback in the future as well.

AUTHORS

Publisher's Note

We value your views, comments and suggestions and hence look forward to your communication at *info.india@mheducation.com.* Please feel free to report piracy issues, if any.

Preface to the First Edition

Accountancy is changing and, perhaps one might say, it is both green and flourishing. Many developments and modifications have taken place in this field of study because of the dynamic nature of business and the corollary changes in the textual treatment of books on accountancy.

In today's competitive world of real business, corporate accounting has assumed critical importance. Corporate accounting is not an end itself, but is intended to provide information that is vital in making business decisions.

We are indeed gratified by the reader response to Financial Accounting. Since its release in 2003, we have actively sought feedback from students, teachers and other professionals in the field. Corporate Accounting, almost two years in the making benefited from all the comments, suggestions and enthusiasm showered on Financial Accounting.

Essentially, we have retained all the winning ways of Financial Accounting. Each topic has been developed gradually and special care has been taken to ensure conceptual clarity. Topics of examination focus and those of particular relevance for students in their later-day professional careers have been given utmost importance. As in Financial Accounting, we have followed a pattern of theory, examples, illustrations (solved problems), theoretical questions, practice problems and guide to answers in each chapter.

Topics like Issue of Shares, Company Final Accounts, Amalgamation, Holding Company, Accounting Standards, Ratio Analysis, Fund Flow Statement, Cash Flow Statement, have been dealt with elaborately.

From our teaching experience, we found that it is extremely important to reinforce the theoretical principles with actual practice. For this purpose, we have included about 630 fully solved problems interspersed within the text. In addition, nearly 340 unsolved problems (with guide to answers) have been graded with different levels of difficulty. Almost all the problems presented in this book have been taken from different university and professional examinations.

Mr. S. Rangarajan bore us his hand in more ways than one in the production of the title. Much of the attractiveness and layout of this title is due to his untiring efforts.

A number of colleagues and friends helped us in the preparation of this book. We thank each and every one of them.

There is never any finality or perfection in human creation. We trust that there is always scope for innovation and, as such, of improvement. Suggestions for further improvements would be more than welcome from fellow teachers and students.

AUTHORS

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www.mhhe.com/corporateaccounting2e

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1

Company : Introduction and Issue of Shares

Introduction

There are several forms of business organisations. ***Examples*** are : sole proprietorship, partnership, company, etc. For management and protection of interest of the partners, there is Partnership Act, 1932. However, for management of sole proprietorship business there is no specific Act. For management of company, there is Companies Act. It is important to note that other than company, no form of business organisations have 'legal entity' separate from its owner / partners / members.

A company is a legal entity separate from its shareholders / members. It is an association of persons for a business purpose or other purposes*. Its capital is subscribed by the shareholders and it operates as one single unit in the success of which all the members participate.

Definition of a Company

As per the provision of Section 2(20) of the Companies Act, 2013 'company' means a company incorporated under this Act or under any previous company law. It is worth mentioning that there were number of Companies Acts / Laws before the enactment of the Companies Act, 2013 such as :

(i) The Companies Act, 1956
(ii) The Companies Act, 1913
(iii) The Companies Act, 1882
(iv) The Companies Act, 1866

It is to be noted that the above definition of company is not comprehensive. To understand the meaning of company, the following definitions given by different authors are very important. Some of the definitions are given below :

Prof. Haney defines a company as "the company is an artificial person created by law, having separate entity, with a perpetual succession and common seal."

Lord Justice Lindley defines a Company as follows :

"By a Company is meant an association of many persons who contribute money or money's worth to a common stock and employ it for a common purpose. The common stock so contributed is denoted in money and is the capital of the Company. The persons who contribute it or to whom it belongs are members. The proportion of capital to which each member is entitled is his share".

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* The Companies Act, 2013 allows to form a company for non-economic purposes also, *e.g.*, promoting commerce, arts, science, sports, religion or charity, etc.

Characteristics of a Company

The following are the main characteristics of a Company :

1. A Company comes into existence only after incorporation under the Companies Act.
2. A Company is a legal entity separate and distinct from its members. It can enter into a contract. It can sue and be sued in its own name.
3. A shareholder of a company, in its individual capacity, cannot bind the Company in any way.
4. The equity capital of a Company is typically subscribed by shareholders who receive return in the form of dividend.
5. The shareholder of a Company can transfer its share and ordinarily the transferee becomes a member of the Company.
6. The liabilities of shareholder of a Company are usually limited.
7. A Company is managed by the Board of Directors, whole time Directors, Managing Director or Manager. These persons are selected according to the provision of the Companies Act and Articles of Association of the Company.
8. The Company has perpetual succession. The insolvency or death of a shareholder will not affect its existence.
9. A Company must have a registered office.
10. A Company must have a common seal.

Types of Companies

The Companies Act, 2013 allows to form a company for economic as well as non-economic purposes. A company may be either :

(i) a company limited by shares; or
(ii) a company limited by guarantee; or
(iii) an unlimited company

The most common types of companies are :

1. Private Companies; and
2. Public Companies

Private Companies

As per the provision of Section 2(68) of the Companies Act, 2013 'private company' means a company having a minimum paid-up share capital of one lakh rupees or such higher paid-up capital as may be prescribed and which by its articles —

(i) restricts the right to transfer its share;
(ii) except in case of one person company, limits the number of its members to two hundred;
(iii) prohibits any invitation to the public to subscribe for any securities of the company.

Private companies can be re-classified as :

(i) One Person Company (OPC)
(ii) Small Companies

One Person Company (OPC)

The concept of one person company has been introduced for the first time in the Companies Act, 2013. As per the provision of Section 2(62) of the Companies Act, 2013 '***one person company' means a company which has only one person as member***'.

Characteristics of One Person Company

1. It is a one member company.
2. It is a private company.
3. It may be registered as 'limited by shares' or 'limited by guarantee'.
4. The phrase 'one person company' shall be mentioned within a bracket below the name of the company.
5. In the memorandum, it should indicate the name of the 'other person; who shall become member of the company in case of death or incapability of the promoter. Prior written consent in the prescribed form should be taken from such person.
6. It may not have to prepare 'Cash Flow Statement' as part of Financial Statements.

7. There is no need of holding Annual General Meeting.
8. The Financial Statements can be submitted within 6 months from the date of closing of the books of accounts.

Small Company

The concept of small company has been introduced in the Companies Act, 2013. As per the provision of 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 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.

However, this clause ***shall not*** apply to

(a) a holding or a subsidiary company;

(b) a company registered under Section 8 (Non-profit association for charitable purposes);

(c) a company or body corporate governed by any special Act.

Public Company

As per the provision of Section 2(71) of the Companies Act, 2013 'public company' means a company which—

(a) is not a private company;

(ii) has a minimum paid-up share capital of ***five lakh rupees*** or such higher paid-up capital as may be prescribed.

However, 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.

Distinction between a Public Company and a Private Company

Sl. No.	**Basis of Distinction**	**Public Company**	**Private company**
1.	Formation	Minimum 7 persons are required to form a public company.	Minimum 2 persons are required to form a private company. However, 'one person company' can be formed as per the provision of Section 3 of the Companies Act, 2013 with a single person.
2.	Maximum Number of Members	In a public company there may be any number of members.	In a private company (except one person company) maximum number of members cannot exceed 200.
3.	Restriction on Transfer of Shares	In a public company the shares are freely transferrable.	In a private company the right to transfer shares is restricted by the Articles of Association.
4.	Number of Directors	A public company must have at least 3 directors.	A private company must have least 2 directors.
5.	Independent Director	In case of a ***listed*** public company at least $^{1}/_{3}$rd should be independent directors.	Question of independent director does not arise.
6.	Invitation to Public	There is no restriction for a public company to invite the public to purchase its shares or debentures or bonds.	A private company cannot invite the public to purchase its shares or debentures.

7.	Prospectus	A public company must file a prospectus or a statement in lieu of prospectus before public issue.	A private company need not file a prospectus or a statement in lieu of prospectus.
8.	Small Company	In case of a public company there is no concept of 'small company'.	In case of a private company there is a concept of 'small company'. A private company will be treated as a small company when its paid-up capital does not exceed fifty lakh rupees and turnover does not exceed two crore rupees.
9.	Minimum Paid-up Capital	In case of a public company minimum paid-up capital is five lakh rupees.	In case of a private company minimum capital is one lakh rupees.
10.	Special Privilege	A public company enjoys no special privileges.	A private company enjoys some special privileges.
11.	Retirement of Directors	The directors of a public company retires by rotation.	All directors of a private company can be non-rotational directors.
12.	Managerial Remuneration	In case of a public company the managerial remuneration is restricted to 11% of the net profit of the company.	In case of a private company there is no restriction on managerial remuneration.
13.	Acceptance of Public Deposits	Subject to the provision of Section 76, a public company can accept deposits from public.	A private company cannot accept deposits from the public.
14.	Name	The word 'Limited' is used with the name of the company. ***For example***, 'Reliance Industries Limited', 'Tata Motors Limited', etc.	The phrase 'Private Limited' is used with the name of the company. ***For example***, 'McGraw Hill Education (India) Private Limited'.

Sources of Capital of a Company — Shares

A joint stock company (private or public) raises its capital by issuing shares. A private limited company, however, issues shares informally, by personal contact between the directors and investors. It cannot invite the public to buy its shares. On the contrary a public limited company is free to invite the public to buy its shares. It issues a prospectus and takes the help of underwriters in order to sell its shares.

Shares

According to Section 2(84) of the Companies Act, 2013, a share represents a 'unit' into which the capital of a company is divided. ***For example***, the share capital of a company is ₹ 6,00,000. It is divided into 1,20,000 units of ₹ 5 each. Each 'unit of ₹ 5' will be called a ***share of the company***.

Each share in a company is distinguished by its appropriate number. Shares are classified as movable property, transferable in the manner specified by the Articles. A certificate under the common seal of the company is issued to the shareholders to provide them with prima facie evidence of their title to the shares specified therein and is known as a ***Share Certificate***.

The Nature and Kinds of Shares

Every company is financed mainly by the issue of shares. To suit the taste and temperament of different types of investors, company issue different kinds of shares. Section 93 of the Companies Act, 2013 provides that the share capital of a company limited by shares shall be of ***two*** kinds, namely,

(a) Equity Share Capital —
  (i) with voting rights; or
  (ii) with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed.

(b) Preference Share Capital

Equity Share / Equity Share Capital

Equity Share Capital means all share capital which is not 'preference share' capital (to be explained shortly). The holder of an equity share with ***voting rights*** is entitled to vote, proportionately, in general meeting of the company. This gives the equity shareholder the power to appoint directors of the company. The equity shareholders are also entitled to a share of the company's annual profit in the form of dividend. The rate of dividend may vary from year to year depending upon the profit and dividend policy of the company. However, the equity shareholders run two risks. ***First,*** when the company fails to earn profit, the equity shareholders may not get any dividend at all. ***Second,*** when the company is liquidated, the equity shareholders get back their capital at last after satisfying creditors, lenders and preference shareholders.

Normally, the company does not repay its equity shareholders before liquidation. Some companies may buy-back some of the equity shares. If a equity shareholder wants to sell his share, he will have to find out the buyer (applicable to unlisted / private companies). However, equity shareholder of a ***listed*** company can sell its share easily at any stock exchange.

It is to be noted here that the Companies Act, 2013 allows the issue of equity shares without voting rights. However, these shares are to be issued as per Rule 4 of the Companies (Share Capital and Debentures) Rules, 2014. These rules have been discussed in page 1.15 of this Chapter.

Features of an Equity Share

(1) It is a part of the capital of the company.
(2) It can be purchased or sold in a stock exchange in case of listed company.
(3) It has no cumulative rights to dividends.
(4) It can vote in the election of directors.
(5) It can take part in the making of certain important company decisions.
(6) It can participate in the profits of the company.
(7) It can purchase a proportionate part of future share issues (i.e., rights issue).
(8) It has the right to share in assets upon liquidation.

Preference Share Capital / Preference Shares

Preference Share Capital means that part of the issued share capital of the company which carries or would carry a preferential right with respect to—

(a) 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
(b) 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.

Unlike equity shares, preference shares carry no voting rights. The preference shareholders are entitled to a fixed rate or fixed amount of dividend.

For example, 10% Preference Shares of ₹ 100 each means that the preference shareholder will get ₹ 10 per share as dividend. According to the situation and market conditions, a company may issue preference shares at different rate of dividend at different points of time.

Features of a Preference Share

(1) It has preferential rights to dividends at a fixed rate or fixed amount as the case may be.
(2) It has cumulative rights to dividends.

(3) It has preferential rights to assets of the company in the case of liquidation.
(4) It is redeemable before the expiry of a period of ***twenty*** years from the date of its issue.
(5) It can be purchased or sold in a stock exchange at a price above or below its face value.
(6) It has no voting power in general.
(7) It may or may not be converted into equity share(s).

Advantages

From the Company's Point of View

1. Since the rate of dividend / amount of dividend is fixed, the company knows in advance the amount of dividend to be paid to the preference shareholders.
2. It is one of the permanent source of long-term capital which does not have to be repaid immediately (not before 20 years; in many cases it is to be repaid within 30 years). ***For example***, a company engaged in the setting up and dealing with infrastructural projects may issue preference shares which will be redeemed within 30 years.

From the Shareholders' Point of View :

1. The rate / amount of dividend is fixed. It is an assured income not depending upon the amount of profit made by the company.
2. No tax is to be paid by the shareholders on dividend received.It is paid by the company.

Disadvantages

From the Company's Point of View :

1. Dividend is not allowable as deduction for calculating taxable income. It is relevant to mention here that interest on debentures or long-term debts are allowable as deduction for calculation of taxable income.
2. The company is liable to pay corporate dividend tax on the dividend paid.

> ***Tutorial Note : Because of the above reasons, it is very unpopular to issue preference shares. Now-a-days, majority of the companies prefer to take long-term loans from bank or other financial institutions.***

From Shareholders' Point of View :

1. They can not take part in the election of directors.
2. When the company is earning good profits and paying equity dividend at a higher rate, the preference shareholders only get a fixed percentage of dividend which is very low in many cases.
3. True return on investment is low when the inflation is high.

Sub-division of Preference Shares

Preference Shares can be sub-divided into different classes, such as :

(a) Cumulative and non-cumulative preference shares;
(b) Participating and non-participating preference shares; and
(c) Redeemable and non-redeemable preference shares.

(i) Cumulative and Non-cumulative Preference Shares

A fixed rate / amount of dividend is paid to preference shareholders before payment of dividend paid to the equity shareholders. It may so happen that the company's current year profit is not enough or the company has incurred losses and it cannot pay the dividend to the preference shareholders. In the case of cumulative preference shares, the deficiency accumulates and it is to be paid out of the profits of the subsequent years.
In case of non-cumulative preference shares, dividend is only payable out of net profit of each year and shares do not have the privilege of accumulation of the unpaid dividends. It should be noted that if nothing is specified in the Articles, it will be treated as ***cumulative preference shares***.

(ii) Participating and Non-participating Preference Shares

Participating preference shares are those preference shares which are entitled to a fixed rate of preferencial dividend and in addition, enjoy a right to participate in the surplus profits (along with equity shareholders) after paying dividend to equity shareholders at a certain rate. Further, in the event of winding up, if there is any surplus left after paying preference shareholders and equity shareholders, then participating preference shareholders are entitled to get a portion of the surplus of assets of the company.

If the articles or the terms of issue of preference shares do not specifically allow participation in surplus, then preference shareholders get only the fixed preferencial dividend and return of capital at the time of winding up of the company, after meeting external liabilities and these preference shares are called non-participating preference shares.

(iii) Redeemable and Non-redeemable Preference Shares

Redeemable preference shares are those which are redeemed by the company after certain years (as per the terms and conditions of the issue). Irredeemable preference shares are those which cannot be redeemed before liquidation.

In this respect, the provision of ***Section 55 of the Companies Act, 2013*** is very important. which states that:

(1) No company limited by shares shall, after the commencement of this Act, issue any preference shares which are irredeemable.

(2) 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 subject to such conditions as may be prescribed.

Distinction Between Equity Share and Preference Share

	Equity Share		Preference Share
1.	It is the risk capital of a company.	1.	It is not the risk capital of a company.
2.	A company must have equity shares.	2.	A company may not have any preference share.
3.	It has higher expected rate of dividend than preference shares.	3.	It has the right to get dividend at a fixed rate / fixed amount.
4.	It has no preferential right to dividend.	4.	It has preferential rights to dividends.
5.	It has no cumulative right to dividend.	5.	It has cumulative right to dividend.
6.	It has voting power.	6.	It has no voting power.
7.	Equity shareholders can take part in the meeting of certain important company decisions.	7.	Preference shareholders have no such right.
8.	It is not redeemable.	8.	It is redeemable before the expiry of twenty years from the date of issue.
9.	It cannot be converted into preference shares.	9.	It may be converted into equity shares.
10.	At the time of liquidation, equity shareholders are paid off last.	10.	At the time of liquidation, preference shareholders are paid off before the equity shareholders.
11.	Equity shareholders can purchase a proportionate part of future share issues i.e. rights share.	11.	Preference shareholders have no such right.

Stock

As per the provision of Section 62(1)(c) of the Companies Act, 2013 a limited company having a share capital may, if so authorised by its articles, convert all or any of its fully paid-up shares into stock, and reconvert that stock into fully paid-up shares of any denomination. ***Stock is the aggregate of fully paid-up shares legally consolidated and portion of which aggregate may be transferred or split up into fractions of any amount without regard to the original nominal amount of shares***.

Distinction between Shares and Stock

(1) Shares are in units but stock is in lump holding.

(2) Shares can be issued directly but stock cannot be issued directly.

(3) Shares need not be fully paid but stock must be fully paid.

(4) Shares must be numbered but stock is never numbered.

(5) Shares cannot be transferred in fractional amount but stock can be transferred in fractional amount.

Sub-division of Share Capital of a Company

(i) Authorised Capital or Nominal Capital

It means such capital as is authorised by the memorandum of a company to be the maximum amount of share capital of the company. [***Section 2(8)***]

(ii) Issued Capital

It means such capital as the company issues from time to time for subscription [***Section 2(50)***].

(iii) Subscribed Capital

It means such part of the capital which is for the time being subscribed by the members of a company (***Section 2(86)***].

(iv) Paid-up Share Capital or Share Capital Paid-up

It means such aggregate amount of money credited as paid-up as is equivalent to the amount received as paid-up in respect of shares issued and also includes any amount credited as paid-up in respect of shares of the company, but does not include any other amount received in respect of such shares, by whatever name called [***Section 2(64)***].

(v) Uncalled Capital

It is that part of the subscribed capital which has not been called-up by the Board of Directors.

(vi) Reserve Capital

A limited company may, by special resolution, determine that any portion of its share capital which has not been already called-up shall not be capable of being called-up, except in the event and for the purposes of the company being wound up. This uncalled portion of the share capital is called ***Reserve Capital***.

Disclosure of Share Capital in the Company's Balance Sheet

The disclosures in respect of Share Capital are to be made in the '***Notes to Accounts***'. The following aspects are to be disclosed for each class of share capital (different classes of preference shares are to be treated separately) :

(a) the number and amount of shares authorized;

(b) the number of shares issued, subscribed and fully paid, and subscribed but not fully paid;

(c) par value per share;

(d) a reconciliation of the number of shares outstanding at the beginning and at the end of the reporting period;

(e) the rights, preferences and restrictions attaching to each class of shares including restrictions on the distribution of dividends and the repayment of capital;

(f) shares in respect of each class in the company held by its holding company or its ultimate holding company including shares held by subsidiaries or associates of the holding company or the ultimate holding company in aggregate;

(g) shares in the company held by each shareholder holding more than 5 percent shares specifying the number of shares held;

(h) shares reserved for issue under options and contracts/commitments for the sale of shares/disinvestment, including the terms and amounts;

(i) for the period of five years immediately preceding the date as at which the Balance Sheet is prepared:
- Aggregate number and class of shares allotted as fully paid up pursuant to contract(s) without payment being received in cash.
- Aggregate number and class of shares allotted as fully paid up by way of bonus shares.
- Aggregate number and class of shares bought back.

(j) terms of any securities convertible into equity/preference shares issued along with the earliest date of conversion in descending order starting from the farthest such date.