**SOURCES AND USES OF FUNDS**

For many businesses, the issue about where to get funds from for starting up, development and expansion can be crucial for the success of the business. It is important, therefore, that you undeKshtand the various sources of finance open to a business and are able to assess how appropriate these sources are in relation to the needs of the business.

**Internal Sources**

Traditionally, the major sources of finance for a limited company were internal sources:

* [PeKshonal savings](http://www.bized.co.uk/learn/accounting/financial/sources/savings.htm)
* [Retained profit](http://www.bized.co.uk/learn/accounting/financial/sources/profit.htm)
* [Working capital](http://www.bized.co.uk/learn/accounting/financial/sources/capital.htm)
* [Sale of assets](http://www.bized.co.uk/learn/accounting/financial/sources/assets.htm)

**External Sources**

**OwneKshhip Capital**  
In this context, 'owneKsh' refeKsh to those people/institutions who are shareholdeKsh. Sole tradeKsh and partneKshhips do not have shareholdeKsh - the individual or the partneKsh are the owneKsh of the business but do not hold shares. **Shares** are units of investment in a limited company, whether it be a public or private limited company. Shares are generally broken down into two categories:

* [Ordinary shares](http://www.bized.co.uk/learn/accounting/financial/sources/ordshares.htm)
* [Preference shares](http://www.bized.co.uk/learn/accounting/financial/sources/prefshares.htm)

**Non-OwneKshhip Capital**  
Whilst the following sources of finance are important, they are not classed as OwneKshhip Capital - Debenture holdeKsh are not shareholdeKsh, nor are banks who lend money or creditoKsh. Only shareholdeKsh are owneKsh of the company.

* [Debentures](http://www.bized.co.uk/learn/accounting/financial/sources/debentures.htm)
* [Bank loans](http://www.bized.co.uk/learn/accounting/financial/sources/loans.htm)
* [Overdraft facilities](http://www.bized.co.uk/learn/accounting/financial/sources/overdraft.htm)
* [Hire purchase](http://www.bized.co.uk/learn/accounting/financial/sources/hp.htm)
* [Lines of credit from creditoKsh](http://www.bized.co.uk/learn/accounting/financial/sources/credit.htm)
* [Grants](http://www.bized.co.uk/learn/accounting/financial/sources/grants.htm)
* [Venture capital](http://www.bized.co.uk/learn/accounting/financial/sources/venture.htm)
* [Leasing](http://www.bized.co.uk/learn/accounting/financial/sources/leasing.htm)

**LONG TERM LIABILITIES AND CAPITAL STOCK**

**Long terrm liabilities** are obligations that will not require the use of existing current assets because they do not mature within one year (or operating cycle). Examples include leases, long term notes payable, product warranty liabilities and bonds payable.

**Capital stock** refeKsh to claims that owneKsh have on an organisation- examples include common stock, and preffered stock.

1. **Common stock**

during the formation of a company, there is usually a clause specifying the amount of stock it can issue. If all the authorised shares have the same right and characteristics, it is usually called common stock.

**Rights of common stock holders**

* 1. Right to vote during stockholdeKsh meetings.
  2. Right to sell/ dispose stock.
  3. Right of fiKsht opportunity to purchase any additional shares of common stock issued by the organisation. This helps stockholdeKsh protect their proportionate interest in the firm, and is reffered to as the pre-emptive right.
  4. The right to share with other stakeholdeKsh any dividends so that each common share recieves the same amount.
  5. The right to share in any assets that remain after creditoKsh are paid in case a company is liquidated. This is reffered to as the residual claim.
  6. Right to be informed about the financial perfomance ofthe firm.

1. **Preffered stock**

An organisation may issue more than one kind or class of stock. If two classes are issued one is usually called preffered stock. They are preffered because preffered shares have a higher priority in terms of dividends payment or the distribution of assets during liquidation.

1. Cumulative vs non-cumulative prefered stock. refferd stock is cumulative if any undeclared dividends accumulate each year until paid. It is non-cumulative if the right to recieve dividend is forfeited in any year that dividends are not declared.
2. Participating vs non- participating preffered stock

Dividends paid on preffered stock is usually a fixed percentage of the par value. Such stock is non- participating prefferd stock. However some prefferd stock may be paid additional dividends in excess of the stated percentage . Such stock is called the participating preffered stock.

1. Convertible vs non convertible preffered stock

Convertible stock can be converted into ordinary shares. Non convertible prefferd stock contains no provision to convert to ordinary shares.

**Accounting for Changes in Capital Structure**

1. **Issue of ordinary and preference shares**

This topic explores issues such as the authorised, issued and called-up share capital together with some of the ways in which an organisation might change their proportions. It reviews such aspects of capital as the bookkeeping entries to deal with the application and allotment of share issues. It also discusses the effects on the balance sheet of changes in capital structure.

* [Authorised, issued and called up share capital](http://www.bized.co.uk/learn/accounting/financial/sources/sharecap.htm).
* Bookkeeping for share issues. Shares can be issued in a number of ways, the most important aspect from our point of view being how and when shareholdeKsh pay for the shares they buy:
  + Shares can be issued and paid for in full on application, either
    - [at par](http://www.bized.co.uk/learn/accounting/financial/sources/par.htm), or
    - [at a premium](http://www.bized.co.uk/learn/accounting/financial/sources/premium.htm).
  + Share issues might be [under or over subscribed](http://www.bized.co.uk/learn/accounting/financial/sources/subscribe.htm).
  + Shares are not all issued for cash. Some issues, for example, [bonus issues](http://www.bized.co.uk/learn/accounting/financial/sources/bonus.htm) arise as a result of a capital restructuring of the company, sometimes called a rights issue.
  + Shares can be issued and paid for by instalments.
    - 1. ISSUE OF SHARES IN CASH AND AT PAR.

When shares are issued in cash and at par, the accounting entry is as follows.

Bank Account......................................................xx

Ordinary Share capital Account .....................................xx

(Being issuance of ............ ordinary/ preference shares at par.)

* + - 1. ISSUE OF SHARES IN CASH AT A PREMIUM.

If a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount or value of the premiums on those shares must be transferred to an account called “the share premium account”.

Where, on issuing shares, a company has transferred a sum to the share premium account, it may use that sum to write off—

(a) The expenses of the issue of those shares;

(b) Any commission paid on the issue of those shares.

(c) Preliminary expenses used in setting up the company.

(d) The company may use the share premium account to pay up new shares to be allotted to membeKsh as fully paid bonus shares.

The accounting entry is as follows:

Bank Account......................................................xx

Ordinary Share capital Account .....................................xx

Share premium account ...............................................xx

(Being issuance of ........ordinary/ preference shares at Ksh. ........ per share)

**Illustration**

A company issued 10,000 ordinary shareholders (Ksh 10 par) to its members. The shares were issued at Ksh. 20 per share. The accounting entries will be as follows:

* + - 1. ISSUE OF SHARES IN CASH AT A DISCOUNT.

When the issue price of share is less than the face value, shares are said to have been issued at discount. The Companies Act has laid down certain conditions subject to which a company can issue its shares at a discount. These conditions are as follows :

(i) At least one year must have elapsed from the date of commencement

of business;

(ii) Such shares are of the same class as had already been issued;

(iii) The company has sanctioned such issue by passing a resolution in

its General meeting and the approval of the court is obtained.

Bank account .....................................................................xx

Share discount account .......................................................xx

Ordinary Share capital Account .......................................xx

The amount of discount is generally adjusted towards share allotment money and the following journal entry is made:

Share Allotment A/c Dr

Discount on issue of shares A/c Dr

To Share Capital A/c

Allotment money due on….shares @Ksh ……per share after allowing

discount @Ksh ……….per share.

* + - 1. ISSUE OF SHARES IN INSTALLMENTS.

|  |  |
| --- | --- |
| **(1) On receipt of application money** |  |
|  |  |
| Bank Account | Dr |
| To Share Application A/c |  |
| (Being the application money on....shares..@ KES..per share) |  |
|  |  |
| **(2) On allotment of shares** |  |
|  |  |
| (a) First of all application money on allotted shares is transferred to shares capital account by passing the following entry. |  |
| Share Application Account | Dr |
| To Share Capital A/C |  |
| (Being the application money transferred to Share Capital Account) |  |
|  |  |
| (b) Those applicants who could not be allotted any share, their application money will be returned. For the following entry will be passed. |  |
|  |  |
| Share Application Account | Dr |
| To Bank Account |  |
| (Being the application money of shares returned) |  |

|  |  |
| --- | --- |
| **(3) On the allotment of share, the allotment money becomes due to the company. For this, the company will pass the following entry** |  |
|  |  |
| Share Allotment Account |  |
| To Share Capital Account |  |
| Being the Share allotment money due on ....share @ KES...per share as per resolution dated...) |  |
|  |  |
| **(4) On receipt of allotment money, the entry is** |  |
|  |  |
| Bank A/c | Dr |
| To Share Allotment A/c |  |
| (Being the receipt of allotment money) |  |
|  |  |
| **(5) On making the first call due from shareholdeKsh the entry is** |  |
|  |  |
| Share First Call Account | Dr |
| To Share Capital Account |  |
| (Being the fiKsht call money due on... shares @ KES...per shares as per resolution of the DirectoKsh dated.....) |  |
| **(6) On receipt of the first call money, the entry is** | |  |
|  | |  |
| Bank Account | | Dr |
| To Share First Call Account | |  |
| (Being share fiKsht call money...shares @ KES....per share received) | |  |

**Note:** Similar entries will be passed for second call, third and final call, if any.

Any amount received from or paid to any shareholder is not to be credited or debited to shareholder account but collectively it will be either debited or credited to share application account, share allotment account or share call amount.

As and when any amount is received or become due, it will be entered either in share application and allotment account or share call account.

**Illustration 1**

Fashion Fabrics Ltd. issued 100000 shares of Ksh. 10 each on 1st April, 2006.

The amount payable on these shares was as under:

Ksh 2 per share on application.

Ksh 3 per share on allotment.

Ksh 5 per share on call.

Make journal entries and prepare relevant accounts in the books of company.

**Journal entries**

1. Bank A/c Dr 200000

To Share Application A/c 200000

(Application money received @ Ksh. 2 per share)

2. Share Application A/c Dr 200000

To Share Capital A/c 200000

(Share application money for

100000 shares transferred to share capital A/c)

3. Share Allotment A/c Dr 300000

To Share Capital A/c… 300000

(Allotment money made due on

100000 shares @ Ksh 3/- per share)

4. Bank A/c Dr 300000

To Share Allotment A/c. 300000

(Allotment money received

on 100000 shares @Ksh. 3 per share.)

5. Share FiKsht & Final call A/c. Dr 500000

To Share Capital A/c 500000

(Call money on 1,00,000

shares @ Ksh 5 per share made due)

6. Bank A/c Dr 500000

To Share FiKsht & Final call A/c. 500000

(Call money received on 1,00,000 shares @ Ksh. 5 per share)

**Note :** Although shares may be equity shares or preference shares but if the term shares is used it means equity shares)

**Solve the following:**

ABC company LTD issued 3,000 shares of Ksh 100 par value. The shares were issued as follows:

On application Ksh. 20 per share.

On allotment Ksh. 30 per share.

On first call Ksh. 40 per share.

On second and last call Ksh. 20 per share (including share premium).

Post the transactions in a journal and show an extract of the relevant ledger accounts.

**CALLS IN ARREARS**

Money called up for shares, but not paid at the correct time is calls in arrears. The shares may be forfeited or a special calls in arrears account is established to debit the sums owing. Interest may also be charged on the calls in arrears and is credited in the interest on calls in arrears account.

The following journal entry is made to record Calls-in-Arrears:

Calls-in-Arrears A/c Dr

To Share Allotment/Call A/c

(Share allotment/ Call money not received on …. shares)

When the unpaid balance is received later on the following journal entry

is made:

Bank A/c Dr

To Calls in Arrears A/c

Interest on calls in arrears a/c

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

CALLS IN ADVANCE

If a shareholder pays any amount to company before it is demanded, it is called Call-in-Advance. This amount is put in a separate account known as Calls-in-Advance A/c. This amount is not shown as capital of the company, till such time the company makes a demand from all the shareholders. Call-in-Advance A/c is shown on the liabilities side of the Balance Sheet. For example if a company issued shares of Ksh 10 on which it has already called Ksh 5. Against the uncalled portion of Ksh 5 per share the company makes a call Ksh 3 per share, the entry for call money due will be made only for Ksh 3 per share. Now suppose a shareholder pays Ksh 5 per share including the uncalled amount of Ksh 2 per share along with the Debentures call money, it means he has paid Ksh 2 per share in advance, which will be credited to calls in Advance A/c. The company is required to pay interest on this amount @ 6% till the date of its appropriation.

Accounting teatment

Following journal entry is made for calls-in-advance.

Bank A/c Dr

To Calls-in-Advance A/c

(Calls in advance received on…….shares @ Ksh …….per share)

Appropriation of calls-in-Advance A/c say in the final call

Journal entry will be :

Calls-in-Advance A/c Dr

To Share Final call A/c

(Calls in advance amount adjusted)

For interest given on Calls-in-Advance

Journal entry will be

Interest on calls-in-Advance A/c Dr

To Bank A/c

(Interest paid on the amount of Call-in-Advance)

Illustration 5

Kenya Software Ltd. offered 50000 shares of Ksh 10 each to the public payable

as:

Ksh 2 on application

Ksh 3 on allotment

Ksh 2 on First call and the balance as and when required.

All the shares were applied for and duly allotted but Mukesh a shareholder

holding 200 shares paid the entire balance on allotment.

Make necessary journal entries.

**Share First and Final Call A/c**

Dr Cr

Date Particulars JF Amount Date Particulars JF Amount

Rs Rs

Share Capital A/c 500000

Bank A/c 500000

**23.2 FULL, UNDER AND OVER SUBSCRIPTION**

A company decides to issue number of shares to raise capital. It invites

public to buy these shares. Now there may be three situations :

I. Full Subscription

Company may receive applications equal to the number of shares company has offered to people. It is called full subscription. In case of full subscription the journal entries will be made as follows :

(a) On receipt of application money

Bank A/c Dr

To Share Application A/c

(Application money received for ......... shares)

(b) On allotment of shares

Share Application A/c Dr

To Share Capital A/c

(Application money of shares transferred to capital A/c on their

allotment)

**II.** The company does not receive application equal to the number of shares

offered for subscription, there may be two situations :

(i) under subscription

(ii) over subscription

**(i) Under subscription**

The issue is said to have been under subscribed when the company receives

applications for less number of shares than offered to the public for

subscription. In this case company is not to face any problem regarding

allotment since every applicant will be alloted all the shares applied for.

But the company can proceed with allotment provided the subscription for

shares is at least equal to the minimum required number of shares termed

as minimum subscription.

**(ii) Over Subscription**

When company receives applications for more number of shares than the

number of shares offered to the public for subscription it is a case of over

subscription. A company cannot allot more shares than what it has offered.

In case of over subscription, company has the following options :

**Option I**

**(i) Rejection of Excess Applications and Money Returned**

The company may reject the applications for shares in excess of the shares

offered for issue and a letter of rejection is sent to such applicants. In this

case the application money received from these applicants is refunded to

them in full. The journal entry made is as follows:

Share Application A/c Dr

To Bank A/c

(Application money on … shares refunded to the applicants)

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

**Journal entry made is :**

Shares Application A/c Dr

To Share Allotment A/c

(Excess application money adjusted towards sums due on allotment)

If the application money received on partially accepted applications is more Debentures

than the amount required for adjustment towards allotment money, the

excess money is refunded. However, if the Articles of the company so

authorise, the directors may retain the excess money as calls in advance to

be adjusted against the call/calls falling due later on and the following entry

is made :

Share Application A/c Dr

To Call-in-advance A/c

(The adjustment of excess share application money retained as call-inadvance

in respect of ... shares).

**Option II**

**Partial acceptance of Applications.**

In some cases the company accepts the applications for subscription partially. It means that the company does not allot the full number of shares applied for. For example if an applicant has applied for 5000 shares and

is allotted only 2000 shares, then the applications is said to have been partially accepted. The company may evolve some formula of accepting applications partially or making proportionate allotment/ the Prorata allotment

which means that the applicants are allotted shares proportionately. In such a case the company adjusts the excess share money received on application towards share allotment money due on partially accepted applications. The journal entry recording the adjustment of application money towards share

allotment money, is as under :

Share Application A/c Dr

To Share Allotment A/c

(Share application money transferred to Share Allotment Account in

respect of ... shares).

**Illustration 2**

The Full Health Care Ltd has offered to public for subscription 20000 shares

of Rs 100 each payable as Rs 30 per share on application, Rs 30 per share

on allotment and the balance on call. Applications were received for 30000

shares. Applications for 5000 shares were rejected all together and applicaiton

money was returned. Remaining applicants were alloted the offered shares. Their excess application money was adjusted towards sum due on allotment. Calls were made and duly received. Make journal entries in the books of the company.

FORFEITURE OF SHARES

If a shareholder fails to pay the due amount of allotment or any call on shares issued by the company, the Board of directors may decide to cancel his/her membership of the company. With the cancellation, the defaulting shareholder also loses the amount paid by him/her on such shares. Thus, when a shareholder is deprived of his/her membership due to non payment

of calls, it is known as forfeiture of shares. The result of forfeiture of shares is :

* Cancellation of membership of the shareholder.
* Reduction of issued share Capital of the company.

S.K. Ltd. issued 100,000 shares of Ksh 10 each payable as Ksh 2 on application, Ksh 2 on allotment, Ksh 3 on

first call and Ksh 3 on second and final call. Mr. Harish, the allottee of 100 shares, fails to pay the second and final call money made by the company.

In this case if the Board of Directors decide to forfeit his shares, his membership will be cancelled and the amount of Ksh 700 paid by him (on 100 shares Ksh 2 on application, Ksh 2 on allotment and Ksh 3 on first call per share) will be forfeited. Now Mr. Harish will no longer be the member of the company and the issued capital of the company will be reduced by Rs 1000.

Procedure of forfeiture of shares

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

**1. Forfeiture of shares**

When shares issued are forfeited the accounting treatment will be

as follows:

(i) Debit Share Capital Account with amount called up (whether received or not) per share up to the time of forfeiture.

(ii) Credit Share Forfeited A/c. with the amount received up to the time of forfeiture.

(iii) Credit ‘Unpaid Calls A/c’ with the amount due on forfeited shares. This cancels the effect of debit to such calls which take place when the amount is made due.

The journal entry is :

Share capital A/c Dr

(Amount called up)

To share forfeited A/c

(Amount paid)

To unpaid calls A/c

(Ammount called but not paid)

Note : (i) Amount called up = No. of shares × called up per share

(ii) Amount paid = No. of shares × Amount paid per share

(iii) Amount called but not paid = No. of shares × Amount called but not paid per share

Illustration 1

X, a shareholder, holding 100 shares of Ksh 10 each has paid application money of Ksh 2 per share and allotment money of Ksh 3 per share, but has failed to pay the first call of Ksh 2 per share and second call of Ksh 3 per share. His shares were forfeited. Make the journal entry to record the forfeiture of shares.

DR: Share capital 1000

CR: Share forfeited 500

CR: Share first call 200

CR: Share second/ final 300

Illustration 2

Alpha Ltd. issued 10000 shares of Ksh 100 each payable as:

Ksh 25 on application.

Ksh25 on allotmenth 20 on First call and

Ksh 30 on second and final call.

9000 shares were applied for and allotted. All the payments were received with the exception of allotment money, first call and second and final call money on 300 shares allotted to Ganesh. The Board of Directors decided to forfeit these shares. Make journal entry to record transaction relating to forfeiture of shares.

Solution :

Share Capital A/c (300 × ksh 100) Dr 30000

To Share forfeited A/c (300 × Ksh 25) 7500

To Share allotment A/c (300 × Ksh 25) 7500

To Share first call A/c (300 × Ksh 20) 6000

To Share second call A/c (300 × Ksh 30) 9000

REISSUE OF FORFEITED SHARES

Reissue of forfeited shares at premium and at par, originally issued at par

In this case the whole of the amount that has been credited to Shares

Forfeited A/c is transferred to Capital Reserve A/c on the reissue of such

shares.

**Illustration 2**

Y Ltd. forfeited 400 shares of Rs. 20 each, on which Rs 15 per share have

been received and balance remains due but not paid. These shares were

reissued

(a) at the rate of Ksh 20 per share i.e. at par

(b) at the rate of Ksh. 24 per share i.e. at premium

Make necessary journal entries for reissue of the shares

**Solution**

**Journal Entries**

**Case (a)**

(i) Bank A/c Dr 8000

To Share Capital A/c 8000

(Reissue of 400 share at the rate of Rs 20 per share)

(ii) Shares Forfeited A/c Dr 6000

To Capital Reserve A/c 6000

(Balance amount of Share Forfeited A/c is transferred to Capital

Reserve A/c)

Case (b)

(b) Bank A/c Dr 9600

To Share Capital A/c 8000

To Securities Premium A/c 1600

(Reissue of forfeited shares at premium)

Share Forfeited A/c Dr 6000

To Capital Reserve A/c 6000

(Balance amount of Shares Forfeited A/c is transferred to Capital

Reserve A/c)

In the above two illustrated cases, total amount forfeited on shares reissued is transferred to capital reserve because no discount has been given on reissue of these shares. Therefore, the whole of the amount forfeited is a gain for the company.

**Reissue of forfeited shares at par, at discount and at premium,**

**originally issued at premium :**

If the shares were originally issued at premium, it is not necessary that their

reissue after forfeiture is to be at premium. Such shares can be reissued at

par, at discount or at premium.

If such shares are reissued at premium the premium received should be credited to Securities Premium A/c. Journal entry will be

Bank A/c Dr (Number of shares × amount received per share)

To Share Capital A/c (Number of shares × amount paid up per share)

To Securities Premium A/c (Number of shares × amount of premium per share)

If such shares are reissued at par the amount that has been received and has been credited to share forfeited A/c will be credited to capital reserve A/c

If such shares are reissued at discount, the amount of discount allowed will be adjusted towards the amount credited to share forfeited A/c the balance amount of Share Forfeited A/c will be transferred to Capital Reserve A/c

AZ Ltd. forfeited 200 shares of Rs 10 each originally issued at a premium

of Rs 4 per share, the holder of which paid Rs 3 per share on application

but did not pay the allotment money of Rs 7 per share (including premium)

and call of Rs. 4 per share. Make necessary journal entries for the forfeiture

and for reissue of these shares if :

I. Reissued at Rs 10 per share i.e. at par

II. Reissued at Rs 8 per share i.e. at discount

III. Reissued at Rs 12 per share i.e. at premium

Solution

Share Capital A/c (200 × Rs 10) Dr 2000

Securities Premium A/c (200 × Rs 4) Dr 800

To Share Forfeited A/c (200 × Rs 3) 600

To Share Allotment A/c (200 × Rs 7) 1400

To Share First & Final Call A/c (200 × Rs 4) 800

(Forfeiture of 200 shares for non-payment of dues)

Case I.

(i) Bank A/c Dr 2000

To Share Capital A/c 2000

(Reissue of 200 forfeited shares reissued at par)

(ii) Share Forfeited A/c Dr 600

To Capital Reserve A/c 600

(Share Forfeited A/c balance is transferred to Capital Reserve A/c)

As the forfeited shares have been reissued at par therefore no discount is allowed

on these shares at the time of their reissue. Therefore the full forfeited

amount of Rs 600 is a gain for the caompany which is transferred to Capital reserve account

Case II

(i) Bank A/c Dr 1600

Shares Forfeited A/c Dr 400

To Share Capital 2000

(Reissue of 200 forfeited shares reissued at discount)

(ii) Shares Forfeited A/c Dr 200

To Capital Reserve A/c 200

(Balance amount of Shares Forfeited A/c is transferred to Capital Reserve A/c)

At the time of reissue of forfeited shares a discount of Rs 2 per share is allowed

so the total amount of discount of Rs 400 is adjusted from the forfeited amount

of Rs 600 and the balance amount of Rs 200 is transferred to Capital Reserve

A/c being a capital gain.

Case III

(i) Bank A/c Dr 2400

To Share Capital A/c 2000

To Securities Premium A/c 400

(200 forfeited shares reissued at premium)

(ii) Share Forfeited A/c Dr 600

To Capital Reserve A/c 600

(Balance amout of Share Forfeited A/c transferred to Capital Reserve).

As the forfeited shares have been issued at a premium so no amount of discount is there to be adjusted from the forfeited amount hence the total forfeited amount of Rs 600 is transferred to capital Reserve A/c as capital gain of the company.

ISSUE OF DEBENTURES

The term debenture is generally used to refer to long term unsecured debt. More specifically, a debenture is unsecured debt, normally with a maturity of more than 10 years. Notes refer to similat instruments with maturity less than 10 years.

When a company looks to increase its capital through debentures, the lender does not buy

shares in the company but instead lends money in return for an interest payment. This

interest payment is not dependent on profits, and lenders will normally evaluate the business

for security to ensure that interest will be paid. If security is low, a lender will normally

charge higher interest rates.

Note that there are a few differences between debentures and shares:

· Debentures must be repaid at some specified point in the future.

· Loan lenders do not gain voting rights in the company.

Dividends payable on shares are dependent on profit, while interest payable is not.

Dividends are dependent on the decisions of directors and shareholders, while

interest is not.

Shares vary in value depending on the success of the company, whereas

debentures have a fixed value.

Companies may obtain tax relief on interest but not on dividends.

Debentures are most appropriate for short-term borrowing.

Directors need little authority to increase capital through debentures.

**Types of debentures**

Debenture can be classified as under :

**1. From security point of view**

(i) **Secured or Mortgage debentures :** These are the debentures that are secured by a charge on the assets of the company. These are also called mortgage debentures. The holders of secured debentures have the right to recover their principal amount with the unpaid amount of interest on such debentures out of the assets mortgaged by the company.

(a) First mortgage debentures : The holders of such debentures have a first claim on the assets charged.

(b) Second mortgage debentures : The holders of such debentures have a second claim on the assets charged.

(ii) **Unsecured debentures :** Debentures which do not carry any security with regard to the principal amount or unpaid interest are called unsecured debentures. These are called simple debentures.

**2. On the basis of redemption**

(i) **Redeemable debentures :** These are the debentures which are issued for a fixed period. The principal amount of such debentures is paid off to the debenture holders on the expiry of such period. These can be redeemed by annual drawings or by purchasing from the open market.

(ii) **Non-redeemable debentures :** These are the debentures which are not redeemed in the life time of the company. Such debentures are paid back only when the company goes into liquidation.

**3. On the basis of Records**

(i) **Registered debentures :** These are the debentures that are registered with the company. The amount of such debentures is payable only to those debenture holders whose name appears in the register of the company.

(ii) **Bearer debentures :** These are the debentures which are not recorded in a register of the company. Such debentures are transferrable merely by delivery. Holder of these debentures is

entitled to get the interest.

**4. On the basis of convertibility**

(i) **Convertible debentures :** These are the debentures that can be converted into shares of the company on the expiry of predecided period. The term and conditions of conversion are generally announced at the time of issue of debentures.

(ii) **Non-convertible debentures :** The debenture holders of such debentures cannot convert their debentures into shares of the company.

**5. On the basis of priority**

(i) First debentures : These debentures are redeemed before other debentures.

(ii) Second debentures : These debentures are redeemed after the redemption of first debentures.