6. ACCOUNTING FOR BONUS & RIGHT ISSUE

CONCEPT 1 : INTRODUCTION

- "Capitalisation of profits refers to the process of converting profits or reserves into paid up capital."
- A company may capitalise its profits or reserves which are available for distribution as dividends by issuing fully paid bonus shares to the members.
- A bonus share is free share of stock given to current shareholders upon the number of shares already owns.
- Bonus share does not increase the net worth of the company.
- Although the total number of issued shares increases, the ratio of number of shares held by each shareholder remains constant.
- No new funds are raised with a bonus issue.
- If the subscribed and paid up capital exceeds the authorised share capital, a resolution is passed at its general body meeting for increasing the authorised capital.
- A return of bonus issue along with a copy of resolution required to be filed with the Registrar of Companies.

CONCEPT 2 : PROVISIONS OF THE COMPANIES ACT, 2013 (SECTION 63)

- A company may issue fully paid-up bonus shares to its members out of :
  - (a) Its free reserves;
  - (b) The securities premium account; or
  - (c) The capital redemption reserve account
- No issue of bonus shares made by capitalising reserves created by the revaluation of assets.
- No company shall capitalise its profits or reserves, unless :
  - (a) it is authorised by its articles;
  - (b) it has, on the recommendation of the Board, been authorised in the general meeting;
  - (c) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
  - (d) it has not defaulted in respect of the payment of statutory dues like provident fund, gratuity and bonus;
  - (e) the partly paid-up shares are made fully paid-up;
- Bonus shares shall not be issued in lieu of dividend.

(Above provisions are also required for listed company as per SEBI Regulations.)

CONCEPT 3 : SEBI REGULATIONS

⌘ Restriction on bonus issue - Reg. 93 of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009

- No issuer shall make a bonus issue unless it has made reservation of equity shares of the same class in favour of the holders of outstanding [compulsorily] convertible debt instruments in proportion to the convertible part thereof.
- The equity shares [so] reserved fully or partly [compulsorily] convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments.

⌘ Completion of bonus issue - Reg. 95 of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009

- An issuer, after the approval of its board of directors, shall implement the bonus issue within fifteen days from the date of approval of the issue by its board of directors.
- Provided that where the issuer is required to seek shareholders' approval for bonus issue shall be implemented within two months from the date of the meeting of its board of directors.
- Once the decision to make a bonus issue is announced, the issue cannot be withdrawn.

CONCEPT 4 : JOURNAL ENTRIES

Sr. no.	Particulars	LF	Debit (₹)	Credit (₹)
1]	Conversion of Partly Paid Shares into Fully Paid Shares			
a]	~~Final Call A/c~~ Dr			
	To Eq. Sh. Capital A/c			
b]	Bank A/c Dr			
	~~To Final Call A/c~~			
c]	P & L A/c Dr			
	GR A/c Dr			
	Dividend Equilisation Reserve A/c Dr			
	~~To Bonus to Equity Shareholder A/c~~			
d]	~~Bonus to Equity Share Holder A/c~~ Dr			
	To Eq. Sh. Capital A/c			
2]	Bonus in the form of Fully Paid Shares to Partly paid Shares			
a]	P & L A/c Dr			
	GR A/c Dr			
	Dividend Equilisation Reserve A/c Dr			
	~~To Bonus to Equity Shareholder A/c~~			
b]	~~Final Call A/c~~ Dr			
	To Eq. Sh. Capital A/c			
c]	~~Bonus to Equity Shareholder A/c~~ Dr			
	~~To Final Call A/c~~			
3]	Issue of Bonus to Fully Paid - up Shares			
a]	P & L A/c Dr			
	GR A/c Dr			
	Dividend Equilisation Reserve A/c Dr			
	~~To Bonus to Equity Shareholder A/c~~			
b]	~~Bonus to Equity Shareholder A/c~~ Dr			
	To Eq. Sh. Capital A/c			

CONCEPT 5 : DIFFERENCE BETWEEN BONUS SHARES & DIVIDEND

Bonus Shares

No Cash

GR / P&L A/c Dr
To Eq. Sh. Capital

Dividend

Cash Outflow

GR / P&L A/c Dr
To Cash

CONCEPT 6 : WHAT IS THE PROVISION REGARDING BONUS FOR CONVERTIBLE DEBENTURES

- As per SEBI, at the time of Bonus issue or right issue, it should be seen that the interest of fully or partly Compulsorily Debentures if any, is not diluted
- It means proportionate shares can be reserved for fully convertible / partly convertible debentures at the time of Bonus Issue

P & L / GR /Dividend Equilisation Reserve A/c Dr
To Shares Suspense A/c

(As shares are yet not issued but kept in reserve so, Eq. Sh. Capital is not credited but Shares Suspense A/c is credited)

☺ Example : SS Ltd. Has 10,000 fully paid equity shares of ₹10 each & 5,000 fully convertible debentures of ₹ 10 each. Debentures are convertible into equivalent number of equity shares after 6 months. Bonus issue 1:1. Pass Journal Entries :

Sr. no.	Particulars		₹	₹
1]	Reserves A/c [(10,000+5,000)1/2*₹10]	Dr	75,000	
	To Bonus to Equity Shareholders A/c			75,000
2]	Bonus to equity Shareholders A/c	Dr	75,000	
	To Equity Share Capital A/c (10,000*1/2*10)			50,000
	To Shares Suspense A/c (Convertible Debentures)			25,000
3]	After 6 Months			
	% Debentures A/c	Dr	50,000	
	To Equity Share Capital A/c			50,000
4]	Shares Suspense A/c	Dr	25,000	
	To Equity Share Capital A/c			25,000

- Shares Suspense can be written as Bonus reserved for fully convertible Debentures

CONCEPT 7 : ORDER OF RESERVES USED TO ISSUE BONUS SHARES

1] Capital Redemption Reserve (CRR)
2] Capital Reserve received in Cash
3] Securities Premium received in Cash
4] General Reserve
5] P & L
6] Dividend Equilisation Reserve

CONCEPT 8 : SOME IMP POINTS (Before Bonus, Redemption of Preference Shares)

Sr. no.	Redemption of Preference Share Entries		Buyback of Equity Shares	
1]	% Preference Share Capital A/c	Dr	Equity Shares Buyback A/c	Dr
	Premium on Redemption A/c	Dr	To Bank A/c	
	To Preference Shareholders A/c			
2]	Preference Shareholders A/c	Dr	Equity Share Capital A/c	Dr
	To Bank A/c		Premium on Buyback A/c	Dr
			To Equity Shares Buyback A/c	
3]	SP/P& L A/c	Dr	SP / P& L A/c	Dr
	To Premium on Redemption A/c		To Premium on Buyback A/c	

RIGHT ISSUE

CONCEPT 9 : INTRODUCTION

- Whenever a company intends to issue new shares, existing shareholders are given the offer to subscribe such shares to preserve their position.
- The existing shareholders have a right :
  a] To subscribe any fresh issue of shares by the company in proportion to their existing holding.
  b] To renounce this right in favour of anyone else (if articles allow), or
  c] Reject it completely.

Example :
Assume a company makes a right issue of 10,000 shares when its existing issued and subscribed capital is 100,000 shares. This enables any shareholder having 10 shares to subscribe to 1 new share. Hence X, an existing shareholder holding 1,000 shares, may subscribe to 100 shares as a matter of right. The existing share percentage of X was 1% (1,000 /100,000). If X subscribes these shares, his percentage holding in the company will be maintained (1,100 /110,000). However, if X does not mind his share % diluting (1,000/ 110,000), he may renounce the right in favour of anyone else, say Y. Hence, these 100 shares will be issued to Y, at the insistence of X. X may charge Y for this privilege, which is technically termed as the value of right.

CONCEPT 10 : CONDITIONS TO ISSUE RIGHT SHARES

- A company desirous of issuing new shares has to offer the shares to existing equity shareholders through a letter of offer subject to the following conditions, namely :

1] Offer by Notice specifying : Number of shares offered.

2] Offer deemed to decline (Limited time to accept offer) :
If the offer is not accepted within time of fifteen days to thirty days from the date of offer.

3] Right to renounce :
Unless articles otherwise provide, offer shall be deemed to include a right to renounce shares; and Notice shall contain a statement of this right;

4] Disposal :
After expiry of the time specified in the notice aforesaid or
on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered,
BOD may dispose them in such manner which is not disadvantageous to shareholders & company.

☹ <u>Exceptions to the rights of existing equity shareholders :</u>

❒ Four situations under which further shares need not be offered to the existing shareholders.

➢ Company has passed a special resolution & shares are offered to :

Situations	Explanation
1	Employees under scheme of ESOP subject to certain specified conditions.
2	To any persons, either for cash or for consideration other than cash, if the price of such shares is determined by the valuation report of a registered valuer subject to certain specified conditions.
3	<u>Borrowings :</u> ▸ Companies borrow money through debentures/loans & give their creditor an option (not obligation) to buy equity shares of a company.
4	<u>Loan from government :</u> ▸ Special situation where loan has been obtained from government, and government in public interest, directs the debentures / loan to be converted into equity shares. ▸ Even if terms of issue do not include a term for providing an option for conversion. ▸ Where the terms & conditions of conversion are not acceptable to the company, it may, within sixty days from the date of communication of such order, appeal to the Tribunal which shall pass such order as it deems fit after hearing the company & Government. ▸ In determining the terms & conditions of conversion, Government shall have due regard to i] Financial position of the company, ii] Terms of issue of debentures or loans, as the case may be, iii] Rate of interest payable on such debentures or loans & such other matters as it may consider necessary. iv] Where the Government has directed that any debenture or loan shall be converted into shares & where no appeal has been preferred to the Tribunal or where such appeal has been dismissed, memorandum of such company shall stand altered & authorised share capital of such company shall stand increased by an amount equal to the amount of the value of shares which such debentures or loans has been converted into.

CONCEPT 11 : FINANCIAL EFFECTS OF FURTHER ISSUE

➢ Further issue of shares increase :

a] The amount of equity (net worth)* and

b] The liquid resources (Bank).

*The amount of equity = Product of further number of shares issued *Issue price.

Issue price may be higher than face value (issue at a premium).

Companies Act does not allow issue of shares at a discount, except issue of sweat equity shares u/s 53.

CONCEPT 12 : BOOK VALUE OF A SHARE

Book value of a share = Net worth (as per books)/ Number of shares.

☺ <u>Example :</u>

If there are 10,000 shares with BV ₹1,25,000.

Book value of one share is (₹1,25,000/10,000 shares) ₹12.50.

➥ However, the market value may differ from book value of shares.

➥ Market value represents PV of future cash flows expected to be earned from the share in the form of dividends and capital gains from expected future share price appreciation.

➥ The market price, which exists before rights issue, is termed as Cum-right Market Price of the share.

- If the company decides to issue further shares, it may affect the market value of the share.
- 'Theoretically', the value of a company's shares after a rights issue must equal the sum of market capitalisation immediate prior to rights issue and the cash inflows generated from the rights issue.
- Market price of shares after further issue of shares (right issue) is termed as Ex-right Market Price.

☺ Example :

Assume right issue of 1:10 is made at a price of ₹14 per share. Existing worth of tangible assets held by the business shall become 2,64,000 (Existing net worth ₹ 2,50,000 + Fresh Issue ₹14,000). Equity shares shall correspondingly command a valuation of ₹2,64,000. Mr. Nara in has 100 shares before right issue.

⇨ Solution :

Sr. no.	Particulars	Computation	₹
i]	Current worth of holding of Nara in:		
a]	No. of shares	Given	100 shares
b]	Cum-right Market Price	Given	₹25
c]	Current worth of holding	a * b	₹ 2,500
A]	If Nara in exercises his right :		
i]	Nara in will pay	₹14 * 10 shares	₹140
ii]	Total investment including right	i (c) + A(i)	₹2,640
iii]	Ex-right market price per share	A (i) / 100 + 10 shares	₹24
B]	If Nara in does not exercise right& renounced in favour of Murthy for ₹10 :		
i]	Holding's worth – Nara in (ex-right)	₹24 * 100 shares	₹2,400
ii]	Value of right recd from Murthy	₹10 * 10 shares	₹100
iii]	Nara in's final holding	B (i) + B (ii)	₹2,500
iv]	Murthy's total investment	₹140 (to company) + ₹100 (to Nara in)	₹240

CONCEPT 13 : RIGHT OF RENUNCIATION

- If an existing shareholder decides not to subscribe right shares, he may transfer his right, which is his right of renunciation.
- In case the right issue offer is availed by an existing shareholder, value of right is determined as follows :

1] Value of right = Cum-right value of share - Ex-right value of share

2] Ex-right value of the shares =
[Cum-right value of existing shares + (Right shares *Issue Price)] / (Existing No. of shares + No. of right shares)

☺ In our previous example,
Ex-right value of share = [₹250,000 + (₹14 * 1,000 shares)] / 10,000 + 1,000 shares = ₹24
Value of right = ₹25 - ₹24 = ₹1 per share.

- The Ex-right value of the share is also known as the average price.

CONCEPT 14 : ACCOUNTING FOR RIGHT ISSUE

- Same as that of issue of ordinary shares.
- Journal entry (issued at par) :

  Bank A/c Dr.

  To Equity shares capital A/c
- Journal Entry (issued at premium) :

  Bank A/c Dr.

  To Equity Share Capital A/c

  To Securities Premium A/c

Example :

A company having 100,000 shares of ₹10 each as its issued share capital& having a market value of ₹46, issues rights shares in the ratio of 1:10 at an issue price of ₹31.

The entry at the time of subscription of right shares by the existing shareholders will be

Bank A/c	Dr.	3,10,000	
To Equity Share Capital A/c			1,00,000
To Securities Premium A/c			2,10,000

CONCEPT 15 : ADVANTAGES AND DISADVANTAGES OF RIGHT ISSUE

Sr. no.	Advantages	Explanation
1]	Undiluted control	Right issue enables existing shareholders to maintain proportional holding in company & retain their financial & governance rights.
2]	No manipulation	It discourages management to issue shares to known persons with a view to have a better control over the company's affairs.
3]	Compensation for decrease in value of shares	▸ In well-functioning capital markets, the right issue necessarily leads to dilution in the value of share. ▸ However, the existing shareholders are not affected by it because getting new shares at a discounted value from their cum-right value will compensate decrease in the value of shares. ▸ The cum-right value is maintained otherwise also, if the existing shareholders renounce their right in favour of a third party.
4]	Cut cost (issue expenses)	Right issue is a natural hedge against the issue expenses normally incurred by the company in relation to public issue.
5]	Goodwill	Right issue has an image enhancement effect, as public and shareholders view it positively.
6]	Easier	Chance of success of right issue is better than that of general public issue & is logistically much easier to handle.
Sr. no.	**Disadvantages**	**Explanation**
1]	Dilution in MV	Right issue invariably leads to dilution in the market value of the share of the company.
2]	Assessment	Attractive price of right issue should be objectively assessed against its true worth to ensure that you get a bargained deal.

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