UNIT 7
Introduction to Company Accounts

(9 Hours) — Financial Accounting (CACS152)

1. Meaning of Company

A company is an artificial legal person, created by law (registration under the prevailing Companies Act), having a separate legal existence distinct from the individuals who form it, with perpetual succession and, generally, limited liability for its members. A company is formed by a group of persons (or, in some jurisdictions, even a single person) who contribute capital, called share capital, in exchange for shares representing ownership in the company.

Because a company is a distinct legal person, it can own property, enter into contracts, sue and be sued, and incur debts entirely in its own name, independent of the persons who own or manage it at any given time.

2. Salient Features of a Company

- Separate Legal Entity — a company has an identity distinct from its members; it can own assets, incur liabilities, and enter into contracts in its own name.
- Limited Liability — the liability of members is generally limited to the amount unpaid on the shares they hold (or to the amount they have agreed to guarantee), so their personal assets are not at risk for the company's debts.
- Perpetual Succession — the company's existence is not affected by the death, insolvency, or retirement of any member; it continues until it is legally wound up.
- Artificial Person Created by Law — a company comes into existence only through registration under the Companies Act, and can be dissolved only through a process prescribed by law.
- Common Seal / Authorized Signatory — a company acts and authenticates its documents through its common seal or duly authorized signatories, since it cannot physically sign documents itself.
- Transferability of Shares — shares of a company, particularly a public company, are generally freely transferable, allowing members to exit their investment without dissolving the company.
- Separation of Ownership and Management — shareholders (the owners) elect a Board of Directors to manage the company on their behalf, so day-to-day control is usually separate

from ownership.

3. Types of Company

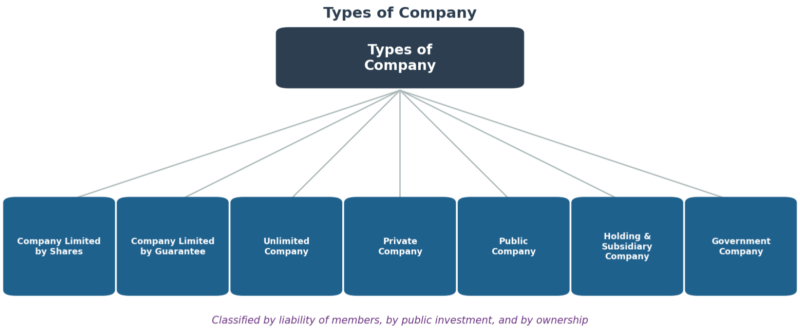


Fig 7.1 — Types of company classified by liability, public investment, and ownership.

3.1 Classification by Liability of Members

• Company Limited by Shares — the liability of members is limited to the amount, if any, unpaid on the shares held by them; the most common form of company.

• Company Limited by Guarantee — the liability of members is limited to a fixed amount that each member undertakes to contribute in the event of winding up; commonly used for non-profit and charitable organizations.

• Unlimited Company — the liability of members is not limited at all, and members remain liable in full for the company's debts, similar to a partnership.

3.2 Classification by Public Investment

• Private Company — restricts the transfer of its shares, limits the number of its members, and cannot invite the public to subscribe to its shares or debentures.

• Public Company — places no restriction on the transfer of its shares, may have an unlimited number of members, and may invite the general public to subscribe to its shares and debentures, often through a stock exchange listing.

3.3 Other Classifications

• Holding and Subsidiary Company — a holding company controls the composition of the Board of Directors, or holds a majority of the shares, of another company (its subsidiary).

• Government Company — a company in which not less than a prescribed percentage of the paid-up share capital is held by the government.

• Non-Profit (Not-for-Distribution) Company — formed to promote objects such as commerce, art, science, religion, or charity, and prohibited from distributing profit to its members.

4. Preparation of Financial Statements

Unlike a sole proprietorship, a company is required by law to prepare and publish its financial statements in a prescribed format at the end of every accounting year, since its shareholders, unlike a sole proprietor, do not participate in day-to-day management and rely on these statements to monitor their investment.

4.1 Components of a Company's Financial Statements

- Statement of Profit and Loss — corresponds to the Trading and Profit & Loss Account of a sole proprietor, showing revenue, expenses, and the profit or loss for the year.
- Balance Sheet (Statement of Financial Position) — presented in a format prescribed by the Companies Act and applicable accounting standards (NFRS), classifying items into equity, non-current liabilities, current liabilities, non-current assets, and current assets.
- Statement of Cash Flows — shows cash inflows and outflows classified into operating, investing, and financing activities during the year.
- Statement of Changes in Equity — reconciles the opening and closing balances of each component of equity, including share capital and reserves.
- Notes to the Accounts — provide detailed information and explanations supporting the figures shown in the statements above.

4.2 Key Differences from a Sole Proprietor's Final Accounts

Basis	Sole Proprietor	Company
Legal Requirement	No statutory format is prescribed	Format is prescribed by the Companies Act and NFRS
Owner's Equity	Shown as a single Capital Account	Shown as Share Capital plus various Reserves and Surplus
Distribution of Profit	Entire profit belongs to the proprietor	Profit may be distributed as dividend, subject to Board and, often, shareholder approval
Audit	Generally not compulsory	Statutory audit by a qualified auditor is compulsory
Publication	Not published or filed with any authority	Filed with the Registrar of Companies and, for listed companies, published for investors

Note: The detailed formats and preparation of a company's Statement of Profit and Loss, Balance Sheet, and Cash Flow Statement, together with the applicable disclosure requirements, are studied in greater depth in later, more advanced accounting courses; this unit introduces only the foundational concepts specific to a company as a form of business organization.

5. Share Capital and Its Types

5.1 Meaning of Share Capital

Share capital is the capital raised by a company through the issue of shares to its members, each share representing a unit of ownership in the company. A shareholder's liability, in a company limited by shares, is limited to the amount, if any, remaining unpaid on the shares held.

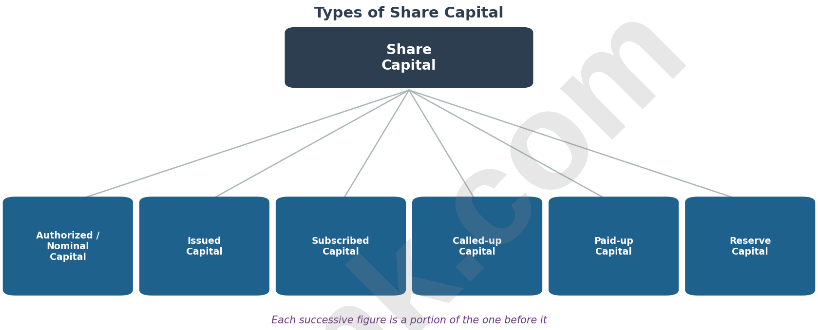


Fig 7.2 — The different figures of share capital, each a narrower slice of the one before it.

5.2 Types of Share Capital (by Stage)

- Authorized (or Nominal) Capital — the maximum amount of share capital that a company is authorized, by its Memorandum of Association (or equivalent charter document), to raise.
- Issued Capital — that part of the authorized capital which the company has actually offered to investors for subscription.
- Subscribed Capital — that part of the issued capital which has actually been taken up (subscribed to) by investors.
- Called-up Capital — that part of the subscribed capital which the company has called upon shareholders to pay.
- Paid-up Capital — that part of the called-up capital which has actually been received (paid) by shareholders; any amount called but not received is termed calls-in-arrears.
- Reserve Capital — that part of the subscribed capital that a company, by special resolution, resolves not to call up except in the event of, and for the purposes of, winding up.

5.3 Classes of Shares

• Equity (Ordinary) Shares — carry voting rights in proportion to the shares held, and are entitled to dividend only after the claims of preference shareholders have been met; the rate of dividend on equity shares is not fixed and depends on the profits available and the decision of the Board.

• Preference Shares — carry a preferential right over equity shares both to receive dividend at a fixed rate and to repayment of capital in the event of winding up, but generally do not carry voting rights except in specified circumstances.

5.4 Types of Preference Shares

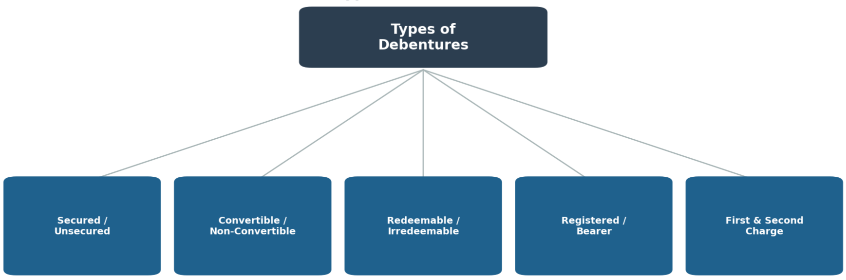
Basis of Classification	Types
Dividend arrears	Cumulative (unpaid dividend accumulates and must be paid before any equity dividend) vs. Non-Cumulative (unpaid dividend does not accumulate)
Participation in surplus profit	Participating (share in surplus profit and/or surplus assets beyond the fixed rate) vs. Non-Participating (entitled only to the fixed rate)
Convertibility	Convertible (may be converted into equity shares after a specified period) vs. Non-Convertible (cannot be converted)
Redemption	Redeemable (repayable by the company after a fixed period or at the company's option) vs. Irredeemable (not repayable during the company's lifetime)

6. Debentures and Their Types

6.1 Meaning of Debenture

A debenture is a document issued by a company acknowledging a debt owed by the company to the holder, usually carrying a fixed rate of interest, and repayable on a specified date or dates. Unlike a shareholder, a debenture holder is a creditor of the company, not an owner, and is entitled to receive interest regardless of whether the company has earned a profit.

Types of Debentures



Classified by security, convertibility, redemption, and registration

Fig 7.3 — Common classifications of debentures.

6.2 Types of Debentures

- Secured (Mortgage) Debentures — backed by a charge on the assets of the company, giving the holder recourse to specific assets in the event of default; Unsecured (Naked) Debentures carry no such charge and rank as ordinary unsecured creditors.
- Convertible Debentures — may be converted, wholly or partly, into equity shares after a specified period, at terms decided at the time of issue; Non-Convertible Debentures remain debt throughout their term and are repaid in cash.
- Redeemable Debentures — repayable by the company either after a fixed period or in installments over a period, as specified in the terms of issue; Irredeemable (Perpetual) Debentures are repayable only on the winding up of the company or on the happening of a specified event.
- Registered Debentures — recorded in the register of debenture holders maintained by the company, and are transferable only by a proper instrument of transfer; Bearer Debentures are transferable by mere delivery, like a negotiable instrument.
- First and Second Charge Debentures — where more than one series of secured debentures is issued, those with a first charge are repaid, out of the secured assets, in priority to those with a second charge.

7. Distinction between Debentures and Shares

Basis	Shares	Debentures
Nature	Represent ownership (capital) of the company	Represent a loan (debt) owed by the company
Status of Holder	Shareholder is a member and owner of the company	Debenture holder is a creditor of the company
Return	Dividend, payable only out of profits, at a rate that may vary	Interest, payable at a fixed rate regardless of profit
Voting Rights	Equity shareholders generally have voting rights	Debenture holders generally have no voting rights
Security	Generally unsecured; no charge on the company's assets	May be secured by a charge on the company's assets
Repayment Priority	Repaid only after all creditors, including debenture holders, have been paid in full on winding up	Repaid in priority to shareholders on winding up
Conversion	Cannot be converted into a debt instrument	May be convertible into equity shares, if so specified at issue

8. Issue of Shares and Debentures

8.1 Issue of Shares

Shares may be issued at par (at their nominal or face value), at a premium (above face value), or, subject to strict legal conditions, at a discount (below face value). The amount payable on a share is usually collected in installments — on application, on allotment, and on one or more calls.

Stage	Journal Entry
On receipt of application money	Bank A/c ... Dr. To Share Application A/c
On allotment of shares (transferring application money, and recording amount due on allotment)	Share Application A/c ... Dr. To Share Capital A/c; and Share Allotment A/c ... Dr. To Share Capital A/c (and To Securities Premium A/c, if issued at a premium)
On receipt of allotment money	Bank A/c ... Dr. To Share Allotment A/c
On making a call, and its receipt	Share Call A/c ... Dr. To Share Capital A/c; then Bank A/c ... Dr. To Share Call A/c

Example 8.1 — Issue of Shares at a Premium

A company issued 10,000 equity shares of Rs. 10 each at a premium of Rs. 2 per share, payable in full on application. Applications were received for all the shares issued, and allotment was made in full. Pass the necessary journal entries.

Solution — Journal Entries

Bank A/c ... Dr. Rs. 1,20,000 To Share Application A/c Rs. 1,20,000 (Being application money received on 10,000 shares @ Rs. 12 per share, including premium)

Share Application A/c ... Dr. Rs. 1,20,000 To Share Capital A/c Rs. 1,00,000 To Securities Premium A/c Rs. 20,000 (Being application money transferred to Share Capital and Securities Premium accounts on allotment)

8.2 Issue of Debentures

Debentures, like shares, may be issued at par, at a premium, or at a discount, and, in addition, may be issued for consideration other than cash (such as for the purchase of assets) or as collateral security for a loan.

- Issue for cash — recorded similarly to the issue of shares, through Application and Allotment accounts.

- Issue as collateral security — where debentures are issued to a lender merely as additional security for a loan, without any cash being received for the debentures themselves; the lender can enforce the debentures only if the company defaults on the principal loan.
- Issue at a discount — permitted for debentures (unlike, generally, for shares), and the discount is written off over the life of the debentures.

Example 8.2 — Issue of Debentures at a Discount
A company issued 1,000, 10% debentures of Rs. 100 each at a discount of 5%, payable in full on application. Pass the journal entry on allotment.

Solution — Journal Entry
Bank A/c ... Dr. Rs. 95,000 Discount on Issue of Debentures A/c ... Dr. Rs. 5,000 To 10% Debentures A/c Rs. 1,00,000 (Being 1,000 debentures of Rs. 100 each issued at a 5% discount)

9. Redemption of Preference Shares

9.1 Meaning of Redemption

Redemption of preference shares refers to the repayment, by the company, of the amount due to preference shareholders, thereby extinguishing the company's obligation on those shares. Only redeemable preference shares can be redeemed; irredeemable preference shares, and equity shares, cannot ordinarily be redeemed in this manner.

9.2 Legal Conditions for Redemption

- Only fully paid-up preference shares can be redeemed; partly paid shares must first be made fully paid up.
- Redemption must be funded either 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 specifically for the purposes of redemption, or a combination of both.
- Where shares are redeemed out of profits, an amount equal to the nominal value of the shares redeemed must be transferred to a Capital Redemption Reserve (CRR) account, which can thereafter be applied only in paying up unissued shares to be issued as fully paid bonus shares.
- Any premium payable on redemption must be provided for out of the profits of the company or out of the company's Securities Premium account.

9.3 Sources of Redemption

Source	Effect
Fresh issue of shares	New share capital replaces the redeemed preference share capital; no transfer to Capital Redemption Reserve is required to the extent redemption is funded this way
Profits otherwise available for dividend (e.g., General Reserve, Retained Earnings)	An amount equal to the nominal value redeemed from profits must be transferred to Capital Redemption Reserve

9.4 Journal Entries for Redemption

Illustrative Journal Entries on Redemption

(i) On making the redemption amount due: Preference Share Capital A/c ... Dr. Premium on Redemption A/c ... Dr. (if any) To Preference Shareholders A/c

(ii) On transferring profits to Capital Redemption Reserve (to the extent not covered by a fresh issue): General Reserve / Retained Earnings A/c ... Dr. To Capital Redemption Reserve A/c

(iii) On payment to preference shareholders: Preference Shareholders A/c ... Dr. To Bank A/c

Example 9.1 — Redemption of Preference Shares

A company had 5,000, 10% Redeemable Preference Shares of Rs. 100 each, fully paid. The company decided to redeem these shares at par, funding the redemption through a fresh issue of 3,000 equity shares of Rs. 100 each at par, and the balance out of General Reserve. Show the amount to be transferred to Capital Redemption Reserve.

Solution

Total redemption amount = 5,000 shares × Rs. 100 = Rs. 5,00,000

Amount raised through fresh issue = 3,000 shares × Rs. 100 = Rs. 3,00,000

Balance to be provided out of General Reserve = Rs. 5,00,000 – Rs. 3,00,000 = Rs. 2,00,000

Amount to be transferred to Capital Redemption Reserve = Rs. 2,00,000 (equal to the nominal value of shares redeemed out of profits, i.e., not covered by the fresh issue)

Note: The Capital Redemption Reserve, once created, is treated as part of the company's capital and can be used only to issue fully paid bonus shares to existing members — it cannot be distributed as cash dividend, preserving the company's capital base for the protection of its creditors.

Key Takeaways

✓ A company is an artificial legal person, created by law, with a separate legal identity, limited liability, and perpetual succession, distinct from its members.

✓ Companies are classified by liability of members (limited by shares, by guarantee, or unlimited), by public investment (private or public), and by ownership or control (holding/subsidiary, government).

✓ A company's financial statements — Statement of Profit and Loss, Balance Sheet, Cash Flow Statement, and Notes — follow a format prescribed by law and accounting standards, and are subject to statutory audit.

✓ Share capital passes through authorized, issued, subscribed, called-up, and paid-up stages, and shares are broadly classed as equity or preference shares.

✓ Debentures represent a loan to the company and are classified by security, convertibility, redemption terms, and registration; debenture holders are creditors, not owners, of the company.

✓ Shares represent ownership with a variable return and voting rights; debentures represent debt with a fixed return and priority of repayment.

✓ Shares and debentures may be issued at par, at a premium, or (for debentures, more commonly) at a discount, and are recorded through Application, Allotment, and Call accounts.

✓ Redeemable preference shares can be redeemed only when fully paid up, and only out of fresh share issue proceeds or distributable profits, with any amount funded from profits transferred to a Capital Redemption Reserve.

— End of Unit 7 —