Financial accounts

Topic 2: **company accounts**

<u>Company</u>

An artificial person created by law with perpetual succession and a common seal

- **Lord Justice Lindley**

Section 3 (1) of the Companies Act 1956 defined company as a company formed and registered under the Companies Act"

A company can be defined as an " artificial person", invisible , intangible created by or under law with a discreate legal entity , perpetual succession and a common seal .

It is not effected by the death, insanity or insolvency of an individual number

Features of Company

• Incorporated association

• Artificial Legal Person

• Separate Legal Entity

• Perpetual Existence

. Common Seal

• Transferability of Shares

• May Sue or be Sued

TYPES OF COMPANIES

1. Classification of Companies by Mode of

Incorporation

II. Classification of Companies based on the liability of the members

III. Classification of Companies based on The Number of Members

IV. Other Form of Companies

TYPES OF COMPANIES

1.Classification of Companies by Mode of Incorporation

a) Royal Chartered Companies

These companies are formed under a special charter by themonarch or by a special order of a king or a queen. Few examples of royal chartered companies are BBC, East India Company, Bank Of England,etc.

b) Statutory Companies

These companies are incorporated by a special act passed by the central or state legislature. These companies are intended to carry out some business of national importance. For example, The Reserve Bank of India was formed under RBI act 1934.

C) Registered or Incorporated Companies

These companies are formed/incorporated under the companies act passed by the government. These companies come into existence only after these are registered under the act and the certificate of incorporation is passed by the Registrar of companies.

II- Classification of Companies based on the liability of the members

a) Companies Limited By Shares

These companies have a defined share capital and the liability of each member is limited by the memorandum to the extent of the face value of shares subscribed by him.

b) Companies Limited By Guarantee

These companies may or may not have a share capital and the liability of each member is limited by the memorandum to the extent of the sum of money (s)he had promised to pay in the event of liquidation of the company for payments of debts and liabilities of the company

• Unlimited Companies

There is no formal restriction to the amount of money that the shareholder/member of the company has to pay in the event of the liquidation of an unlimited company

III- Classification of Companies based on The Number of Members

a) Public Company (or Public Limited Company)

A public company is a corporation whose ownership is open to the public. In other words, anyone can buy the shares of a public company. There are no restrictions to the number of members of a public company or to the transferability of shares.

b) Private Company (or Private Limited Company)

A private company cannot be owned by the public; it restricts the number of members, the right to transfer its shares and prohibits any invitation to the public to subscribe for any shares or debentures of the company.

C) One Person Company

A one-person company is an Indian private limited company which has only one founder/promoter.

Other form of Companies

- Foreign Company
- Government Company
- Subsidiary Company
- Holding Company
- Dormant Company

Share Capital of a Company

A company, being an artificial person, cannot generate its own capital which has necessarily to be collected from several persons. These persons are known as shareholders and the amount contributed by them is called share capital.

Nature and Classes of Shares (Types)

Shares, refer to the units into which the total share capital of a company is divided. Thus, a share is a fractional part of the share capital and forms the basis of ownership interest in a company.

As per Section 86 of The Companies Act, a company can issue

two types of shares

(1) preference shares, and

(2) equity shares

Preference Shares

According to Section 85 of The Companies Act, 1956, a preference share is one, which fulfils the following conditions :

(**a**) That it carries a **preferential right to dividend** to be paid either as a fixed amount payable to preference shareholders or an amount calculated by a fixed rate of the nominal value of each share before any dividend is paid to the equity shareholders.

(b) That with respect to capital it carries or will carry, on the winding up of the company, the **preferential right to the repayment of capital** before anything is paid to equity shareholders.

Types of Preference Shares

- Cumulative and Non-cumulative
- Participating and Non-participating
- Redeemable and irredeemable
- Convertible and Non-convetible

Equity Shares

According to Section 85 of The Companies Act, 1956, an equity share is a share which is not a preference share. In other words, shares which do not enjoy any preferential right in the payment of dividend or repayment of capital, are termed as equity/ordinary shares.

Sweat Equity Shares

According to section 2(88), sweat equity shares mean equity shares issued by a company to its directors or employees at a discount or for consideration, other than cash for providing

know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called

Bonus Shares

Bonus shares are additional shares given to the current shareholders without any additional cost, based upon the number of shares that a shareholder owns. A company may, if its Articles provide, capitalize its profits by issuing fully paid bonus shares.

Source for issue of Bonus shares

(i) its free reserves;

(ii) the securities premium account; or

(iii) the capital redemption reserve account

Rights Issue

A rights issue is a primary market offer to the existing shareholders to buy additional shares of the company on a pro-rata basis within a specified date at a discounted price.than the current market price.

It is important to note that the rights issue offer is an invitation.that provides an opportunity for existing shareholders to increase their shareholding. It is a right that a shareholder may or may not choose to exercise and not an obligation to buy the shares.

Issue of shares

1- Private Placement of Shares- offering its securities or inviting to subscribe its securities for a select group of persons other than by way of a public issue through a private placement offer letter

2- By Allotment to Issue House- concept a company allots their shares or debentures at a price to a financial institution or an issue house for sale to the public.

3- Public Issue- Public Issue is the process of selling and marketing of securities for subscription by public by issue of prospectus

Book Building

Book building is essentially a process used by companies raising capital through public offerings- both initial public offers (IPOS) and follow-on public offers (FPOS) to aid price and demand discovery. It is a mechanism where, during the period for which the book for the offer is open, the bids are collected from investors at various prices, which are within the price band specified by the issuer

Forfeiture of Shares

To forfeit means to take away or to withdraw the rights of a person. In other words forfeit means to lose the right to, be deprived of; to lose or become liable to lose, as in consequence of fault or breach of promise or contract. It is a penalty for a breach of contract or neglect; a fine that is imposed for not complying with the stipulated condition, obligation or duty.

Surrender of Shares

Surrender of shares means **the return of shares by the shareholder to the company for cancellation**. Holder in this case voluntarily abandons all his shares in favour of the company. Shares are said to be surrendered when they are voluntarily given up.

Share Certificate

A share certificate is a certificate issued to the members by the company under its common seal specifying the number of shares held by him and the amount paid on each share.

□Company name □ Date of issue □Details of the member

□ Shares held

□Nominal value □Paid up value □ Definite number.

Share Warrant

The share warrant is a bearer document issued by the company under the common seal of the company stating that the bearer is entitled to the shares mentioned therein.

As share warrant is a negotiable instrument, it is transferred by endorsement and by mere delivery like any other negotiable instrument.

Buy Back of Shares

Buy Back of securities simply implies purchase of its own securities by a Company. Buy Back of securities is a important mode of capital restructuring. A company can buy back its shares under Section 68 of the Companies Act, 2013 which is more or less same as section 77A of The Companies Act, 1956 but there are some procedural Changes.

Underwriting

An under-writer may be an individual, firm or a joint stock company, performing the under-writing function. Under writing may be defined as a contract entered into by the company with persons or institutions, called under-writers, who undertake to take up the whole or a portion of such of the offered shares or debentures as may not be subscribed for by the public. Such agreements are called 'Under-writing agreement'.

Transfer of Shares

Transfer of shares refers to the intentional transfer of title of the shares between the transferor (one who transfers) and the transferee (one who receives). The shares of a public company are freely transferable unless the company has a valid reason to disallow the same. The shares of a private limited company are not transferable subject to certain exceptions. A transfer deed is executed for the transfer of shares.

Transmission of Shares

Transmission of shares takes place due to the operation of law that is when the holder is no more or has become lunatic or insolvent. It can also take place when the holder of shares is a company, and it has wound up. There is no transfer deed executed, and the transferee will be given the rights to the shares, and the transmission is recorded only when the transferee gives proof of entitlement to the shares.

DEMATERIALISATION:

It is the conversion of the physical share and debenture certificates to an electronic form. Managing investment in shares and securities becomes much easier when all physical certificates are present in the dematerialised form.

REMATERIALISATION:

Any investor who has already converted the securities and debenture certificates to electronic formats has the option of changing them to physical form once again. People opt for rematerialisation to avoid paying for the maintenance charge of a Demat account that has only 1 or 2 shares.

DEBENTURE

Debenture is an acknowledgement of debt issued by a company under its common seal.

Meaning of debentures as per section 2(30) of the companies act, 2013:

Debenture includes debenture stock, bonds and any other instrument of the company evidencing a debt, whether constituting a charge on the assets of the company or not.

Characteristics or Features of a Debenture

- A document known as debenture certificate.

- An acknowledgement of debt by the company

- Involves an agreement between the company and its debenture holders to fix the mode and period of repayment of principal and interest

- It is a common practice to prefix 'debentures' with the rate of interest like if the rate of interest is 10%, the title of the debentures will be '10% debentures'.

- It is treated as an external equity or long term borrowings by the company.

- It is usually secured by way of charge on the assets of the company.

- The interest charged on debentures is a charge against profit.

Types of Debentures

1. Security point of view:

a. Secured:

Such debentures are secured by either a fixed charge or a floating charge on the assets of the company. Such charge is to be registered with the Registrar of the Companies.

b. Unsecured:

Such debentures are not secured by any charge on assets of the company.

II. Redemption/Permanence point of view:

a. Redeemable:

Such debentures are repayable by the company at the end of a specified period or by instalments during the existence of the company.

b. Irredeemable:

Such debentures are not repayable during the lifetime of the company and are repayable only when the company is liquidated

iii. Records/Negotiability point of view:

a. Registered:

Such debentures are registered in the company's records in the holder's name. All amounts towards principal and interest are to be paid to the registered debenture holder only. Any transfer of such debentures requires execution of transfer deed.

b. Bearer:

Such debentures are not registered in the records of the company in the name of the holder. They are easily transferable by mere delivery. Interest is paid to the person who produces coupons attached to the debenture.

IV. <u>Priority point of view.</u>

a. First Debentures:

Such debentures are to be repaid before the other debentures.

b. Second Debentures:

Such debentures are to be repaid after the first debentures are redeemed

V. <u>Coupon rate point of view.</u>

a. Specific Coupon Rate

Such debentures are issued with a specified rate of interest, called the coupon rate. This rate may be either fixed or floating. If it's a floating rate, it is usually linked with the bank rate.

b. Zero Coupon Rate (Bonds):

Such debentures do not carry a specific rate of interest. They are issued at a substantial discount. Such difference between the face value and issue price is the total amount of interest related to the duration of debentures.

vi. Convertibility point of view:

a. Convertible:

Such debentures are convertible into shares. Where only a part of the debentures amount is convertible into Equity Shares, they are known as Partly ConvertiblenDebentures. However, when full amount of debentures is convertible into Equity Shares, they are known as Fully Convertible Debentures.

b. Non-Convertible:

Such debentures are not convertible into shares

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