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ACCOUNTING FOR BONUS ISSUE

Learning Objectives

After studying this chapter, you will be able to:

- Understand the provisions relating to issue of bonus shares.
- Account for bonus shares.

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 otherwise are available for distribution as dividends among the members by:

a) paying up amount unpaid on existing partly paid shares so as to make them fully paid shares, or

b) issuing fully paid bonus shares to the members.

The Companies Act does not contain any specific provision regarding capitalisation of profits and consequently issue of bonus shares. However, the Companies Act permits that the share premium amount (collected in cash only) can be used by the company in paying up unissued shares of the company to be issued to its members as fully paid bonus shares.

Also the company can utilise the amount of the capital redemption reserve in paying up unissued shares of the company to be issued to its members as fully paid bonus shares.

The SEBI (Disclosure and Investor Protection) Guidelines, 2000 which came into force w.e.f. 27th day of January, 2000 require that the company while issuing bonus shares shall ensure the following :

(a) No company shall, pending conversion of FCDs/PCDs/ issue any by way of bonus unless similar benefit is extended to the holders of such FCDs/ through reservation of shares in proportion to such convertible part of FCDs or PCDs

(b) The shares so reserved may be issued at the time of conversion(s) debentures on the same terms on which the bonus issues were made.

1.1 Definition

- **Bonus Share:**

  A bonus share is a free share of stock given to current shareholders in a company, based upon the number of shares that the shareholder already owns.

  While the issue of bonus shares increases the total number of shares issued and owned, it 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.

  An issue of bonus shares is referred to as a bonus issue. Depending upon the constitutional documents of the company, only certain classes of shares may be entitled to bonus issues, or may be entitled to bonus issues in preference to other classes.

- **Bonus Issue:**

  A bonus issue (or scrip issue) is a stock split in which a company issues new shares without charge in order to bring its issued capital in line with its employed capital (the increased capital available to the company after profits). This usually happens after a company has made profits, thus increasing its employed capital. Therefore, a bonus issue can be seen as an alternative to dividends. No new funds are raised with a bonus issue.

1.2 Issue of Bonus Shares

Bonus shares are issued by cashing in on the free reserves of the company.

The assets of a company also consist of cash reserves. A company builds up its reserves by retaining part of its profit over the years (the part that is not paid out as dividend). After a while, these free reserves increase, and the company wanting to issue bonus shares converts part of the reserves into capital.

1.2.1 Conditions for Bonus issue:

Bonus shares are issued by converting the reserves of the company into share capital. It is nothing but capitalization of the reserves of the company. There are some conditions which need to be satisfied before issuing Bonus shares:

(a) The bonus issue is not made unless the partly-paid shares, if any, are made fully paid-up.

(b) The company has not defaulted in payment of interest or principal in respect of fixed deposits and interest on existing debentures or principal on redemption and

(c) The Company has sufficient reason to believe that it has not defaulted in respect of payment of statutory dues of the employees such as contribution to provident fund, gratuity, bonus etc.

(d) A company which announces its bonus issue after the approval of the Board of directors must implement the proposal within a period of six months from the date of such approval and shall not have the option of changing the decision.

(i) The articles of association of the company shall contain a provision for capitalisation of reserves; etc.

(ii) If there is no such provision in the articles the company shall pass a resolution at its general body meeting making provisions in the articles of association for capitalisation.

1.2.2 Resolution for Increased Authorised Capital

Consequent to the issue of bonus shares, if the subscribed and paid up capital exceed the authorised share capital, a resolution shall be passed by the company at its general body meeting for increasing the authorised capital.

1.2.3 Return of Bonus Issue

A return of bonus issue alongwith a copy of resolution authorising the issue of bonus shares is to be filed with the Registrar within 30 days of the allotment of such shares.

1.2.4 Issue of Bonus Shares by Public Sector Undertakings

It has come to the notice of the Government that a number of Central Government Public Sector Undertakings are carrying substantial reserves in their balance sheets against a relatively small paid up capital base. The question of the need for these enterprises to capitalize a portion of their reserves by issuing Bonus Shares to the existing shareholders has been under consideration of the Government. The issue of Bonus Shares helps in bringing about a proper balance between paid up capital and accumulated reserves, elicit good public response to equity issues of the public enterprises and helps in improving the market image of the company.

Therefore, the Government has decided that the public enterprises, which are carrying substantial reserves in comparison to their paid up capital issue Bonus Shares to capitalize the reserves for which the certain norms/conditions and criteria may be followed and fulfilled. There are some SEBI guidelines for Bonus issue which are contained in Chapter XV of SEBI (Disclosure & Investor Protection) Guidelines, 2000 which should be followed in deciding the correct proportion of reserves to be capitalized by issuing Bonus Shares.

2. Journal Entries

(A) **(1)** ***Upon the sanction of an issue of bonus shares***

(a) Debit Profit & Loss Account

Debit General Reserve Account

Debit Capital Reserve Account (realised in cash only)

Debit Securities Premium Account

Debit Capital Redemption Reserve Account

(b) Credit Bonus to Shareholders Account.

(2) **Upon issue of share**

(a) Debit Bonus to Shareholders Account

(b) Credit Share Capital Account.

(B) **(1)** ***Upon the sanction of bonus by converting partly paid shares into fully paid shares***

(a) Debit Profit & Loss Account

Debit General Reserve Account

Debit Capital Reserve Account (realised in cash only)

(b) Credit Bonus to Shareholders Account

(2) ***On making the final call due***

(a) Debit Share Final Call Account

(b) Credit Share Capital Account.

(3) ***On adjustment of final call***

(a) Debit Bonus to Shareholders Account

(b) Credit Share Final Call Account

Illustration 1

Following is the extract of the Balance Sheet of Solid Ltd. as at 31st March, 2012:

		Rs.
Authorised capital :		
10,000	12% Preference shares of Rs. 10 each	1,00,000
1,00,000	Equity shares of Rs. 10 each	10,00,000
		11,00,000
Issued and Subscribed capital:		
8,000 12% Preference shares of Rs. 10 each fully paid		80,000
90,000 Equity shares of Rs. 10 each, Rs. 8 paid up		7,20,000
Reserves and Surplus :		
General reserve		1,20,000
Capital reserve		75,000
Securities premium		25,000
Profit and Loss Account		2,00,000
Secured Loan :		
12% Partly Convertible Debentures @ Rs. 100 each		5,00,000

On 1st April, 2012 the Company has made final call @ Rs. 2 each on 90,000 equity shares. The call money was received by 20th April, 2012. Thereafter the company decided to capitalise its reserves by way of bonus at the rate of one share for every four shares held. Share premium of Rs. 25,000 includes a premium of Rs. 5,000 for shares issued to vendors pursuant to a scheme of amalgamation. Capital reserves include Rs. 40,000, being profit on sale of plant and machinery. 20% of 12% debentures are convertible into equity shares of Rs. 10 each fully paid on 1st July, 2012.

Show necessary entries in the books of the company and prepare the extract of the Balance Sheet immediately after bonus issue but before conversion of debentures. Are the convertible debenture holders entitled to bonus shares?

Solution

Solid Ltd.

Journal Entries

			Dr.	*Cr.*
2012			*Rs.*	*Rs.*
April 1	Equity Share Final Call A/c	*Dr.*	1,80,000	
	To Equity Share Capital A/c			1,80,000
	(Final call of Rs. 2 per share on 90,000 equity shares due as per Board's Resolution dated....)			

April 20	Bank A/c	Dr.	1,80,000	
	To Equity Share Final Call A/c			1,80,000
	(Final Call money on 90,000 equity shares received)			
	Capital Reserve A/c	Dr.	40,000	
	Securities Premium A/c	Dr.	20,000	
	General Reserve A/c	Dr.	1,20,000	
	Profit and Loss A/c	Dr.	45,000	
	To Bonus to Shareholders A/c			2,25,000
	(Bonus issue @ one share for every four shares held by utilising various reserves as per Board's Resolution dated...)			
April 20	Bonus to Shareholders A/c	Dr.	2,25,000	
	To Equity Share Capital A/c			2,25,000
	(Capitalisation of profit)			

Balance Sheet (Extract) as on 30th April, 2012 (after bonus issue)

		Particulars	Notes	Amount (Rs.)
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	1,205,000
	b	Reserves and Surplus	2	195,000
2		**Non-current liabilities**		
	a	Long-term borrowings	3	500,000
		Total		**1,900,000**

Notes to Accounts

1 Share Capital

Equity share capital	
Authorised share capital	
1,25,000 Equity shares of Rs. 10 each	12,50,000
Issued, subscribed and fully paid share capital 1,12,500 Equity shares of Rs. 10 each, fully paid (Out of above, 22,500 equity shares @ Rs. 10 each were issued by way of bonus) (A)	11,25,000
Preference share capital	
Authorised share capital	

	10,000 12% Preference shares of Rs. 10 each	1,00,000
	Issued, subscribed and fully paid share capital	
	8,000 12% Preference shares of Rs. 10 each (B)	80,000
	Total (A + B)	**12,05,000**
2	**Reserves and Surplus**	
	Capital Reserves	35,000
	Securities Premium Reserves	5,000
	Surplus (Profit & Loss Account)	1,55,000
	Total	**1,95,000**
3	**Long-term borrowings**	
	Secured	
	Secured12% Convertible Debentures @ Rs. 100 each(Out of above, 1,000 Debentures @ Rs. 100 each to be converted into 10,000 Equity shares @ Rs. 10 each on 1st July, 2011)	5,00,000
	Total	**500,000**

Working Notes

1. Capital reserve realised in cash can be utilised for issue of fully paid bonus shares.
2. As per SEBI guidelines, securities premium collected in cash can only be utilised for bonus issue.
3. It is assumed that the company will pass necessary resolution at its general body meeting for increasing the authorised capital. In anticipation, the authorised capital has been suitably increased as below:

Existing number of equity shares as authorised	1,00,000*
Add : Issue of bonus shares to equity shareholders	22,500
Add: Number of bonus shares to be issued to debenture holders after conversion	2,500
	1,25,000

*This figure covers the number of shares required for conversion of debentures.

4. As per para (*ii*) of SEBI guidelines, no company can issue bonus shares to its shareholders without extending similar benefit to convertible debenture holders. Pending such conversion, necessary number of shares should be earmarked for convertible debenture holders. Therefore, convertible debenture holders are also entitled to the bonus shares in the same ratio as the equity shareholders.

Summary

- Bonus Issue means an offer of free additional shares to existing shareholders. A company may decide to distribute further shares as an alternative to increasing the dividend payout.
- Bonus Issue is also known as a "scrip issue" or "capitalization issue".
- Bonus issue has following major effects :
  - ✓ Share capital gets increased according to the bonus issue ratio
  - ✓ Liquidity in the stock increases.
  - ✓ Effective Earnings per share, Book Value and other per share values stand reduced.
  - ✓ Markets take the action usually as a favourable act.
  - ✓ Market price gets adjusted on issue of bonus shares.
  - ✓ Accumulated profits get reduced.
- Bonus shares can be issued from following :
  - ✓ General reserves
  - ✓ Capital Reserve realised in cash
  - ✓ Securities Premium realised in cash