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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 securities 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.

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.

Subject to the provisions of the Companies Act, 1956 or any other applicable law for the time being in force, a listed issuer may issue bonus shares to its members if:

- (a) it is authorised by its articles of association for issue of bonus shares, capitalisation of reserves, etc.:
- Provided that if there is no such provision in the articles of association, the issuer shall pass a resolution at its general body meeting making provisions in the articles of association for capitalisation of reserve;
- (b) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
 - (c) it has sufficient reason to believe that it has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity and bonus;
 - (d) the partly paid shares, if any outstanding on the date of allotment, are made fully paid up

1.2.2 Restriction on bonus issue*

1. *No issuer shall make a bonus issue of equity shares unless it has made reservation of equity shares of the same class in favour of the holders of outstanding [compulsorily] convertible debt instruments [if any,] in proportion to the convertible part thereof.*

4.3 Accounting

2. *The equity shares [so] reserved for the holders of fully or partly [compulsorily] convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments on the same terms or same proportion [at] which the bonus shares were issued.*

**Amended vide SEBI (Issue of Capital and Disclosure Requirements) (Second Amendment) Regulations, 2012.*

1.2.3 Bonus shares only against reserves, etc. if capitalised in cash

1. *The bonus issue shall be made out of free reserves built out of the genuine profits or securities premium collected in cash only and reserves created by revaluation of fixed assets shall not be capitalised for the purpose of issuing bonus shares.*
2. *Without prejudice to the provisions of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, the bonus share shall not be issued in lieu of dividend.*

1.2.4 Completion of bonus issue

1. *An issuer, announcing a bonus issue after the approval of its board of directors and not requiring shareholders' approval for capitalisation of profits or reserves for making the bonus issue, 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 capitalisation of profits or reserves for making the bonus issue, the bonus issue shall be implemented within two months from the date of the meeting of its board of directors wherein the decision to announce the bonus issue was taken subject to shareholders' approval.

2. *Once the decision to make a bonus issue is announced, the issue can not be withdrawn.*

1.2.5 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.

1.2.6 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.

1.2.7 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.

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

4.5 Accounting

Illustration 1

Following items appear in the trial balance of Bharat Ltd. as on 31st March, 2012:

	₹
40,000 Equity shares of ₹ 10 each	4,00,000
Capital Reserve (including 30,000 being profit on sale of machinery)	75,000
Capital Redemption Reserve	25,000
Securities Premium	30,000
General Reserve	1,05,000
Surplus i.e. credit balance of Profit and Loss Account	50,000

The company decided to issue to equity shareholders bonus shares at the rate of 1 share for every 4 shares held and for this purpose, it decided that there should be the minimum reduction in free reserves. Pass necessary journal entries.

Solution

Journal Entries in the books of Bharat Ltd.

		Dr.	Cr.
		₹ in lakhs	₹ in lakhs
Capital Reserve A/c	Dr.	30,000	
Capital Redemption Reserve A/c	Dr.	25,000	
Securities Premium A/c	Dr.	30,000	
General Reserve A/c	Dr.	15,000	
To Bonus to Shareholders A/c			1,00,000
(Bonus issue of one share for every four shares held, by utilising various reserves as per Board's resolution dated.....)			
Bonus to Shareholders A/c	Dr.	1,00,000	
To Equity Share Capital A/c			1,00,000
(Capitalisation of profit)			

Note: Capital reserve amounting ₹ 30,000 realised in cash can only be used for bonus issue.

Illustration 2

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

		₹
Authorised capital :		
10,000 12% Preference shares of ₹ 10 each		1,00,000

1,00,000 Equity shares of ₹ 10 each	<u>10,00,000</u>
	<u>11,00,000</u>
Issued and Subscribed capital:	
8,000 12% Preference shares of ₹ 10 each fully paid	80,000
90,000 Equity shares of ₹ 10 each, ₹ 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 @ ₹ 100 each	5,00,000

On 1st April, 2012 the Company has made final call @ ₹ 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 ₹ 25,000 includes a premium of ₹ 5,000 for shares issued to vendors pursuant to a scheme of amalgamation. Capital reserves include ₹ 40,000, being profit on sale of plant and machinery. 20% of 12% debentures are convertible into equity shares of ₹ 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

2012		Dr. ₹	Cr. ₹
April 1	Equity Share Final Call A/c Dr. To Equity Share Capital A/c (Final call of ₹ 2 per share on 90,000 equity shares due as per Board's Resolution dated...)	1,80,000	1,80,000
April 20	Bank A/c Dr. To Equity Share Final Call A/c (Final Call money on 90,000 equity shares received)	1,80,000	1,80,000

4.7 Accounting

	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 (₹)
	Equity and Liabilities		
1	Shareholders' funds		
a	Share capital	1	12,05,000
b	Reserves and Surplus	2	1,95,000
2	Non-current liabilities		
a	Long-term borrowings	3	<u>5,00,000</u>
	Total		<u>19,00,000</u>

Notes to Accounts

1	Share Capital	
	Equity share capital	
	Authorised share capital	
	1,25,000 Equity shares of ₹ 10 each	<u>12,50,000</u>
	Issued, subscribed and fully paid share capital	
	1,12,500 Equity shares of ₹ 10 each, fully paid	
	(Out of above, 22,500 equity shares @ ₹ 10 each were issued by way of bonus) (A)	11,25,000
	Preference share capital	
	Authorised share capital	
	10,000 12% Preference shares of ₹ 10 each	<u>1,00,000</u>
	Issued, subscribed and fully paid share capital	
	8,000 12% Preference shares of ₹ 10 each (B)	<u>80,000</u>
	Total (A + B)	<u>12,05,000</u>

2	Reserves and Surplus		
	Capital Reserves	75,000	
	Less: Utilised for bonus issue	<u>(40,000)</u>	35,000
	Securities Premium	25,000	
	Less: Utilised for bonus issue	<u>(20,000)</u>	5,000
	General reserve	1,20,000	
	Less: Utilised for bonus issue	<u>(1,20,000)</u>	Nil
	Profit & Loss Account	2,00,000	
	Less: Utilised for bonus issue	<u>(45,000)</u>	<u>1,55,000</u>
	Total		<u>1,95,000</u>
3	Long-term borrowings		
	Secured		
	12% Convertible Debentures @ ₹ 100 each (Out of above, 1,000 Debentures @ ₹ 100 each to be converted into 10,000 Equity shares @ ₹ 10 each on 1st July, 2012)		<u>5,00,000</u>
	Total		<u>5,00,000</u>

Working Notes

- Capital reserve realised in cash can be utilised for issue of fully paid bonus shares.
- As per SEBI guidelines, securities premium collected in cash can only be utilised for bonus issue.
- 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*
<i>Add</i> : Issue of bonus shares to equity shareholders	22,500
<i>Add</i> : Number of bonus shares to be issued to debenture holders after conversion	<u>2,500</u>
	<u>1,25,000</u>

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

- As per 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
 - ✓ Capital Redemption Reserve
 - ✓ Profit & Loss Account