

EDEMPTION OF PREFERENCE SHARES

Q.A. 8

Section 80 requires that the preference shares can be redeemed only if the following conditions are satisfied:

- (1) Such shares must be fully paid up.
- (2) Such shares can be redeemed
 - (a) out of the proceeds of a fresh issue of equity or preference shares made for the purpose of redemption; or
 - (b) out of divisible profits i.e. profits which would otherwise be available for distribution of dividends;
 - (c) out of a combination of both.
- (3) Any premium payable on redemption of such shares shall be provided out of the Company's security premium account (including premium on the issue of debentures) or out of the Company's profits including both divisible and non-divisible profits, capital profits and capital reserve.
- (4) Where the shares are redeemed out of divisible profits, the face value of the shares so redeemed must be transferred to the Capital Redemption Reserve Account out of the divisible or distributable profits.
- (5) The amount credited to Capital Redemption Reserve

A/c may be used by the company for the issue of fully paid Bonus shares.

Meaning of some important terms

Proceeds from ~~the~~ fresh issue of shares

Where the nominal value of preference shares is redeemed partly out of the proceeds of a fresh issue and partly out of the divisible profits, the difference between the nominal value of the shares redeemed and the proceeds of the fresh issue must be transferred from the divisible profits to the Capital Redemption Reserve A/c. The accountants agree that the proceeds from fresh issue of shares means as follows:

<u>Fresh issue of shares</u>	<u>Proceeds</u>
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(i) Issued at par

Face value or nominal value of the shares issued.

(ii) Issued at premium

Face value or nominal value of the shares issued.

(iii) Issued at discount

Net amount received (i.e. face value - the amount of discount).

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Divisible profits (profits otherwise available for dividend distribution)

Transfer to Capital Reserve A/c is allowed from divisible profits as given below:

- (i) Surplus in the Profit and Loss Statement
- (ii) General reserve or any other free revenue reserve
- (iii) Dividend equalisation reserve or fund
- (iv) Reserve fund
- (v) Insurance fund or reserve*
- (vi) Workmen's compensation fund*
- (vii) Workmen's accident compensation fund*
- (viii) Contingency reserve*
- (ix) Provision or Reserve for doubtful debts*
- (x) Provision for taxation*

Note

* It may be noted that if there is any liability against these provisions or funds, then it should first be set off against the fund or reserve, and only the balance may be utilised for redeeming the nominal value of the preference shares.

Non-divisible profits (Profits not available for dividend distribution)

Transfer to Capital

Redemption Reserve A/c is not allowed from non-divisible profits as given below:

- (i) Securities premium A/c
- (ii) Shares Forfeited A/c
- (iii) Capital Reserve
- (iv) Capital Redemption Reserve (old or previous or opening balance)
- (v) Debenture Redemption Reserve
- (vi) Profits prior to incorporation
- (vii) Revaluation reserve (profit from appreciation in the value of fixed assets)
- (viii) Profit from sale of fixed assets
- (ix) Development rebate reserve*
- (x) Investment allowance reserve*

Note

* It may be noted that these two reserves are capital profits, but they are available for redemption of nominal value of preference shares to the extent of the amount stated in the examination problem but otherwise not.

12-6-2023

ACCOUNTING TREATMENT

REDEMPTION OF PREFERENCE SHARES

- (1) For making partly paid R.P. shares as fully paid
- i. final call A/c - Dr.
To R.P.S. Capital A/c --- Cr.
 - ii) Bank A/c ---- Dr.
To S.F. Call A/c --- Cr.
To Call-in-arrears - Cr.
(for money received
on call-in-arrears)
R.P.
- (2) For forfeiture of shares
(on which call-in-arrears are not paid
and re-issue)
- i) R.P. Share Capital A/c - Dr.
To Call-in-arrears - Cr.
To S. Forfeited A/c --- Cr.
 - ii) Bank A/c ---- Dr.
S. Forfeited A/c - Dr.
To R.P.S. Capital A/c - Cr.
 - iii) S. Forfeited A/c - Dr.
To C. Reserve A/c --- Cr.
- (3) For sale of fixed assets,
investments etc. to
provide cash for redemption
- Bank A/c --- Dr.
P&L A/c . . . Dr. (for loss
if any)
To Respective Asset A/c - Cr.
To P&L A/c ----- Cr
(for profit
if any)
- (4) For issue of debentures
to provide cash for
redemption
- Bank A/c --- Dr.
Discount on the
issue of debentures - Dr. (if any)
To Debentures A/c - - - Cr.
To Premium on
debentures A/c . . . Cr.
(if any)

- (5) For issue of new shares
for redemption out of
proceeds from the fresh issue
- i) Bank A/c - - - Dr.
To S. Application &
Allotment A/c - Cr.
 - ii) S. Application &
Allotment A/c - - - Dr.
Discount on issue
+ || of shares A/c --- Dr. (if
any)
To S. Capital A/c --- Cr.
To S. Premium A/c - Cr.
(if
any)
- (6) For transferring the
amount payable on
redemption
- R.P.S. Capital A/c - Dr.
Premium on
redemption of
preference shares A/c - Dr. (if
any)
To P. Shareholders A/c - Cr.
- (7) For making adjustment
for premium on redemption
- Security Premium A/c - Dr.
Capital Profit A/c - Dr.
General Reserve A/c - Dr.
Surplus A/c - - - Dr.
To Premium on
redemption of
preference shares A/c - Cr.
- (8) For the creation of
Capital Redemption Reserve
- Surplus A/c --- Dr.
Any other Revenue
Reserve A/c - - - Dr.
To Capital Redemption
Reserve A/c - - - Cr.

(9) For making payment on
redemption to preference
shareholders

Preference shareholders A/c Dr.
To Bank A/c --- Cr.

(10) For the arrangement
of Bank Overdraft for
making payment to
preference shareholders

Bank A/c --- Dr.
To Bank Overdraft
A/c --- Cr.

(11) For payment of expenses
on fresh issue of shares
or debentures

Expense on fresh
issue of shares or
debentures A/c --- Dr.

To Bank A/c --- Cr.

(12) For the issue of fully
paid bonus shares

(i) Capital Redemption

Reserve A/c --- Dr.

Security premium A/c Dr.

General reserve A/c Dr.

P & L A/c . . . Dr.

To Bonus Issue A/c --- Cr.

(ii) Bonus Issue A/c - Dr.

To L. Capital A/c --- Cr.

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Illustration 9 (Redemption of Preference Shares Partly Out of Profits and Partly from the Fresh Proceeds)

The following are the account balances of Abhipraya Limited as On 31 March 2013

Credit	₹	Debit	
5,000 12% Redeemable Preference Shares of ₹ 100 each	5,00,000	Fixed Assets	24,00,000
10,000 Equity Shares of ₹ 100 each	10,00,000	Stock	5,00,000
Capital Reserve	1,00,000	Debtors	50,000
Securities Premium Account	1,00,000	Cash	50,000
<u>General Reserve</u>	2,00,000		
<u>Surplus</u>	1,00,000		
Current Liabilities	10,00,000		
	30,00,000		30,00,000

The preference shares are to be redeemed on 1 April 2013 at 10 per cent premium. On 1 April 2013, a fresh issue of equity shares was made to the extent it is required under the Companies Act for the purpose of redemption of preference shares. The shortfall in cash resources for the purpose of redemption after utilising the proceeds of fresh issue was met by raising a bank loan, the cash balance of ₹ 50,000 being the minimum amount the company requires for its trading operations. Draft journal entries in the books of the company to record these transactions and prepare the balance sheet in the form prescribed by the Companies Act immediately after redemption. [B.Com. (Hons.) Delhi]

Solution