

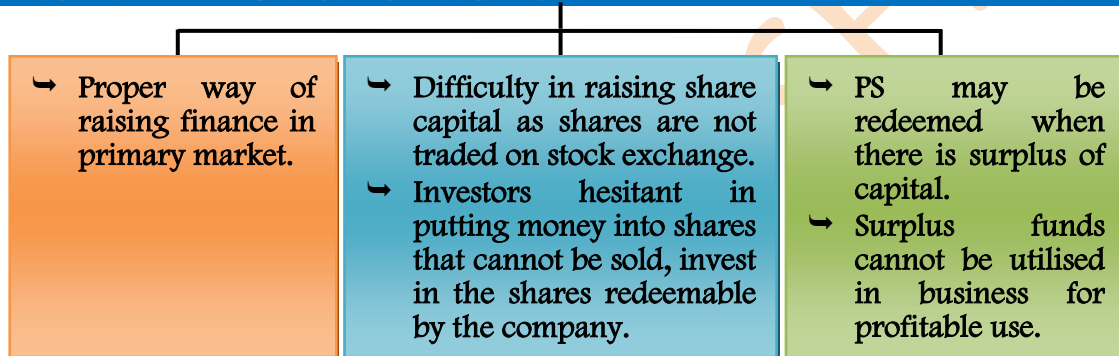


7. REDEMPTION OF PREFERENCE SHARES

CONCEPT 1 : INTRODUCTION

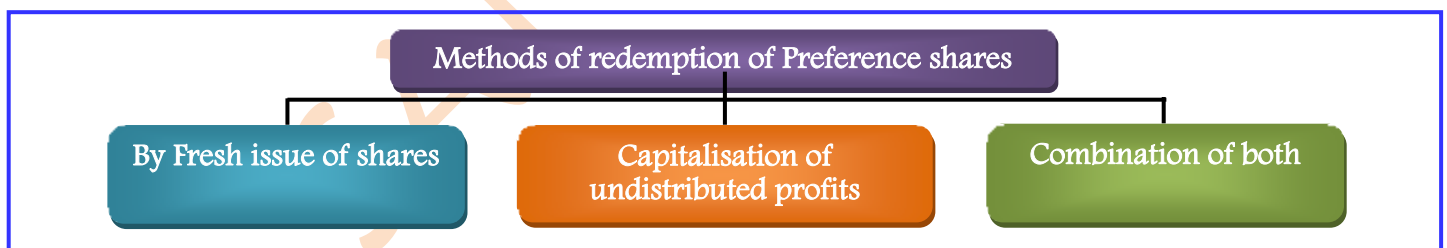
- Redemption is the process of repaying an obligation, at prearranged amounts and timings.
- It is a contract giving the right to redeem preference shares within or at the end of a given time period at an agreed price.
- Shareholders will be repaid at a future date, the amount which they invested in the company (along with frequent payment as return on investment)
- The redemption date is the maturity date on which repayment takes place.
- The redemption date is printed on the preference share certificate.
- A company can adjust its financial structure by eliminating PS & replacing it with other securities if it is advantageous.
- A company cannot issue irredeemable preference shares.

CONCEPT 2 : PURPOSE OF ISSUING REDEEMABLE PREFERENCE SHARES



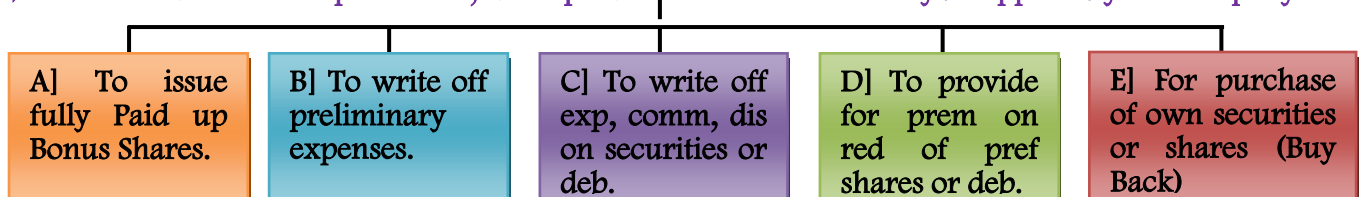
- In India, issue & redemption of preference shares is governed by Section 55 of the Companies Act, 2013.

CONCEPT 3 : METHODS OF REDEMPTION OF FULLY PAID-UP SHARES



[a] Redemption of Preference Shares by Fresh Issue of Shares :

- The proceeds from issue of debentures cannot be utilised for the purpose.
- When a fresh issue is made for the purpose of redemption of preference shares at a premium, the question arises whether the proceeds of a fresh issue of shares will include the amount of securities premium (SP) for the purpose of redemption of preference shares or not.
- Section 52 of the Companies Act, 2013 provides that the SPA/c may be applied by the company:

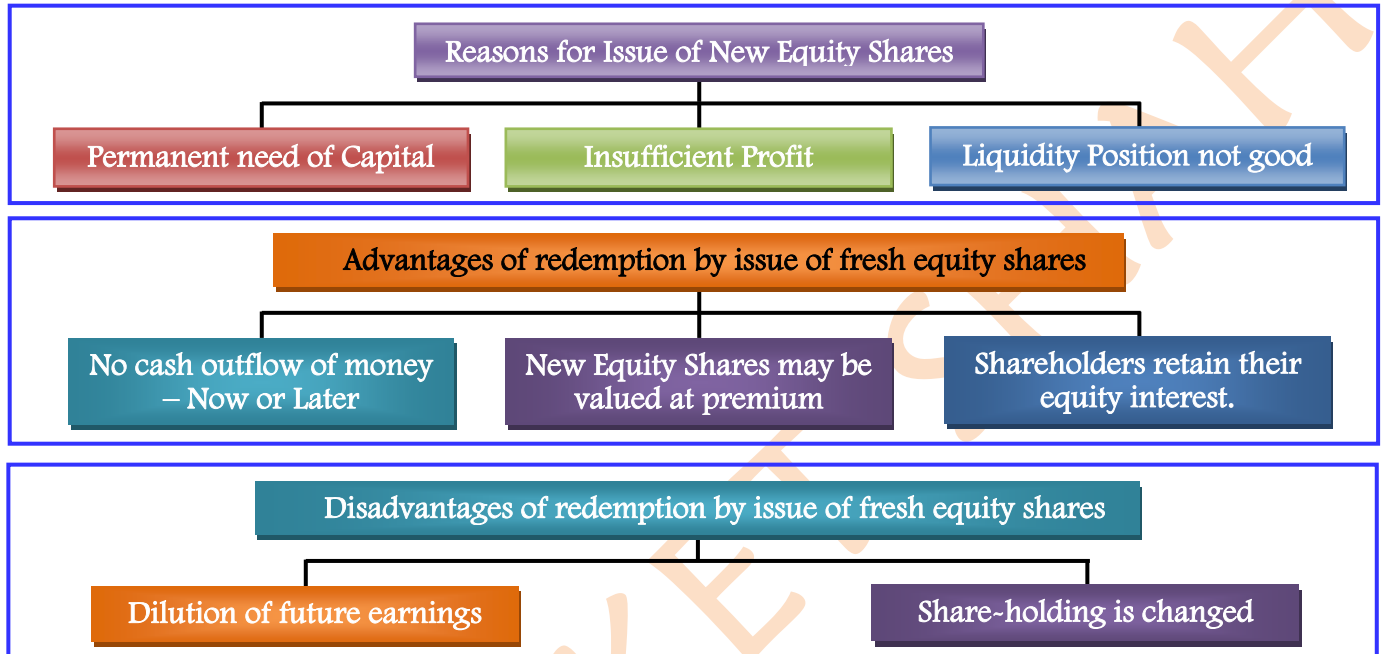




✍ Notes :

- [1] Companies whose financial statements comply with AS prescribed u/s 133 of the Companies Act, 2013, can't apply SP A/c for the purposes (b) and (d) mentioned above.
- [2] All questions have been solved on the basis that the companies referred in questions comply with AS prescribed u/s 133. So, SP A/c has not been utilized for the purpose of pref payable on red of pref share.

➤ Thus, the proceeds of a fresh issue of shares will not include the amount of SP for the purpose of redemption of preference shares.

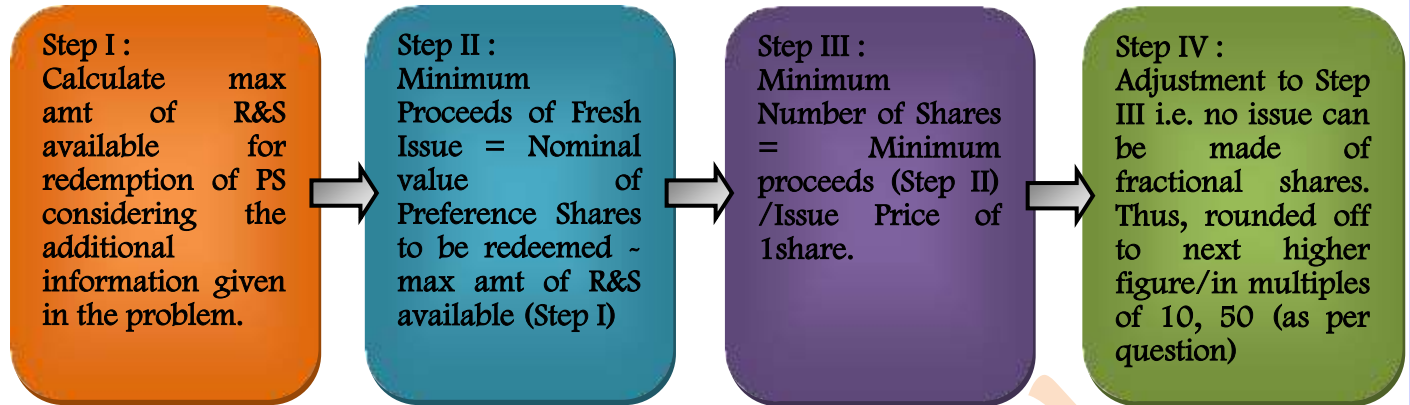


★ Accounting Entries:

Sr. no.	Particulars	Dr. (₹)	Cr. (₹)
1]	When new shares are issued at par		
	Bank Account Dr.		
	To Share Capital Account		
2]	When new shares are issued at a premium		
	Bank Account Dr.		
	To Share Capital Account		
	To Securities Premium Account		
3]	When preference shares are redeemed at par		
	Redeemable Preference Share Capital Account Dr.		
	To Preference Shareholders Account		
4]	When preference shares are redeemed at a premium		
	Redeemable Preference Share Capital Account Dr.		
	Premium on Redemption of Preference Shares Account Dr.		
	To Preference Shareholders Account		
5]	When payment is made to preference shareholders		
	Preference Shareholders Account Dr.		
	To Bank Account		
6]	For adjustment of premium on redemption		
	Profit and Loss Account Dr.		
	To Premium on Redemption of Preference Shares Account		

★ Calculation of Minimum Fresh Issue of Shares :

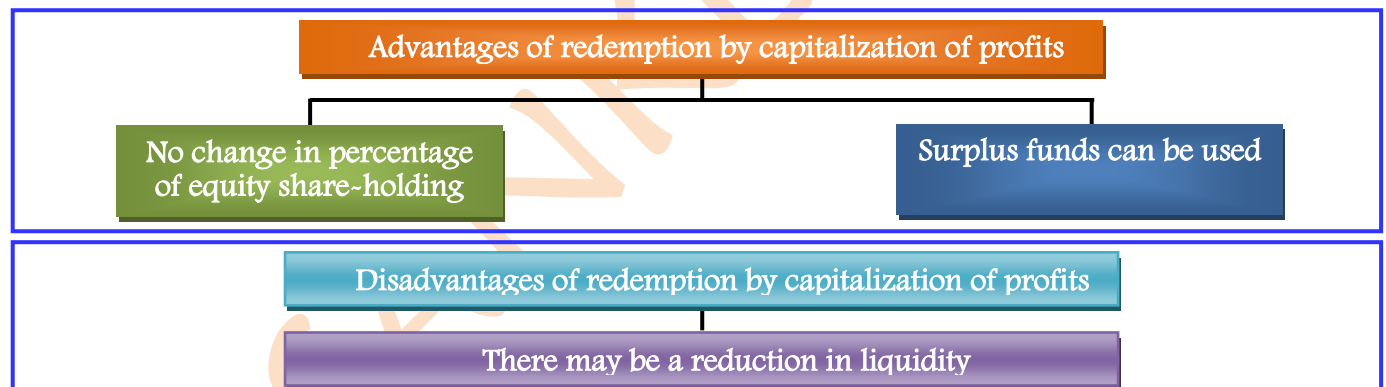
- If examination problem does not specify the no. of shares to be issued for the purpose of redemption, the minimum number of shares should be issued following the four steps as given below :

[b] Redemption of Preference Shares by Capitalisation of Undistributed Profits :

- Another method is to use the distributable profits in place of issuing new shares.
- When shares are redeemed by utilising distributable profit, an amount equal to the face value of shares redeemed is transferred to Capital Redemption Reserve Account (CRR) by debiting the distributable profit.

✎ The provisions of the Companies Act state that :

- ▶ 'When any such shares are redeemed otherwise than out of the proceeds of a fresh issue, there shall out of profits which would otherwise have been available for dividend, be transferred to a reserve fund to be called the CRR A/c sum equal to the nominal amount of the shares redeemed'.

★ Accounting Entries :

Sr. No	Particulars	Dr. (₹)	Cr. (₹)
1]	When shares are redeemed at par		
	Redeemable Preference Share Capital Account Dr.		
	To Preference Shareholders Account		
2]	When shares are redeemed at a premium		
	Redeemable Preference Share Capital Account Dr.		
	Premium on Redemptions of Preference Shares Account Dr.		
	To Preference Shareholders Account		
3]	When payment is made to preference shareholders		
	Preference Shareholders Account Dr.		
	To Bank Account		
4]	For adjustment of premium of redemption		
	Profit and Loss Account Dr.		
	To Premium on Redemption of Preference Shares Account		



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For transferring nominal amount of shares redeemed to CRR Account		
General Reserve Account	Dr.	
Profit and Loss Account	Dr.	
To Capital Redemption Reserve Account		

Formula :

Sr. No	Particulars	₹
i]	Amount to be Transferred to Capital Redemption Reserve	
	Face value of shares redeemed	xxx
	Less: Proceeds from new issue	xxx
		xxx
ii]	Proceeds to be collected from New Issue	
	Face value of shares redeemed	xxx
	Less: Profits available for distribution as dividend	xxx
		xxx

- ↳ Companies may have sufficient investments, which can be sold, in the market to arrange funds for redemption of preference shares.

➤ One of the conditions of redemption is that only fully paid up preference shares can be redeemed.

[1] If examination problem states that it is decided to redeem partly called up pref shares, then it is assumed that final call on these shares is demanded & recd before proceeding with redemption of these shares.

[2] If information of both fully & partly paid pref shares is provided, then, only fully paid shares are redeemed.

★ When calls-in-arrears is received by the company :

Bank A/c Dr.
To Calls-in-Arrears A/c

➤ After receipt of calls in arrears, the shares become fully paid up.

Now, the company can proceed with redemption in the normal course.

- ➡ If the shareholders fail to pay the unpaid calls after getting proper notice, the BOD may decide to forfeit and cancel these shares instead of reissuing the forfeited shares.

👉 This is because redemption of these shares is due immediately or in near future.

➡ In this case, entry for forfeiture is passed as usual.
