

# **REDEMPTION OF PREFERENCE SHARES**

## **LEARNING OBJECTIVES**

- ❖ To understand the intension of issuing redeemable preference shares
- ❖ To understand the meaning of redemption
- ❖ To understand the provisions of the Companies Act, 2013 regarding the issue and redemption of redeemable preference shares
- ❖ To understand the methods of redemption
- ❖ To understand the need for the creation of Capital Redemption Reserve Account

Redemption is nothing but repayment of the financial obligations. The redeemable preference shares are redeemed within or at the end of a fixed period at an agreed price. The redeemable preference shares are issued by mentioning the terms of repayment. The date of repayment is also called maturity date. It is generally printed on the share certificate.

## **WHY THE REDEEMABLE PREFERENCE SHARES ARE ISSUED BY THE COMPANY?**

The company issues redeemable preference shares due to the following reasons:

- ✓ When the primary market is not attractive to raise finance
- ✓ When the equity market is not in favour of company, issuing of redeemable preference shares will be best suited
- ✓ When the company faces over capitalized situation, redemption of preference shares will be opted for.

## **PROVISIONS OF COMPANIES ACT OF 2013**

A joint stock company limited by shares at its option may issue redeemable preference shares not exceeding 20 years of maturity from the date of issue that too when its articles of association permits.

**Following are the provisions under section 55:**

1. Only fully paid shares are to be redeemed
2. Shares are to be redeemed out of the proceeds of fresh issue or from the divisible profits or from both
3. When the shares are redeemed out of divisible profits, the nominal amount redeemed from the divisible profit must be transferred to Capital Redemption Reserve Account
4. Fresh issue can be made at par, premium or discount
5. Redemption of preference shares may be made at par or at premium but not at a discount

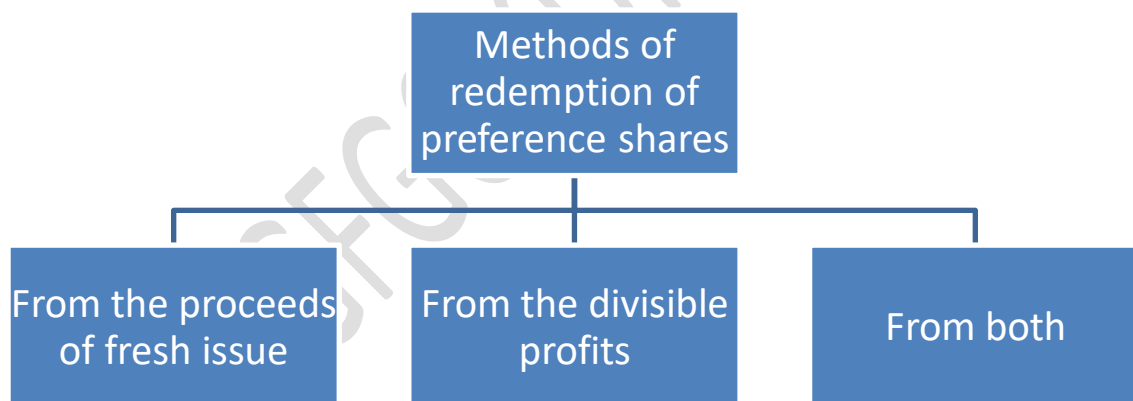
6. When the preference shares are redeemed at premium, the premium on redemption must be utilised from the balance in the Security Premium Account. If the Security Premium Account is not available or the balance is insufficient to pay the premium on redemption, then for the balance, divisible profit is to be used.

### **REDEMPTION OF PREFERENCE SHARES FROM THE PROCEEDS OF FRESH ISSUE OF SHARES:**

This is one of the methods of redeeming the preference shares. The company in order to redeem its preference shares may issue new equity shares or preference shares.

**Section 52 of the Companies Act, 2013, the Securities Account is to be utilised for the following purposes:**

- To issue fully paid bonus shares to the members
- To write off the expenses/commission/ discount in connection with the securities issued by the company
- To write off preliminary expenses
- In order to facilitate buyback of shares by the company
- To provide for the premium on redemption of preference shares or debentures



### **Why and when the company will opt for the redemption from the proceeds of fresh issue?**

If the company wishes to reduce its paying burden of fixed dividend (as the preference shares carries fixed rate of dividend) and if the company wants to raise capital, it may resort to the issue of fresh equity shares replacing the already existing preference shares.

In addition to this, if the company has an insufficient balance in the divisible profits to redeem the preference shares fully, it may resort to the issuing of fresh shares.

As the company gets cash from fresh issue its liquidity position becomes good.

## **DIVISIBLE PROFITS**

The profits available in the company not distributed that is, retained which is otherwise available for distribution as dividend among shareholders is called divisible profits. In other words, it is that portion of undistributed profits not declared as dividend but retained in the business. This profit is also called distributable profits.

### **Examples for divisible profits:**

- ✓ General Reserve/Reserve Fund
- ✓ Dividend Equalisation Fund
- ✓ Profit and loss Account balance (credit)
- ✓ Investment Fluctuation Fund
- ✓ Workmen's Compensation Fund
- ✓ Insurance Fund
- ✓ Contingency Reserve
- ✓ Provision for Doubtful Debts
- ✓ Provision for Taxation

### **Following are the profits retained but not considered as divisible profits:**

- ❖ Capital Reserve
- ❖ Securities Premium
- ❖ Capital Redemption Reserve
- ❖ Debenture Redemption Fund or Sinking Fund

**ACCOUNTING TREATMENT:****JOURNAL ENTRIES****I. For the issue of shares (in order to enable the company redeem the preference shares from the proceeds of fresh issue)****a. When the new shares are issued at par:**

Date	Particulars	L.F.	Debit	Credit
	Bank A/C Dr <p style="text-align: right;">To Equity Share Capital A/C</p> (Being the entry for the issue of ..... no. of new shares of Rs..... each)		XXX	XXX

**b. When the new shares are issued at a premium:**

Date	Particulars	L.F.	Debit	Credit
	Bank A/C Dr <p style="text-align: right;">To Equity Share Capital A/C To Security Premium A/C</p> (Being the entry for the issue of ..... no. of new shares of Rs..... each at a premium of .....)		XXX	XXX XXX

**c. When the new shares are issued at a discount:**

Date	Particulars	L.F.	Debit	Credit
	Bank A/C Dr Discount on Issue of Shares A/C Dr <p style="text-align: right;">To Equity Share Capital A/C</p> (Being the entry for the issue of ..... no. of new shares of Rs..... each at a discount of ....)		XXX XXX	XXX

**II. For the redemption of preference shares:****a. When the preference shares are redeemed at par:**

Date	Particulars	L.F.	Debit	Credit
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	Redeemable Preference Share Capital A/c Dr To Redeemable Preference Share holders A/C (Being the entry for the transfer of preference share capital to redeemable preference shareholders )		XXX	XXX
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**b. When the preference shares are redeemed at a premium:**

Date	Particulars	L.F.	Debit	Credit
	Redeemable Preference Share Capital A/c Dr Premium on Redemption of Preference shares A/c Dr To Redeemable Preference Share holders A/C (Being the entry for the transfer of preference share capital to redeemable preference shareholders )		XXX XXX	XXX

**c. For the final payment made to preference shareholders:**

Date	Particulars	L.F.	Debit	Credit
	Redeemable Preference Shareholders A/C Dr To Bank A/C (Being the entry for the final payment made to redeemable preference shareholders )		XXX	XXX

**III. For the adjustment of Premium on Redemption of Preference Shares:**

**a. If adjusted from Security Premium Account:**

Date	Particulars	L.F.	Debit	Credit
	Security Premium A/C Dr To Premium on Redemption of Preference shares A/c (Being the entry for the premium on redemption of preference shares adjusted from security premium account)		XXX	XXX

**Note:** For providing the Premium on Redemption of Preference shares the first preference is to be given to the balance available in Securities Premium Account

**b. If adjusted from divisible profits:**

Date	Particulars	L.F.	Debit	Credit
	Concerned Divisible profits A/C Dr To Premium on Redemption of Preference shares A/c (Being the entry for the premium on redemption of preference shares adjusted from ..... *** account)		XXX	XXX

\*\*\* Concerned Divisible Profits Account and it may be General Reserve Account, Profit and Loss Account, etc.

**IV. For the nominal amount if redeemed from the divisible profits:**

Date	Particulars	L.F.	Debit	Credit
	Concerned Divisible Profits A/C Dr To Capital Redemption Reserve Account A/c (Being the entry for the nominal amount redeemed from the divisible profits transferred to Capital Redemption Reserve Account)		XXX	XXX

\*\*\* Concerned Divisible Profits Account and it may be General Reserve Account, Profit and Loss Account, etc.

**V. For the declaration and issue of bonus shares to equity shareholders:**

**a. For the declaration of bonus to equity shareholders:**

Date	Particulars	L.F.	Debit	Credit
	Capital Redemption Reserve Account Dr To Bonus to Equity Shareholders A/c (Being the entry for the declaration of bonus shares to equity shareholders)		XXX	XXX

Note: Declaration of bonus to equity shareholders need to be from Capital Redemption Reserve Account

**b. For the issue of bonus shares:**

Date	Particulars	L.F.	Debit	Credit
	Bonus to Equity Shareholders A/C Dr To Equity Share Capital A/c (Being the entry for the issue of bonus shares to equity shareholders)		XXX	XXX