CHAPTER 12

REDEMPTION OF PREFERENCE SHARES

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.
- These shares are issued on the terms that shareholders will at a future date be repaid the amount which they invested in the company (along with frequent payment of a specified amount as return on investment during the tenure of the preference shares).
- The redemption date is the maturity date, which specifies when repayment takes place and is usually printed on the preference share certificate.

PURPOSE OF ISSUING REDEEMABLE PREFERENCE SHARES

A company may face difficulty in raising share capital, as its shares are not traded on the stock exchange. Potential investors, hesitant in putting money into shares that cannot easily be sold, may be encouraged to invest if the shares are redeemable by the company.

PROVISIONS OF THE COMPANIES ACT (SECTION 55)

A company limited by shares if so authorised by its Articles, may issue preference shares which at the option of the company, are liable to be redeemed within a period, normally not exceeding 20 years from the date of their issue. Thus, a company cannot issue irredeemable preference shares. It should be noted that:

(a) no shares can be redeemed except out of profit of the company which would otherwise be available for dividend or out of proceeds of fresh issue of shares made for the purpose of redemption;

(b) no such shares can be redeemed unless they are fully paid;

(c) the premium, if any, payable on redemption shall be provided for out of the profits of the company or out of the company's securities premium account, before the shares are redeemed:

(d) where any such shares are proposed to be redeemed out of the profits of the company, there shall, out of profits which would otherwise have been available for dividends, be transferred to a reserve account to be called Capital Redemption Reserve Account, a sum equal to the nominal amount of the shares redeemed.

(e) The utilisation of CRR Account is further restricted to issuance of fully paid-up bonus shares only.

Important Note:

From the legal provision outlined above, it is apparent that on the redemption of redeemable preference shares out of accumulated profits it will be necessary to transfer to the Capital Redemption Reserve Account an amount equal to the amount repaid on the redemption of preference shares on account of face value less proceeds of a fresh issue of capital made for the purpose of redemption. The object is that with the repayment of redeemable preference shares, the security for creditors/ bankers, etc. should not be reduced. At times, a part of the preference share capital may be redeemed out of accumulated profits and the balance out of a fresh issue.

Section 55 of the Companies Act, 2013, deals with provisions relating to redemption of preference shares. It ensures that there is no reduction in shareholders' funds due to redemption and, thus, the interest of outsiders is not affected. **For this, it requires that either fresh issue of shares is made or distributable profits are retained and transferred to 'Capital Redemption Reserve Account'.**

The rationale behind these provisions is to protect the interest of outsiders to whom the amount is payable before redemption of preference share capital.
In case of redemption of preference shares out of proceeds of a fresh issue of shares, replacement of capital and tangible assets is obvious. But, if redemption is done out of distributable profits, replacement of capital is ensured in an indirect manner by retention of profit by transfer to Capital Redemption Reserve. In this case, the amount which would have gone to shareholders in the form of dividend is retained in the business and is used for settling the claim of preference shareholders.
Thus, there is no additional claim on net assets of the Company. The transfer of divisible profits to Capital Redemption Reserve makes them non-distributable profits. As Capital Redemption Reserve can be used only for issue of fully paid bonus shares, profits retained in the business ultimately get converted into share capital.

From the above paras, it can be concluded that the 'gap' created in the company's capital by the redemption of redeemable preference shares much be filled in by:
(a) the proceeds of a fresh issue of shares;
(b) the capitalisation of undistributed profits; or
(c) a combination of (a) and (b).

METHOD - 1

REDEMPTION OF PREFERENCE SHARES BY FRESH ISSUE OF SHARES

One of the methods for redemption of preference shares is to use the proceeds of a fresh issue of shares. A company can issue new shares (equity share or preference share) and the proceeds from such new shares can be used for redemption of preference shares.

The proceeds from issue of debentures cannot be utilised for the purpose.
A problem arises when a fresh issue is made for the purpose of redemption of preference shares, at a premium. The point to ponder is that whether the proceeds of a fresh issue of shares will include the amount of securities premium for the purpose of redemption of preference shares.

For securities premium account, Section 52 of the Companies Act, 2013 provides that the securities premium account may be applied by the company;
(a) Towards issue of un-issued shares of the company to be issued to members of the company as fully paid bonus securities
(b) To write off preliminary expenses of the company
(c) To write off the expenses of, or commission paid, or discount allowed on any of the securities or debentures of the company
(d) To provide for premium on the redemption of redeemable preference shares or debentures of the company.

(e) For the purchase of its own shares or other securities.

Note: If may be noted that certain class of Companies whose financial statements comply with the Accounting Standards as prescribed under Section 133 of the Companies Act, 2013, can't apply the securities premium account for the purposes (b) and (d) mentioned above.

Note: All the questions in this chapter have been solved on the basis that the companies referred in the questions are governed by Section 133 of the Companies Act, 2013 and comply with the Accounting Standards prescribed for them. **Accordingly the balance in securities premium account has not been utilized for the purpose of premium payable on redemption of preference shares**.

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

Reasons for issue of New Equity Shares

A company may prefer issue of new equity shares for the following reasons:

(a) When the company has come to realise that the capital is needed permanently and it makes more sense to issue Equity Shares in place of Redeemable Preference Shares which carry a fixed rate of dividend.

(b) When the balance of profit, which would otherwise be available for dividend, is insufficient.

(c) When the liquidity position of the company is not good enough.

Disadvantages of redemption of preference shares by issue of fresh equity shares

The disadvantages are:

(1) There will be dilution of future earnings;

(2) Share-holding in the company is changed.

Accounting Entries

1. When new shares are issued at par	Bank Account Dr. To Share Capital Account (Being the issue of ....shares of Rs......each for the purpose of redemption of preference shares, as per Board's Resolution No...... dated.......)
2. When new shares are issued at a premium	Bank Account Dr. To Share Capital Account To Securities Premium Account (Being the issue of ....shares of Rs......each at a premium of Rs......each for the purpose of redemption of preference shares as per Board's Resolution No..... Dated......)
3. When preference shares are redeemed at par	Preference Share Capital Account Dr. To Preference Shareholders Account
4. When preference shares are redeemed at a premium	Preference Share Capital Account Dr. Premium on Redemp of Pref. Shares A/c 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 Redemp. of Pref. Shares A/c

Calculation of Minimum Fresh Issue of Shares

Sometimes, examination problem does not specify the number of shares to be issued for the purpose of redemption of preference shares and requires that the minimum number of shares should be issued to ensure that provisions of Section 55 of the Companies Act, 2013, are not violated. This is done in four steps as given below:

(1) In such cases, the maximum amount of reserves and surplus available for redemption is ascertained taking into account the balances appearing in the balance sheet before redemption and the additional information provided in the problem. For example, if balance of general reserve in the balance sheet is Rs1,00,000 and additional information provides that the Board of Directors have decided that the balance of general reserve should not be less than Rs40,000 under any circumstances, then, the maximum amount of general reserve available for redemption is Rs60,000.

(2) After ascertaining the maximum amount of reserves and surplus available for redemption, adjustment for premium on redemption payable out of profits is made and then it is compared with the nominal value of shares to be redeemed. By comparison, one gets the minimum proceeds of fresh issue as Section 55 permits redemption either out of proceeds of fresh issue or out of divisible profits.

    Thus, Minimum Proceeds of Fresh Issue of shares =

    Nominal value of preference shares to be redeemed – Maximum amount of reserve and surplus available for redemption.

(3) After computation of minimum proceeds, the minimum number of shares to be issued are determined by dividing minimum proceeds by the proceeds of one share. This is done as follows:

    Minimum Number of Shares = Minimum proceeds to comply with Section 55/ face value of one share

    Proceeds of one share mean the par value of a share issued, if it is issued at par or premium. However, in case of issue of share at a discount, it refers to the discounted value.

(4) Minimum number of shares calculated as per (3) above, needs to be adjusted due to various reasons. Firstly, shares fractions cannot be issued. Thus, if minimum number of shares as per (3) above includes a fraction, it must be approximated to the next higher figure to ensure that provisions of Section 55 are not violated. Secondly, if the examination problem states that the proceeds/number of shares should be a multiple of say, 10 or 50 or 100, then again the next higher multiple should be considered.

Fresh Issue at a Premium and Minimum Fresh Issue

The calculation of minimum number of shares, when fresh issue is at a premium should be handled very carefully Minimum fresh issue cannot be calculated unless one knows the profits available for replacement of preference shares and profit available for replacement cannot be determined unless one knows the portion of profit available for redemption which is required for paying premium on redemption. To tackle this, assume that profits available for redemption is not required for paying premium on redemption of preference shares. In other words, it means that securities premium including premium on fresh issue is comparatively more than premium on redemption.

If the above assumption holds good, minimum number of shares can be calculated in a simple manner without use of equation. But, if above condition does not hold good, then an equation is used to determine the minimum number of shares.

Minimum Fresh Issue to Provide Funds for Redemption

Besides, ensuring compliance with Section 55, the fresh issue of shares is made to provide funds for making payment to preference shareholders. To calculate minimum number of fresh shares to be issued to provide funds, amount payable to preference shareholders is compared with funds available for redemption and the balance of funds to be raised by fresh issue of shares are calculated. The amount to be raised is divided by the issue price of a share (amount payable by shareholder including premium, if any, on fresh issue) to compute the minimum number of shares to be issued.

METHOD - 2

REDEMPTION OF PREFERENCE SHARES BY CAPITALISATION OF UNDISTRIBUTED PROFITS

Another method for redemption of preference shares, as per the Companies Act, 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 by debiting the distributable profit. In other words, some of the distributable profits are kept aside to ensure that it can never be distributed to shareholders as dividend.

In this connection, 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 Capital Redemption Reserve Account sum equal to the nominal amount of the shares redeemed'.

Advantages of redemption of preference shares by capitalisation of undistributed profits

The advantages of redemption of preference shares by capitalisation of undistributed profits are:

(1) No change in the percentage of equity share-holding of the company;

(2) Surplus funds can be used.

Disadvantages of redemption of preference shares by capitalisation of undistributed profits

The disadvantage of redemption of preference shares by capitalisation of undistributed profits is that there may be a reduction in liquidity.

Accounting Entries

1. When shares are redeemed at par	Redeemable Preference Share Capital Account Dr. To Preference Shareholders Account (Being the amount payable on redemption of preference shares transferred 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 (Being the amount payable on redemption transferred to Preference Shareholders Account)
3. When payment is made to preference shareholders	Preference Shareholders Account Dr. To Bank Account (Being the payment to preference shareholders as per terms)
4. For adjustment of premium of redemption	Profit and Loss Account Dr. To Premium on Redemption of Preference Shares Account (Being the premium on redemption adjusted against Profit and Loss Account)
5. For transferring nominal amount of shares redeemed to Capital Redemption Reserve Account	General Reserve Account Dr. Profit and Loss Account Dr. To Capital Redemption Reserve Account (Being the amount transferred to Capital Redemption Reserve Account as per the requirement of the Act).

REDEMPTION OF PREFERENCE SHARES BY COMBINATION OF FRESH ISSUE AND CAPITALISATION OF UNDISTRIBUTED PROFITS

A company can redeem the preference shares partly from the proceeds from new issue and partly out of profits. In order to fill in the 'gap' between the face value of shares redeemed and the proceeds of new issue, a transfer should be made from distributable profits (Profit & Loss Account, General Reserve and other Free Reserves) to Capital Redemption Reserve Account.

(i) Amount to be Transferred to Capital Redemption Reserve	
Face value of shares redeemed	***
Less: Proceeds from new issue	***
	***

(ii) Proceeds to be collected from New Issue	
Face value of shares redeemed	***
Less: Profits available for distribution as dividend	***
	***

SALE OF INVESTMENTS TO PROVIDE SUFFICIENT FUNDS FOR REDEMPTION

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

REDEMPTION OF PARTLY CALLED-UP PREFERENCE SHARES

One of the conditions of redemption is that only fully paid up preference shares can be redeemed by a company. If the examination problem states that it is decided to redeem preference shares which are partly called up, then it is assumed that final call on these shares is demanded and received before proceeding with redemption of these shares. If information about both fully paid and partly paid preference shares is provided, then, only fully paid shares are redeemed.

REDEMPTION OF FULLY CALLED BUT PARTLY PAID-UP PREFERENCE SHARES

The problem of unpaid calls on fully called up shares may be studied under following categories:

WHEN CALLS-IN-ARREARS IS RECEIVED BY THE COMPANY

If the amount of unpaid calls is received by the Company before redemption, the entry passed is as under: Bank A/c Dr. to Calls-in-Arrears A/c After receipt of calls in arrears, the shares become fully paid up and, then, company can proceed with redemption in the normal course.

IN CASE OF FORFEITED SHARES

If, on getting a proper notice from the company, the shareholders fail to pay the unpaid calls, the Board of Directors may decide to forfeit the shares and cancel these shares instead of reissuing the forfeited shares because redemption of these shares is due immediately or in near future. In this case, entry for forfeiture is passed as usual.

IMPROTANT QUESTION

Question – 1.
C Ltd. had 10,000, 10% Redeemable Preference Shares of Rs 100 each, fully paid up. The company decided to redeem these preference shares at par, by issue of sufficient number of equity shares of Rs 10 each at a premium of Rs 2 per share as fully paid up. You are required to pass necessary Journal Entries including cash transactions in the books of the company.

Solution:

In the books of C Ltd.
Journal Entries

Particulars	Dr. (Rs)	Cr. (Rs)
Bank A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (Being the issue of 1,00,000 Equity Shares of Rs 10 each at a premium of Rs 2 per share as per Board's Resolution No..... dated)	12,00,000	 10,00,000 2,00,000
10% Redeemable Preference Share Capital A/c Dr. To Preference Shareholders A/c (Being the amount payable on redemption of preference shares transferred to Preference Shareholders A/c)	10,00,000	 10,00,000
Preference Shareholders A/c Dr. To Bank A/c (Being the amount paid on redemption of preference shares)	10,00,000	 10,00,000

Note: Amount required for redemption is Rs 10,00,000. Therefore, face value of equity shares to be issued for this purpose must be equal to Rs 10,00,000. Premium received on new issue cannot be used to finance the redemption.

Question - 2.
G India Ltd. had 9,000 10% redeemable Preference Shares of Rs 10 each, fully paid up. The company decided to redeem these preference shares at par by the issue of sufficient number of equity shares of Rs 9 each fully paid up.
You are required to pass necessary Journal Entries including cash transactions in the books of the company.

Solution:

In the books of G India Limited
Journal

Particulars	Dr. (Rs)	Cr. (Rs)

Bank A/c Dr. To Equity Share Capital A/c (Being the issue of 10,000 Equity Shares of Rs 9 each at par, as per Board's Resolution No.......Dated.....)	90,000	90,000
10% Redeemable Preference Shares Capital A/c Dr. To Preference Shareholders A/c (Being the amount payable on redemption of preference shares transferred to Preference Shareholders A/c)	90,000	90,000
Preference Shareholders A/c Dr. To Bank A/c (Being the amount paid on redemption of preference shares)	90,000	90,000

Question - 3.

The Board of Directors of a Company decide to issue minimum number of equity shares of Rs 9 to redeem Rs 5,00,000 preference shares. The maximum amount of divisible profits available for redemption is Rs 3,00,000. Calculate the number of shares to be issued by the company to ensure that provisions of Section 55 are not violated. Also determine the number of shares if the company decides to issue shares in multiples of Rs 50 only.

Solution:

Particulars	Amount
Nominal value of preference shares	5,00,000
Maximum possible redemption out of profits	3,00,000
Minimum proceeds of fresh issue Rs(5,00,000 – 3,00,000)	2,00,000
Proceed of one share = Rs 9	9
Minimum number of shares = $\frac{2,00,000}{9}$	**22,222.22 shares.**

As fractional shares are not permitted, the minimum number of shares to be issued is 22,223 shares.

If shares are to be issued in multiples of 50, then the next higher figure which is a multiple of 50 is 22,250. Hence, minimum number of shares to be issued in such a case is 22,250 shares.

Question – 4.

The Balance Sheet of X Ltd. as on 31st March, 20X3 is as follows:

	Particulars	Rs
	EQUITY AND LIABILITIES	
1.	***Shareholders' funds***	
	Share capital	*2,90,000*
	Reserves and Surplus	*48,000*
2.	***Current liabilities***	
	Trade Payables	
	Total	***3,94,500***
	ASSETS	
1.	***PPE***	
	Tangible asset	*3,45,000*
	Non-current investments	*18,500*
2.	***Current Assets***	

	Cash and cash equivalents (bank)	*31,000*
	Total	***3,94,500***

The share capital of the company consists of Rs 50 each equity shares of Rs 2,25,000 and Rs 100 each Preference shares of Rs 65,000(issued on 1.4.20X1). Reserves and Surplus comprises Profit and Loss Account only.

In order to facilitate the redemption of preference shares at a premium of 10%, the Company decided:

(a) to sell all the investments for Rs 15,000.

(b) to finance part of redemption from company funds, subject to, leaving a bank balance of Rs 12,000.

(c) to issue minimum equity share of Rs 60 each share to raise the balance of funds required.

You are required to pass:

The necessary Journal Entries to record the above transactions and prepare the balance sheet as on completion of the above transactions.

Solution:

Journal

In the books of X Ltd

Particulars	Dr. (Rs)	Cr. (Rs)
Bank A/c Dr. To Share Application A/c (For application money received on 625 shares @ Rs 60 per share)	37,500	 37,500
Share Application A/c Dr. To Equity Share Capital A/c (For disposition of application money received)	37,500	 37,500
Preference Share Capital A/c Dr. Premium on Redemption of Preference Shares A/c . To Preference Shareholders A/c (For amount payable on redemption of preference shares)	65,000 6,500	 71,500
Profit and Loss A/c Dr. To Premium on Redemption of Preference Shares A/c (For writing off premium on redemption out of profits)	6,500	 6,500
Bank A/c Dr. Profit and Loss A/c (loss on sale) A/c To Investment A/c (For sale of investments at a loss of Rs 3,500)	15,000 3,500	 18,500
Profit and Loss A/c Dr. To Capital Redemption Reserve A/c (For transfer to CRR out of divisible profits an amount equivalent to excess of nominal value of preference shares over proceeds (face value of equity shares) i.e., Rs 65,000 - Rs 31,250)	33,750	 33,750
Preference Shareholders A/c Dr. To Bank A/c (For payment of preference shareholders)	71,500	 71,500

Balance Sheet (after redemption)

	Particulars	Notes No.	Rs
	EQUITY AND LIABILITIES		
1.	**Shareholders' funds**		
a)	Share capital	1	2,62,500
b)	Reserves and Surplus	2	38,000
2.	**Current liabilities**		
	Trade Payables		56,500
	Total		**3,57,000**
	ASSETS		
1.	**PPE**		
	Tangible asset		3,45,000
2.	**Current Assets**		
	Cash and cash equivalents (bank)	3	12,000
	Total		**3,57,000**

Notes to accounts

		Rs
1.	**Share Capital**	
	Equity share capital (2,25,000 + 37,500)	2,62,500
2.	**Reserves and Surplus**	
	Capital Redemption Reserve	33,750
	Profit and Loss Account (48,000 – 6,500 – 3,500 – 33,750)	4,250
		38,000
3.	**Cash and cash equivalents**	
	Balances with banks (31,000 + 37,500 +15,000 – 71,500)	12,000

Working Note:

Calculation of Number of Shares:	`
Amount payable on redemption	71,500
Less: Sale price of investment	(15,000)
	56,500
Less: Available bank balance (31,000 - 12,000)	(19,000)
Funds from fresh issue	**37,500**
No. of shares = 37,500/60=625 shares	

Question - 5.

C Limited had 3,000, 12% Redeemable Preference Shares of Rs 100 each, fully paid up. The company had to redeem these shares at a premium of 10%.

It was decided by the company to issue the following:

(i) 25,000 Equity Shares of Rs 10 each at par,

(ii) 1,000 14% Debentures of Rs 100 each.

The issue was fully subscribed and all amounts were received in full. The payment was duly made. The company had sufficient profits. Show Journal Entries in the books of the company.

Solution:

In the books of C Limited
Journal Entries

Particulars	Dr. (Rs)	Cr. (Rs)

Bank A/c Dr. To Equity Share Capital A/c (Being the issue of 25,000 equity shares of Rs 10 each at par as per Board's resolution No......dated.....)	2,50,000	2,50,000
Bank A/c Dr. To 14% Debenture A/c (Being the issue of 1,000 Debentures of Rs 100 each as per Board's Resolution No.....dated......)	1,00,000	1,00,000
12% Redeemable Preference Share Capital A/c Dr. Premium on Redemption of Preference Shares A/c To Preference Shareholders A/c (Being the amount payable on redemption transferred to Preference Shareholders Account)	3,00,000 30,000	3,30,000
Preference Shareholders A/c Dr. To Bank A/c (Being the amount paid on redemption of preference shares)	3,30,000	3,30,000
Profit & Loss A/c Dr. To Premium on Redemption of Preference Shares A/c (Being the adjustment of premium on redemption against Profits & Loss Account)	30,000	30,000
Profit & Loss A/c Dr. To Capital Redemption Reserve A/c (Being the amount transferred to Capital Redemption Reserve Account as per the requirement of the Act)	50,000	50,000

Working Note:
Amount to be transferred to Capital Redemption Reserve Account

Face value of shares to be redeemed	3,00,000
Less: Proceeds from new issue	(2,50,000)
Total Balance	50,000

Question - 6.
The capital structure of a company consists of 20,000 Equity Shares of Rs 10 each fully paid up and 1,000 8% Redeemable Preference Shares of Rs 100 each fully paid up (issued on 1.4.20X1).
Undistributed reserve and surplus stood as: General Reserve Rs 80,000; Profit and Loss Account Rs 20,000; Investment Allowance Reserve out of which Rs 5,000, (not free for distribution as dividend) Rs 10,000; Securities Premium Rs 2,000, Cash at bank amounted to Rs 98,000. Preference shares are to be redeemed at a Premium of 10% and for the purpose of redemption, the directors are empowered to make fresh issue of Equity Shares at par after utilising the undistributed reserve and surplus, subject to the conditions that a sum of Rs 20,000 shall be retained in general reserve and which should not be utilised.
Pass Journal Entries to give effect to the above arrangements and also show how the relevant items will appear in the Balance Sheet of the company after the redemption carried out.

Solution:

In the books of ....

Journal Entries

Particulars	Dr. (Rs)	Cr. (Rs)
Bank A/c Dr. To Equity Share Capital A/c (Being the issue of 2,500 Equity Shares of Rs 10 each at a premium of Re. 1 per share as per Board's Resolution No.....dated.......)	25,000	 25,000
8% Redeemable Preference Share Capital A/c Dr. Premium on Redemption of Preference Shares A/c Dr. To Preference Shareholders A/c (Being the amount paid on redemption transferred to Preference Shareholders Account)	1,00,000 10,000	 1,10,000
Preference Shareholders A/c Dr. To Bank A/c (Being the amount paid on redemption of preference shares)	1,10,000	 1,10,000
Profit & Loss A/c Dr. To Premium on Redemption of Preference Shares A/c (Being the premium payable on redemption is adjusted against Profit & Loss Account)	10,000	 10,000
General Reserve A/c. Dr. Profit & Loss A/c Dr. Investment Allowance Reserve A/c Dr. To Capital Redemption Reserve A/c (Being the amount transferred to Capital Redemption Reserve Account as per the requirement of the Act)	60,000 10,000 5,000	 75,000

Balance Sheet as on .... [Extracts]

	Particulars	Notes No.	Rs
	EQUITY AND LIABILITIES		
1.	**Shareholders' funds**		
a	Share capital	1	2,25,000
b	Reserves and Surplus	2	1,02,000
	Total		**3,27,000**
	ASSETS		
2.	**Current Assets**		
	Cash and cash equivalents (98,000 + 25,000 – 1,10,000)		13,000
	Total		**3,27,000**

Notes to accounts

1.	**Share Capital** 22,500 Equity shares (20,000 + 2,500) of Rs 10 each fully paid up	**2,25,000**
2.	**Reserves and Surplus**	
	General Reserve	20,000
	Securities Premium	2,000
	Capital Redemption Reserve	75,000
	Investment Allowance Reserve	5,000
		1,02,000

Working Note:

No of Shares to be issued for redemption of Preference Shares:

Face value of shares redeemed	1,00,000
Less: Profit available for distribution as dividend	
General Reserve : Rs (80,000-20,000	(60,000)
Profit and Loss (20,000 – 10,000 set aside for adjusting premium payable on redemption of preference shares)	(10,000)
Investment Allowance Reserve: (Rs 10,000-5,000)	(5,000)
Balance	**25,000**
Therefore, No. of shares to be issued = 25,000 / Rs 10 = 2,500 shares.	

Question - 7.

The following is the summarised Balance Sheet of Bumbum Limited as at 31st March, 20X1:

Particulars	***Rs***
Sources of funds Authorized capital	
50,000 Equity shares of Rs 10 each	*5,00,000*
10,000 Preference shares of Rs 100 each (8% redeemable)	*10,00,000*
	15,00,000
Issued, subscribed and paid up	
30,000 Equity shares of Rs 10 each	*3,00,000*
5,000, 8% Redeemable Preference shares of Rs 100 each	*5,00,000*
Reserves & Surplus	
Securities Premium	*6,00,000*
General Reserve	*6,50,000*
Profit & Loss A/c	*40,000*
2,500, 9% Debentures of Rs 100 each	*2,50,000*
Trade payables	*1,70,000*
Total	***25,10,000***
Application of funds	
Fixed Assets (net)	*7,80,000*
Investments (market value Rs 5,80,000)	*4,90,000*
Deferred Tax Assets	*3,40,000*
Trade receivables	*6,20,000*
Cash & Bank balance	*2,80,000*
Total	***25,10,000***

In Annual General Meeting held on 20th June, 20X1 the company passed the following resolutions:

- ***To split equity share of Rs 10 each into 5 equity shares of Rs 2 each from 1st July.***
- ***To redeem 8% preference shares at a premium of 5%.***
- ***To redeem 9% Debentures by making offer to debenture holders to convert their holdings into equity shares at Rs 10 per share or accept cash on redemption.***
- ***To issue fully paid bonus shares in the ratio of one equity share for every 3 shares held on record date.***

On 10th July, 20X1 investments were sold for Rs 5,55,000 and preference shares were redeemed.

40% of Debenture holders exercised their option to accept cash and their claims were settled on 1st August, 20X1.

The company fixed 5th September, 20X1 as record date and bonus issue was concluded by 12th September, 20X1

You are requested to journalize the above transactions including cash transactions and prepare Balance Sheet as at 30th September, 20X1. All working notes should form part of your answer.

Solution:

Bumbum Limited
Journal Entries

20X1	Particulars	Dr. (Rs)	Cr. (Rs)
July 1	Equity Share Capital A/c (Rs 10 each) Dr. To Equity share capital A/c (Rs 2 each) (Being equity share of Rs 10 each splitted into 5 equity shares of Rs 2 each) {1,50,000 X 2}	3,00,000	 3,00,000
July 10	Cash & Bank balance A/c Dr. To Investment A/c To Profit & Loss A/c (Being investment sold out and profit on sale credited to Profit & Loss A/c)	5,55,000	 4,90,000 65,000
July 10	8% Redeemable preference share capital A/c Dr. Premium on redemption of pref. share A/c Dr. To Preference shareholders A/c (Being amount payable to preference shareholders on redemption) (refer W.N.1)	5,00,000 25,000	 5,25,000
July 10	Preference shareholders A/c Dr. To Cash & bank A/c (Being amount paid to preference shareholders)	5,25,000	 5,25,000
July 10	General reserve A/c Dr. To Capital redemption reserve A/c (Being amount equal to nominal value of preference shares transferred to Capital Redemption Reserve A/c on its redemption as per the law)	5,00,000	 5,00,000
Aug 1	9% Debentures A/c Dr. Interest on debentures A/c (2,50,000 x 9% x 4/12) Dr. To Debenture holders A/c (Being amount payable to debenture holders along with interest payable)	2,50,000 7,500	 2,57,500
Aug. 1	Debenture holders A/c Dr. To Cash & bank A/c (1,00,000 + 7,500) To Equity share capital A/c (15,000 X 2) To Securities premium A/c (15,000 x 8) (Being claims of debenture holders satisfied) (refer W.N.2)	2,57,500	 1,07,500 30,000 1,20,000
Sept. 5	Capital Redemption Reserve A/c Dr. To Bonus to shareholders A/c (Being balance in capital redemption reserve capitalized to issue bonus shares) (refer W.N.3)	1,10,000	1,10,000
Sept. 12	Bonus to shareholders A/c Dr. To Equity share capital A/c (Being 55,000 fully paid equity shares of Rs 2 each issued as bonus in ratio of 1 share for every 3 shares held)	1,10,000	 1,10,000
Sept. 30	General Reserve A/c Dr. To Premium on redemption of preference shares A/c (Being premium on preference shares adjusted from general reserve)	25,000	 25,000
Sept. 30	Profit & Loss A/c Dr. To Interest on debentures A/c (Being interest on debentures transferred to Profit & Loss Account)	7,500	 7,500

Balance Sheet as at 30th September, 20X1

	Particulars	Notes	Rs
	Equity and Liabilities		
1	**Shareholders' funds**		
a	Share capital	1	4,40,000
b	Reserves and Surplus	2	13,32,500
2	**Current liabilities**		
a	Trade Payables		1,70,000
	Total		**19,42,500**
	Assets		
1	**Non-current assets**		
a	Property, Plant and Equipment		
	Tangible assets		7,80,000
b	Deferred tax asset		3,40,000
2	**Current assets**		
	Trade receivables		6,20,000
	Cash and bank balances (W.N.4)		2,02,500
	Total		**19,42,500**

Notes to accounts

	Particulars	Rs	
1	**Share Capital**		
	Authorized share capital		
	2,50,000 Equity shares of Rs 2 each	5,00,000	
	10,000 Preference shares of Rs100 each	10,00,000	15,00,000
	Issued, subscribed and paid up		
	2,20,000 Equity shares of Rs 2 each [(30,000 x 5) + 15,000 + 55,000]		4,40,000
2	**Reserves and Surplus**		
	Securities Premium A/c		
	Balance as per balance sheet	6,00,000	
	Add: Premium on equity shares issued on conversion of debentures (15,000 x 8)	1,20,000	
	Balance		**7,20,000**
	Capital Redemption Reserve (5,00,000-1,10,000)		3,90,000
	General Reserve (6,50,000 – 5,00,000- 25,000)		1,25,000
	Profit & Loss A/c	40,000	
	Add: Profit on sale of investment	65,000	
	Less: Interest on debentures	(7,500)	97,500
	Total		**13,32,500**

Working Notes:

	Rs
1. Redemption of preference share:	
5,000 Preference shares of ` 100 each	5,00,000
Premium on redemption @ 5%	25,000
Amount Payable	5,25,000
2. Redemption of Debentures	
2,500 Debentures of Rs 100 each	2,50,000
Less: Cash option exercised by 40% holders	(1,00,000)
Conversion option exercised by remaining 60%	1,50,000
Equity shares issued on conversion $=\frac{1,50,000}{10}$ =15,000 shares	
3. Issue of Bonus Shares	

Existing equity shares after split (30,000 x 5)	1,50,000 shares
Equity shares issued on conversion	15,000 shares
Equity shares entitled for bonus	1,65,000 shares
Bonus shares (1 share for every 3 shares held) to be issued	55,000 shares
4. Cash and Bank Balance	
Balance as per balance sheet	2,80,000
Add: Realization on sale of investment	5,55,000
	8,35,000
Less: Paid to preference share holders	(5,25,000)
Paid to Debenture holders (7,500 + 1,00,000)	(1,07,500)
Balance	2,02,500
5. Interest of Rs 7,500 paid to debenture holders have been debited to Profit & Loss Account.	

Student Notes:-