Unit 5: REDEMPTION OF PREFERENCE SHARES

CH 11E

"Make schedule, Don't just stick it on your study table but work on it..."

1. Redemption of Preference Shares means repaying the Capital back to the Preference Shareholders, at an agreed amount at an agreed date.
2. The process of discharging the liability / obligation towards Preference Share Capital is called redemption. So, Redemption = Repayment of Capital during the lifetime of the Company.
3. Date of redemption is called "Maturity Date" and is usually printed on the Preference Share Certificate itself.

CONDITIONS TO BE FULFILLED FOR REDEMPTION OF PREFERENCE SHARES (SECTION 55 OF COMPANIES ACT, 2013)

Authorized by Articles	The Articles of Association should contain a provision authorizing the Company to issue Redeemable Preference Shares (not exceeding 20 years from the date of issue)	
Fully Paid	Preference share Capital cannot be redeemed unless they are fully paid. If the Company has partly paid-up Preference Shares which are to be redeemed, they should be made fully paid before redeeming them.	
Sourcing Redemption	The Preference Shares can be redeemed only out of – a) Fresh Issue: Proceeds of Fresh Issue of shares for purpose of redemption, & / or b) Divisible Profits: Profits otherwise available for distribution as Dividend.	
Capital Redemption Reserve	If the Redemption is not sourced by Fresh Issue of Share Capital, then an amount equal to the Nominal Value of shares redeemed, to the extent not financed by fresh issue, should be transferred to Reserve called Capital Redemption Reserve (CRR). <u>Amount to be transferred to CRR</u> Face Value of Preference Shares to be redeemed Less Face Value of Fresh Issue of Share Capital	
Utilization of CRR	The balance in CRR can be utilized only for the purpose of issuing Fully Paid Bonus Shares. It shall not be used for any other Purpose, e.g. distribution of dividend, etc.	
Sourcing Premium on Redemption	Prescribed Companies & whose financial statements comply with AS (u/s 133)	Provided for out of the profits of the company before the shares are redeemed
	Other Companies	Provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

(i) Out of Undistributed Profits, and (b) Out of Fresh Issue of Capital.

Redemption of Preference Shares

Out of Capital (i.e. Out of Fresh Issue of Shares)	Out of Profit (i.e. Capitalization of Undistributed Profits)
(a) To raise finance for repaying the Preference Shareholders, Company can issue Equity Shares or Pref. Shares. (b) Such fresh issue can be made either at par, or at premium.	A company having surplus profits, can use these surplus funds for redemption of Preference Shares. In such a case, transfer to CRR is necessary.

Note:

1. A company may redeem its Preference Share Capital out of Capital and Profits, i.e. combination of above.
2. Redemption out of Capital means that the Company can issue either Equity Shares or Preference Shares. So, Preference Shares cannot be redeemed by fresh issue of Debentures

PURPOSE OF TRANSFER TO CRR

Retention of Capital	When Preference Shares are redeemed out of Profits, replacement / retention of Capital is ensured in an indirect manner, by transfer of profit to CRR. The amount, which would otherwise have been distributed as dividend, is now retained in the business, in the form of CRR, and this is subsequently converted into Equity Share Capital, by issuing Bonus Shares. Transfer to CRR creates non-distributed profits, and maintains the Capital Base of the Company
Protection of Outsiders Interest	The purpose of transfer to CRR is to ensure Capital Maintenance, and to protect the interests of Outsiders / Creditors of the Company. Transfer to CRR ensures that there is no reduction in "Shareholders' Funds" or Capital Base due to the redemption, and hence the interest of outsiders is not affected.

ACCOUNTING ENTRIES FOR REDEMPTION OF PREFERENCE SHARES

	Transaction	Journal Entries
1.	Calling unpaid portion of Preference Share Capital, if any	Redeemable Preference Share Final Call A/c Dr. To Redeemable Preference Share Capital A/c
2.	Receipt of Final Call Amount [Also see Note below]	Bank A/c Dr. To Redeemable Preference share final call A/c
3.	Fresh issue of Share Capital for the purpose of redemption	Bank A/c Dr. To Share Capital A/c (at Face value) To Securities Premium A/c (if at premium)
4.	Sale of Investments or Current Assets for raising funds for redemption	Bank A/c Dr. Profit and loss A/c (if sold at a loss) Dr. To Investment/ Current Assets A/c To Profit and loss A/c (if sold at profit)
5.	Transfer of preference share capital & premium on redemption (if any) to preference shareholders A/c	Redeemable Preference Share Capital A/c Dr. Premium on Redemption of Pref. Share Dr. To Preference shareholders A/c

6.	Transferring divisible profit to capital redemption reserve account	General Reserve A/c Dr. Profit and Loss A/c Dr. Other divisible profits A/c Dr. To Capital Redemption Reserve A/c (Nominal Value of PSC to be redeemed Less Nominal value of any fresh issue of share capital)
7.	Sourcing Premium payable on Redemption of Preference share	Profit and loss A/c Dr. General Reserve A/c Dr. To Premium on Redemption of Preference shares A/c
8.	Making Payment to Preference shareholders	Preference shareholders A/c Dr. To Bank A/c

Note: Non-Payment of Final Call:

1. If final Call is made on partly paid-up Preference Shares (as per Entry 1 above), but some Preference shareholders fail to pay the call amount due, those Preference Shares can be forfeited.
2. Such Forfeited Shares are generally not re-issued, since redemption of these Shares is due immediately or in the near future.

Conditions when company should issue new equity shares for redemption of pref. shares:

A company may prefer issue of new equity shares in the following situations:

(a) When the company realizes 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.

Redemption of Preference shares by issue of fresh equity shares

Advantages:

(1) No cash outflow of money is required – now or later.
(2) New equity shares may be valued at a premium.
(3) Shareholders retain their equity interest.

Disadvantages:

(1) There will be dilution of future earnings;
(2) Share-holding in the company is changed.

Redemption of Preference shares by capitalization of undistributed divisible profits

Advantages:

(1) No change in the percentage of equity share-holding of the company;
(2) Surplus funds can be used.

Disadvantages:

(1) There may be a reduction in liquidity or assets may need to be sold such as investments.

Example 1: Preference Share Capital ₹ 2,00,000. New Issue 15,000 shares of 10 each.

Example 2: Preference Share Capital ₹ 2,00,000. New Issue 15,000 shares of 10 each @ 10% premium.

Example 3: Preference Share Capital ₹ 2,00,000. New Issue 30,000 shares of 10 each.

Example 4: Preference Share Capital ₹ 2,00,000. Premium on Redemption 10%.
New Issue 15,000 shares of 10 each @ 10 % premium.

Example 5: Preference Share Capital 2,500 shares of 100 each 80 paid up
New Issue 15,000 shares of 10 each.

Example 6: Preference Share Capital ₹ 4,00,000 Premium on Redemption 10%.
Free Reserves 2,60,000. Find equity shares to be issued FV= 10 each

Example 7: Preference Share Capital ₹ 65,000 Premium on Redemption 10%.
Free Reserves 48,000. P&L balance to be maintained 15,000.
Find equity shares to be issued FV= 50 each issued at a premium of 13 each.

Example 8: Preference Share Capital ₹ 2,00,000 Premium on Redemption 10%.
Existing bank balance 20,000. Investment sold for 27,500.
Minimum Bank Balance to be maintained 15,000.
Find equity shares to be issued FV= 10 each issued at 25% premium.

ASSIGNMENT QUESTIONS

Question 1 *(ICAI Study Material)* *Pg no._____*

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

Question 2 *(ICAI Study Material) / (RTP May 2023) (Similar)* *Pg no._____*

The Board of Directors of a Company decide to issue minimum number of equity shares of ₹ 9 to redeem ₹ 5,00,000 preference shares. The maximum amount of divisible profits available for redemption is ₹ 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 number of shares if company decides to issue shares in multiples of 50 only.

Question 3 *(RTP Nov 2019)* *Pg no._____*

The following are the extracts from the Balance Sheet of ABC Ltd. as on 31st December, 2021: Share capital: 50,000 Equity shares of ₹10 each fully paid – ₹5,00,000; 2,000 10% Redeemable preference shares of ₹100 each fully paid – ₹ 2,00,000. Reserve & Surplus: Capital reserve – ₹2,00,000; General reserve –₹ 2,00,000; Profit and Loss Account – ₹75,000.
On 1st January 2022, Board of Directors decided to redeem the preference shares at premium of 5% by utilization of reserves.
Pass Journal Entries including cash transactions in the books of company.

Question 4 *(RTP May 2019)/(May 2020)/(Nov 2023) (Similar) / (ICAI Study Material)* *Pg no._____*

The capital structure of a company consists of 20,000 Equity Shares of ₹ 10 each fully paid up and 1,000 8% Redeemable Preference Shares of ₹ 100 each fully paid up (issued on 1.4.2021). Undistributed reserve and surplus stood as: General Reserve ₹ 80,000; Profit and Loss Account ₹ 20,000; Investment Allowance Reserve out of which ₹ 5,000, (not free for distribution as dividend) ₹ 10,000; Securities Premium ₹ 2,000, Cash at bank amounted to ₹ 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 utilizing the undistributed reserve and surplus, subject to the conditions that a sum of ₹ 20,000 shall be retained in general reserve and which should not be utilized.
Pass Journal Entries to give effect to the above arrangements.

Question 5 *(ICAI Study Material) / (RTP May 2023) (Similar)* *Pg no._____*

C Limited had 3,000, 12% Redeemable Preference Shares of ₹ 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:
a) 25,000 Equity Shares of ₹ 10 each at par,
b) 1,000 14% Debentures of ₹ 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.

Question 6

Pg no._____

The balance sheet of A Ltd. as on 31.12.2021 is given below:

EQUITIES & LIABILITIES	₹
Shareholder's Funds	
5,000 Equity Shares (₹ 100 each fully paid-up)	5,00,000
9% Redeemable Preference Shares (₹ 10 each fully paid-up)	2,00,000
Profit & Loss Account	1,60,000
Current Liabilities	1,20,000
	9,80,000
ASSETS	**₹**
Non-Current Assets	
Property, Plant & Equipment	4,00,000
Investments	2,00,000
Current Assets	
Bank balance	10,000
Other Current Assets	3,70,000
	9,80,000

On 1.1.2022 the company:

(a) Redeemed preference shares at a premium of ₹ 2 per share.
(b) Realized investments at a value of ₹ 1,60,000.
(c) Issued at a premium of ₹ 40 per share, such number of equity shares of ₹ 100 each for the purpose of redemption as to ensure that after the compliance with requirements of the Companies Act, 2013, the credit balance in Profit & Loss A/c would be ₹ 25,000.
(d) Issued of bonus equity share at par at the rate of 1 share for every 20 shares held on 31st December, 2021.

You are required to show journal entries to record the above transactions.

Question 7 *(ICAI Study Material)*

Pg no._____

X Ltd. gives you the following information as at 31st March, 2023:

Particulars	₹
EQUITY AND LIABILITIES	
1. Shareholders' funds	
Share capital	2,90,000
Reserves and Surplus	48,000
2. Current liabilities	
Trade Payables	56,500
TOTAL	3,94,500
ASSETS	
Non Current Assets	
Property, Plant & Equipment & Intangible Assets	
Property, Plant & Equipment	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 ₹ 50 each equity shares of ₹ 2,25,000 and ₹ 100 each Preference shares of ₹ 65,000 (issued on 1.4.2021). 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 ₹ 15,000.

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

c) to issue minimum equity share of ₹ 50 each to raise the balance of funds required.

You are required to pass the necessary Journal Entries to record the above transactions.

Question 8 *(ICAI Study Material)* *Pg no._____*

The books of B Ltd. showed the following balance on 31st December, 2023:

30,000 Equity Shares of ₹ 10 each fully paid; 18,000 12% Redeemable Preference Shares of ₹ 10 each fully paid; 4,000 10% Redeemable Preference Shares of ₹ 10 each, ₹ 8 paid up (all shares issued on 1st April, 2022).

Undistributed Reserve and Surplus stood as: Profit and Loss Account ₹ 80,000; General Reserve ₹ 1,20,000; Securities Premium Account ₹ 15,000 and Capital Reserve ₹ 21,000.

Preference shares are redeemed on 1st January, 2024 at a premium of ₹ 2 per share. The whereabouts of the holders of 100 shares of ₹ 10 each fully paid are not known.

For redemption, 3,000 equity shares of ₹ 10 each are issued at 10% premium. At the same time, a bonus issue of equity share was made at par, two shares being issued for every five held on that date out of the Capital Redemption Reserve Account. However, equity shares, issued for redemption are not eligible for bonus.

Show the necessary Journal Entries to record the transactions. (Ignore date column)

Question 9 *Pg no._____*

The following is the summarized balance sheet of XYZ Ltd.

EQUITIES & LIABILITIES		₹
50,000 Equity Shares (₹ 10 each)		5,00,000
1,000 Preference Shares (₹ 100 each)	1,00,000	
Less: Calls-in-Arrear (50 X 20)	(1,000)	99,000
Securities Premium Account		20,000
Profit & Loss Account		60,000
General Reserve		70,000
Non-Current Liabilities		-
Current Liabilities		1,51,000
		9,00,000
ASSETS		**₹**
Non-Current Assets		90,000
Current Assets		8,10,000
		9,00,000

The redeemable preference shares were redeemed on the following basis:

(1) Further 4,500 equity shares were issued at a premium of 10%.

(2) Of the 50 preference shares, holders of 40 shares paid the call money before the date of redemption. Balance 10 shares were forfeited for non-payment of calls before redemption. The forfeited shares were re-issued as fully paid on receipt of ₹ 500 before redemption.

(3) Preference shares were redeemed at a premium of 10%. All payments were made except to holders of 150 shares who cannot be traced. Show journal entries.

Question 10 *(ICAI Study Material)* Pg no._____

The Balance Sheet of XYZ Ltd. as at 31st December, 2021 *inter alia* includes the following:

50,000, 8% Preference Shares of ₹ 100 each, ₹ 70 paid up	35,00,000
1,00,000 Equity Shares of ₹ 100 each fully paid up	1,00,00,000
Securities Premium	5,00,000
Capital Redemption Reserve	20,00,000
General Reserve	50,00,000
Bank	15,00,000

Under the terms of their issue, the preference shares are redeemable on 31st March, 2022 at 5% premium. In order to finance the redemption, the company makes a rights issue of 50,000 equity shares of ₹ 100 each at ₹ 110 per share, ₹ 20 being payable on application, ₹ 35 (including premium) on allotment & the balance on 1st January, 2023. The issue was fully subscribed & allotment made on 1st March, 2022. The money due on allotment were received by 31st March, 2022.

The preference shares were redeemed after fulfilling the necessary conditions of Section 55 of the Companies Act, 2013.

You are asked to pass necessary Journal Entries (Ignore date column).

Question 11 *(ICAI Study Material)* Pg no._____

With the help of details in Question 10 above and further assuming that the Preference Shareholders holding 2,000 shares fail to make the payment for the final call made under Sec 55, you are asked to pass the necessary Journal Entries assuming that the shares in default are forfeited after giving proper notice. (Ignore date column).

Question 12 *(CA Inter Nov 2022) (5 Marks)* Pg no._____

Given below are extracts of Balance Sheet of Sea Chemicals Limited as on 31st March, 2022:

Particulars	Amount in ₹
9% Redeemable Preference Share Capital	10,00,000
Calls in arears (Redeemable Preference Shares)	20,000
General Reserve	7,00,000
Securities Premium	80,000

It is provided that:

a. Preference Shares are of 100 each fully-called, due for immediate redemption at a premium of 5%.

b. Calls-in-arrears are on account of final call on 1000 shares held by four members whose whereabouts are not known.

c. Balance of General Reserve and Securities Premium to be fully utilized for the purposes of redemption and the shortfall to be made good by issue of equity shares of ₹ 10 each at par.

d. The redemption of preference shares was duly carried out.

You are required to pass the necessary journal entries (narration not required) to give effect to the above redemption.

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

1) Securities premium cannot be used to _______.
   (a) Issue bonus shares
   (b) Redeem preference shares
   (c) Write-off preliminary expenses

2) S Ltd. issued 2,000, 10% Preference shares of ₹ 100 each at par on 1.4.2021, which are redeemable at a premium of 10%. For the purpose of redemption, the company issued 1,500 Equity Shares of ₹ 100 each at a premium of 20% per share. At the time of redemption of Preference Shares, the amount to be transferred by the company to the Capital Redemption Reserve Account = ?
   (a) ₹ 50,000
   (b) ₹ 40,000
   (c) ₹ 2,00,000

3) Which of the following cannot be used for the purpose of creation of capital redemption reserve account?
   (a) Profit and loss account (credit balance)
   (b) General reserve account
   (c) Unclaimed dividend account

4) According to Section 52 of the Companies Act, 2013, the amount in the Securities Premium A/c cannot be used for the purpose of
   (a) Issue of fully paid bonus shares
   (b) Writing off losses of the company
   (c) For purchase of own securities

5) Which of the following can be utilized for redemption of preference shares?
   (a) The proceeds of fresh issue of equity shares
   (b) The proceeds of issue of debentures
   (c) The proceeds of issue of fixed deposit

6) Preference shares amounting to ₹ 2,00,000 (already issued on 1.4.2021) are redeemed at a premium of 5%, by issue of shares amounting to ₹ 1,00,000 at a premium of 10%. The amount to be transferred to capital redemption reserve = ?
   (a) ₹ 1,05,000
   (b) ₹ 1,00,000
   (c) ₹ 2,00,000

ANSWERS MCQs

1. (b) 2. (a) 3. (c) 4. (b) 5. (a) 6. (b)

TRUE / FALSE

State with reasons whether the following statement is true or false:

1) When shares are redeemed by utilising distributable profit, an amount equal to the face value of shares redeemed is transferred to Capital Reserve account by debiting the distributable profit.
2) A company who prepares financial statements in compliance with Accounting Standards under Section 133 of the Companies Act, 2013, it cannot utilize securities premium for the purpose of providing for premium on the redemption of Redeemable Preference shares of the Company.
3) The balance in forfeited shares account can be used for transfer to capital redemption reserve account.
4) Capital redemption reserve cannot be used for writing off miscellaneous expenses and losses

Solution

1) False: 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.
2) True: A company who prepares financial statements in compliance with Accounting Standards under Section 133 of the Companies Act, 2013, it cannot utilize securities premium for the purpose of providing the premium on the redemption of redeemable preference shares.
3) False: The balance in Forfeited shares account cannot be used for transfer to capital redemption reserve account.
4) True: Capital redemption reserve cannot be used for writing off miscellaneous expenses and losses.

HOMEWORK QUESTIONS

Question 1 *(ICAI Study Material)* *Pg no._____*

Hinduja Company Ltd. had 5,000, 8% Redeemable Preference Shares of ₹ 100 each, fully paid up. The company decided to redeem these preference shares at par by the issue of sufficient number of equity shares of ₹ 10 each fully paid up at par. You are required to pass necessary Journal Entries including cash transactions in the books of the company.

Question 2 *(ICAI Study Material)* *Pg no._____*

G India Ltd. had 9,000 10% redeemable Preference Shares of ₹ 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 ₹ 9 each fully paid up. You are required to pass necessary Journal Entries including cash transactions in the books of the company.

Question 3 *(ICAI Study Material)* *Pg no._____*

The following are the extracts from the Balance Sheet of ABC Ltd. as on 31st December, 2023.
Share capital: 40,000 Equity shares of ₹ 10 each fully paid - ₹ 4,00,000; 1,000 10% Redeemable preference shares of ₹ 100 each fully paid – ₹ 1,00,000.
Reserve & Surplus: Capital reserve – ₹ 50,000; Securities premium – ₹ 50,000; General reserve – ₹ 75,000; Profit and Loss Account – ₹ 35,000
On 1st January 2024, the Board of Directors decided to redeem the preference shares at par by utilisation of reserve. You are required to pass necessary Journal Entries including cash transactions in the books of the company.

Question 4 *(RTP May 2018) / (RTP Nov 2020) (Similar) / (RTP May 2021) (Similar)* *Pg no._____*

The following are the extracts from the Balance Sheet of ABC Ltd. as on 31st December, 2021:
Share capital: 50,000 Equity shares of ₹10 each fully paid – ₹5,00,000;
1,500 10% Redeemable preference shares of ₹100 each fully paid – ₹ 1,50,000.
Reserve & Surplus: Capital reserve – ₹1,00,000; General reserve –₹ 1,00,000; Profit and Loss Account – ₹75,000.
On 1st January 2022, the Board of Directors decided to redeem the preference shares at premium of 10% by utilization of reserves. You are required to prepare necessary Journal Entries including cash transactions in the books of the company.

Question 5 *(RTP Nov 2018)* *Pg no._____*

The following are the extracts from Balance Sheet of Meera Ltd. as on 31st December, 2021.
Share capital: 60,000 Equity shares of ₹10 each fully paid – ₹ 6,00,000; 1,500 10% Redeemable preference shares of ₹ 100 each fully paid – ₹1,50,000.
Reserve & Surplus: Capital reserve – ₹ 75,000; Securities premium – ₹ 75,000; General reserve – ₹ 1,12,500; Profit & Loss A/c – ₹ 62,500.
On 1st January 2022, the Board of Directors decided to redeem the preference shares at premium of 10% by utilisation of reserve. You are required to prepare necessary Journal Entries including cash transactions in the books of the company.

Question 6 *(CA Inter May 2018) (10 Marks) / (RTP Nov 2022)* *Pg no._____*

Dheeraj Limited had 5,000, 10% Redeemable Preference Shares of ₹ 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) 40,000 Equity Shares of ₹ 10 each at par

(ii) 2,000 12% Debentures of ₹ 100 each.

The issue was fully subscribed and all accounts were received in full. The payment was duly made. The company had sufficient profits. Show journal entries in the books of the company.

Question 7 Pg no._____

Extract of ledger balances of Kalpana Ltd. as on 31st March, 2022 includes the following:

	₹
2,000, 12% Preference shares of ₹ 100 each, fully paid	2,00,000
Surplus	40,000
Securities Premium	12,000

Under the terms of issue, the preference shares are redeemable on 31st March, 2022 at a premium of 10%. The directors desire to make a minimum fresh issue of equity shares of ₹ 10 each at a premium of 5% for redemption purpose.

You are required to ascertain the amount of fresh issue to be made and pass necessary journal entries in the books of the company.

Question 8 *(CA Inter Jan 2021) (12 Marks) / (RTP Nov 2021) (Similar)* Pg no._____

The Capital structure of a company BK Ltd. consists of 30,000 Equity Shares of ₹ 10 each fully paid up and 2,000 9% Redeemable Preference Shares of ₹ 100 each fully paid up as on 31.03.2022. The other particulars as at 31.03.2022 are as follows:

	Amount (₹)
General Reserve	1,20,000
Profit & Loss Account	60,000
Investment Allowance Reserve (not free for distribution as dividend)	15,000
Cash at Bank	1,95,000

Preference Shares are to be redeemed at a premium of 10%. For the purpose of redemption, the directors are empowered to make fresh issue of Equity Shares at per after utilizing the undistributed reserve & surplus, subject to the conditions that a sum of ₹ 40,000 shall be retained in General Reserve and which should not be utilized.

Company also sold investment of 4500 Equity Shares in G Ltd., costing ₹ 45,000 at ₹ 9 per share. Pass Journal entries to give effect to the above arrangements and also show how the relevant items will appear in the Balance Sheet as at 31.03.2022 of BK Ltd., after the redemption is carried out.

Question 9 *(CA Inter May 2019) (10 Marks)* Pg no._____

The Summarized Balance Sheet of Clean Ltd. as on 31st March, 2022 is as follows:

Particulars	₹
EQUITY AND LIABILITIES	
1. Shareholders' funds	
Share capital	5,80,000
Reserves and Surplus	96,000
2. Current liabilities	
Trade Payables	1,13,000
TOTAL	7,89,000
ASSETS	
1. Non Current Assets	
Property, Plant & Equipment & Intangible Assets	
Property, Plant & Equipment	6,90,000
Non Current Investments	37,000

2. Current Assets	
Cash and cash equivalents (bank)	62,000
TOTAL	7,89,000

The Share Capital of the company consists of ₹ 50 each Equity shares of ₹ 4,50,000 and ₹ 100 each 8% Redeemable Preference Shares of ₹ 1,30,000 (issued on 1.4.2019).

Reserves and Surplus comprises statement of profit and loss 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 ₹ 30,000.

(b) to finance part of redemption from company funds, subject to, leaving a Bank balance of ₹ 24,000.

(c) to issue minimum equity share of ₹ 50 each at a premium of ₹ 10 per share to raise the balance of funds required.

You are required to

(1) Pass Journal Entries to record the above transactions.

(2) Prepare Balance Sheet after completion of the above transactions.

Question 10 *(CA Inter Nov 2020) (12 Marks)* *Pg no._____*

The Books of Arpit Ltd. shows the following Balances as on 31st December, 2021:

	Amount (₹)
6,00,000 Equity shares of ₹ 10 each fully paid up	60,00,000
30,000, 10% Preference shares of ₹ 100 each, ₹ 80 paid up	24,00,000
Securities Premium	6,00,000
Capital Redemption Reserve	18,00,000
General Reserve	35,00,000

Under the terms of issue, the Preference Shares are redeemable on 31st March, 2022 at a premium of 10%. In order to finance the redemption, the Board of Directors decided to make a fresh issue of 1,50,000 Equity shares of ₹ 10 each at a premium of 20%, ₹ 2 being payable on application, ₹ 7 (including premium) on allotment and the balance on 1st January, 2023. The issue was fully subscribed and allotment made on 1st March, 2022. The money due on allotment was received by 20th March, 2022. The preference shares were redeemed after fulfilling the necessary conditions of Section 55 of the Companies Act, 2013.

You are required to pass the necessary Journal Entries and also show how the relevant items will appear in the Balance Sheet of the company after the redemption carried out on 31st March, 2022 with comparative figures of 31st December,2021.

Question 11 *(CA Inter Nov 2018) (5 Marks)* *Pg no._____*

Explain the conditions when a company should issue new equity shares for redemption of the preference shares. Also discuss the advantages and disadvantages of redemption of preference shares by issue of equity shares.

REDEMPTION OF PREFERENCE SHARES

Solution 1

Journal Entries in the books of Hinduja Company Ltd.

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
-	Bank A/c Dr.		5,00,000	
	To Equity Share Capital A/c			5,00,000
	(Being the issue of 50,000 Equity Shares of 10 each at par for the purpose of redemption of preference shares, as per Board Resolution No ……. dated...)			
-	8% Redeemable Preference Share Capital A/c Dr.		5,00,000	
	To Preference Shareholders A/c			5,00,000
	(Being amount payable on redemption of preference shares transferred to Preference Shareholders A/c)			
	Preference Shareholders A/c Dr.		5,00,000	
	To Bank A/c			5,00,000
	(Being the amount paid on redemption of preference shares)			

Solution 2

Journal Entries in the books of G India Ltd.

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
-	Bank A/c Dr.		90,000	
	To Equity Share Capital A/c			90,000
	(Being the issue of 10,000 Equity Shares of 9 each at par for the purpose of redemption of preference shares, as per Board Resolution No ……. dated...)			
-	10% Redeemable Preference Share Capital A/c Dr.		90,000	
	To Preference Shareholders A/c			90,000
	(Being amount payable on redemption of preference shares transferred to Preference Shareholders A/c)			
	Preference Shareholders A/c Dr.		90,000	
	To Bank A/c			90,000
	(Being the amount paid on redemption of preference shares)			

Solution 3

Journal Entries in the books of ABC Ltd.

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
-	10% Redeemable Preference Share Capital A/c Dr.		1,00,000	
	To Preference Shareholders A/c			1,00,000
	(Being amount payable on redemption of preference shares transferred to Preference Shareholders A/c)			
	Preference Shareholders A/c Dr.		1,00,000	
	To Bank A/c			1,00,000
	(Being amount paid on redemption of pref. shares)			
	General Reserve A/c Dr.		75,000	
	Profit & Loss A/c Dr.		25,000	
	To Capital Redemption Reserve A/c			1,00,000
	(Being the amount transferred to Capital Redemption Reserve Account as per the requirement of the Act)			

Note: Securities premium & capital reserve cannot be utilised for transfer to Capital Redemption Reserve.

Solution 4

Journal Entries in the books of ABC Ltd.

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
-	10% Redeemable Preference Share Capital A/c Dr.		1,50,000	
	Premium on Redemption of Pref. Shares A/c Dr.		15,000	
	To Preference Shareholders A/c			1,65,000
	(Being amount payable on redemption of preference shares transferred to Preference Shareholders A/c)			
	Preference Shareholders A/c Dr.		1,65,000	
	To Bank A/c			1,65,000
	(Being the amount paid on redemption of preference shares)			
	General Reserve A/c Dr.		1,00,000	
	Profit & Loss A/c Dr.		50,000	
	To Capital Redemption Reserve A/c			1,50,000
	(Being the amount transferred to Capital Redemption Reserve Account as per the requirement of the Act)			
	Profit & Loss A/c Dr.		15,000	
	To Premium on Redemption of Pref. Shares A/c			15,000
	(Being premium on redemption charged to P&L A/c)			

Note: Capital reserve cannot be utilized for transfer to Capital Redemption Reserve.

Solution 5

Journal Entries

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
-	10% Redeemable Preference Share Capital A/c Dr.		1,50,000	
	Premium on Redemption of Pref. Shares A/c Dr.		15,000	
	To Preference Shareholders A/c			1,65,000
	(Being amount payable on redemption of preference shares transferred to Preference Shareholders A/c)			
	Preference Shareholders A/c Dr.		1,65,000	
	To Bank A/c			1,65,000
	(Being amount paid on redemption of pref. shares)			
	General Reserve A/c Dr.		1,12,500	
	Profit & Loss A/c Dr.		37,500	
	To Capital Redemption Reserve A/c			1,50,000
	(Being the amount transferred to Capital Redemption Reserve Account as per the requirement of the Act)			
	Profit & Loss A/c Dr.		15,000	
	To Premium on Redemption of Pref. Shares A/c			15,000
	(Being premium on redemption charged to P&L A/c)			

Note: Securities premium & capital reserve cannot be utilized for transfer to Capital Redemption Reserve

Solution 6

In the books of Dheeraj Limited Journal Entries

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bank A/c Dr.		4,00,000	
	To Equity Share Capital A/c			4,00,000
	(Being the issue of 40,000 equity shares of ₹ 10 each at par as per Board's resolution No……dated…..)			
	Bank A/c Dr.		2,00,000	
	To 12% Debentures A/c			2,00,000

	(Being the issue of 2,000 Debentures of ₹ 100 each as per Board's Resolution No…..dated……)			
-	10% Redeemable Preference Share Capital A/c Dr.		5,00,000	
	Premium on Redemption of Preference shares A/c Dr.		50,000	
	To Preference Shareholders A/c			5,50,000
	(Being amount payable on redemption of preference shares transferred to Preference Shareholders A/c)			
	Preference Shareholders A/c Dr.		5,50,000	
	To Bank A/c			5,50,000
	(Being the amount paid on redemption of preference shares)			
	Profit & Loss A/c Dr.		50,000	
	To Premium on Redemption of Pref. shares A/c			50,000
	(Being Premium on redemption of preference shares written off)			
	Profit & Loss A/c Dr.		1,00,000	
	To Capital Redemption Reserve A/c			1,00,000
	(Being the amount transferred to Capital Redemption Reserve Account as per the requirement of the Act)			

Amount to be transferred to CRR:

Nominal Value of preference shares to be redeemed = 5,00,000
Less: Nominal Value of shares issued = (4,00,000)
Amount = 1,00,000

Note: Proceeds of fresh issue of equity shares can be used for the purpose of redemption of preference shares but not the proceeds of issue of debentures

Solution 7

Journal Entries in the books of Kalpana Ltd.

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bank A/c Dr.		1,89,000	
	To Equity Share Capital A/c			1,80,000
	To Securities Premium A/c			9,000
	(Being the issue of 18,000 Equity Shares of 10 each at 5% premium for the purpose of redemption of preference shares, as per Board Resolution No …….)			
-	12% Redeemable Preference Share Capital A/c Dr.		2,00,000	
	Premium on Redemption of Preference shares A/c Dr.		20,000	
	To Preference Shareholders A/c			2,20,000
	(Being amount payable on redemption of preference shares transferred to Preference Shareholders A/c)			
	Preference Shareholders A/c Dr.		2,20,000	
	To Bank A/c			2,20,000
	(Being the amount paid on redemption of preference shares)			
	Surplus A/c Dr.		20,000	
	To Premium on Redemption of Pref. shares A/c			20,000
	(Being Premium on redemption of preference shares written off)			
	Surplus A/c Dr.		20,000	
	To Capital Redemption Reserve A/c			20,000
	(Being the amount transferred to Capital Redemption Reserve Account as per the requirement of the Act)			

Nominal value of preference shares ₹ 2,00,000
Premium on redemption 10% of ₹ 2,00,000 = ₹ 20,000
Premium on redemption payable out of Profits/Surplus A/c = 20,000
Profits available for redemption 40,000-20,000 = ₹ 20,000 (Transfer to CRR)
Minimum proceeds 2,00,000 - 20,000 = ₹ 1,80,000
Minimum number of shares 1,80,000/10 = 18,000 shares

Solution 8

Journal Entries

S.No.	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1	Bank A/c Dr.		84,500	
	To Equity Share Capital A/c			84,500
	(Being the issue of 8,450 Equity Shares @ 10 per share)			
2	9% Preference Share Capital A/c Dr.		2,00,000	
	Premium on Redemption of Preference shares A/c Dr.		20,000	
	To Preference Shareholders A/c			2,20,000
	(Being amount payable on redemption of preference shares transferred to Preference Shareholders A/c)			
3	Bank A/c Dr.		40,500	
	Profit & Loss A/c Dr.		4,500	
	To Investments A/c			45,000
	(Being investments sold at loss)			
4	Preference Shareholders A/c Dr.		2,20,000	
	To Bank A/c			2,20,000
	(Being amount paid on redemption of pref. shares)			
5	Profit & Loss A/c Dr.		20,000	
	To Premium on Redemption of Pref. shares A/c			20,000
	(Being Premium on redemption of preference shares written off)			
6	General Reserve A/c Dr.		80,000	
	Profit & Loss A/c Dr.		35,500	
	To Capital Redemption Reserve A/c			1,15,500
	(For transfer to CRR out of divisible profits an amount equivalent to excess of nominal value of preference shares over proceeds i.e., 2,00,000-84,500)			

Balance Sheet (after redemption) (Extracts)

	Particulars	Note	Amount
I	**Equity and Liabilities**		
	Shareholders' funds		
	a) Share Capital	1	3,84,500
	b) Reserves and surplus	2	1,70,500
II	**Assets**		
	Current assets		
	a) Cash and cash equivalents	3	1,00,000

Notes to Accounts

No.	Particulars	Amount
1.	**Share Capital**	
	Issued & subscribed capital	

	38,450 Equity shares of ₹ 10 each	3,84,500
		3,84,500
2.	**Reserve & Surplus:**	
	General Reserve	40,000
	Capital Redemption Reserve	1,15,500
	Profit and Loss Account	Nil
	Investment Allowance Reserve	15,000
		1,70,500
3.	**Cash and cash equivalents**	
	Cash at bank (1,95,000 + 84,500+ 40,500 – 2,20,000)	1,00,000
		1,00,000

Working Note:

Calculation of Number of Shares:

Face value of shares redeemed		2,00,000
Less: Profit available for distribution as dividend:		
General Reserve: (1,20,000-40,000)	80,000	
Profit and Loss (60,000 less 20,000 set aside for adjusting premium payable on redemption of Pref. shares less 4,500 loss on sale of investments)	35,500	(1,15,500)
		84,500

No. of shares = 84,500/10 = 8,450 shares

Solution 9

Journal Entries

S.No.	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1	Bank A/c Dr.		75,000	
	To Share Application A/c			75,000
	(For application money received on 1,250 shares @ 60 per share)			
2	Share Application A/c Dr.		75,000	
	To Equity Share Capital A/c			62,500
	To Securities Premium A/c			12,500
	(For disposition of application money received)			
3	8% Preference Share Capital A/c Dr.		1,30,000	
	Premium on Redemption of Preference shares A/c Dr.		13,000	
	To Preference Shareholders A/c			1,43,000
	(Being amount payable on redemption of preference shares transferred to Preference Shareholders A/c)			
4	Bank A/c Dr.		30,000	
	Profit & Loss A/c Dr.		7,000	
	To Investments A/c			37,000
	(Being investments sold at loss)			
5	Preference Shareholders A/c Dr.		1,43,000	
	To Bank A/c			1,43,000
	(Being amount paid on redemption of pref. shares)			
6	Profit & Loss A/c Dr.		13,000	
	To Premium on Redemption of Pref. shares A/c			13,000
	(Being Premium on redemption of preference shares written off)			
7	Profit & Loss A/c Dr.		67,500	
	To Capital Redemption Reserve A/c			67,500

	(For transfer to CRR out of divisible profits an amount equivalent to excess of nominal value of preference shares over proceeds i.e., 1,30,000 - 62,500)			

Balance Sheet of Clean Ltd. (after redemption)

	Particulars	Note	Amount
I	**Equity and Liabilities**		
	(1) Shareholders' funds		
	a) Share Capital	1	5,12,500
	b) Reserves and surplus	2	88,500
	(2) Current Liabilities		
	a) Trade payables		1,13,000
			7,14,000
II	**Assets**		
	(1) Non Current assets		
	a) Property,Plant & Equipment & Intangible Assets		
	(i) Property,Plant & Equipment		6,90,000
	(2) Current assets		
	a) Cash and cash equivalents	3	24,000
			7,14,000

Notes to Accounts

No.	Particulars	Amount
1.	**Share Capital**	
	Issued & subscribed 10,250 Equity shares of ₹ 50 each	5,12,500
		5,12,500
2.	**Reserve & Surplus:**	
	Capital Redemption Reserve	67,500
	Profit and Loss Account (96,000 – 13,000 – 7,000 – 67,500)	8,500
	Securities Premium	12,500
		88,500
3.	**Cash and cash equivalents**	
	Cash at bank (62,000 + 75,000 +30,000 – 1,43,000)	24,000
		24,000

Working Note:

Calculation of Number of Shares:

Amount payable on redemption (1,30,000 + 10% Premium)	1,43,000
Less: Sale price of investment	(30,000)
	1,13,000
Less: Available bank balance (62,000 - 24,000)	(38,000)
Funds required from fresh issue	75,000

No. of shares = 75,000/60 = 1,250 shares

Solution 10

Journal Entries

S.No.	Particulars		Amount	Amount
1	10% Preference Share Final Call A/c	Dr.	6,00,000	
	To 10% Preference Share Capital A/c			6,00,000
	(For final call made on preference shares @ ₹ 20 each to make them fully paid up)			

2	Bank A/c	Dr.	6,00,000	
	To 10% Preference Share Final Call A/c			6,00,000
	(For receipt of final call money on preference shares)			
3	Bank A/c	Dr.	3,00,000	
	To Equity Share Application A/c			3,00,000
	(For receipt of application money on 1,50,000 equity shares @ ₹ 2 per share)			
4	Equity Share Application A/c	Dr.	3,00,000	
	To Equity Share Capital A/c			3,00,000
	(For capitalization of application money received)			
5	Equity Share Allotment A/c	Dr.	10,50,000	
	To Equity Share Capital A/c			7,50,000
	To Securities Premium A/c			3,00,000
	(For allotment money due on 1,50,000 equity shares @ ₹ 7 per share including a premium of ₹ 2 per share)			
6	Bank A/c	Dr.	10,50,000	
	To Equity Share Allotment A/c			10,50,000
	(For receipt of allotment money on equity shares)			
7	10% Preference Share Capital A/c	Dr.	30,00,000	
	Premium on Redemption of Preference Shares A/c	Dr.	3,00,000	
	To Preference Shareholders A/c			33,00,000
	(For amount payable to preference shareholders on redemption at 10 % premium)			
8	General Reserve A/c	Dr.	3,00,000	
	To Premium on Redemption A/c			3,00,000
	(Writing off premium on redemption of preferenceshares)			
9	General Reserve A/c	Dr.	19,50,000	
	To Capital Redemption Reserve A/c			19,50,000
	(For transfer of CRR the amount not covered by the proceeds of fresh issue of equity shares i.e., 30,00,000 – 3,00,000 - 7,50,000)			
10	Preference Shareholders A/c	Dr.	33,00,000	
	To Bank A/c			33,00,000
	(For amount paid to preference shareholders)			

Balance Sheet (extracts)

		Particulars	Notes No.	As at 31.3.2022 ₹	As at 31.12.2021 ₹
	EQUITY AND LIABILITIES				
	Shareholders' funds				
1.	a)	Share capital	1	70,50,000	84,00,000
	b)	Reserves and Surplus	2	59,00,000	59,00,000

Notes to Accounts:

		As at 31.3.2022	As at 31.12.2021
1.	**Share Capital**		
	Issued, Subscribed and Paid up:		
	6,00,000 Equity shares of ₹ 10 each fully paid up	60,00,000	60,00,000
	1,50,000 Equity shares of ₹ 10 each ₹ 7 paid up	10,50,000	-

	30,000, 10% Preference shares of ₹ 100 each, ₹ 80 paid up	-	24,00,000
		70,50,000	**84,00,000**
2.	**Reserves and Surplus**		
	Capital Redemption Reserve	37,50,000	18,00,000
	Securities Premium	9,00,000	6,00,000
	General Reserve	12,50,000	35,00,000
		59,00,000	**59,00,000**

Note:

Securities premium has not been utilized for the purpose of premium payable on redemption of preference shares assuming that the company referred in the question is governed by Section 133 of the Companies Act, 2013 and comply with the Accounting Standards prescribed for them.

Amount received (excluding premium) on fresh issue of shares till the date of redemption should be considered for calculation of proceeds of fresh issue of shares. Thus, proceeds of fresh issue of shares are ₹ 10,50,000 (₹ 3,00,000 application money plus ₹ 7,50,000 received on allotment towards share capital) and balance ₹ 19,50,000 to taken from general reserve account.

Solution 11

A company may prefer issue of new equity shares in the following situations:

(a) When the company realizes 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.

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

(1) No cash outflow of money is required – now or later.

(2) New equity shares may be valued at a premium.

(3) Shareholders retain their equity interest.

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

(1) There will be dilution of future earnings;

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