

## Redemption of Shares

Companies issue **Redeemable Shares** (provided that it has also issued shares that are not redeemable) because:

- a) they may be redeemed (purchased back) when the company has surplus funds
- b) the funds from the issue will be used in a project – the proceeds from which can be used to redeem the shares
- c) wary investors may buy these shares if they know they will be bought back by the company

The Companies Act 1985 allows companies to purchase back shares that it has previously issued to the shareholders – whether these shares were redeemable or not.

A company is allowed to buy back (redeem) their own shares in the following ways:

1. out of the proceeds (money) from a **NEW SHARE ISSUE**
2. by using the revenue reserves and converting them to a capital reserve called the **CAPITAL REDEMPTION RESERVE**
3. by using a combination of the above two methods

### Method 1 – Redeeming Shares from a New Share issue

#### **BEFORE**

Fixed Assets	1000
Net Current Assets	700
	<b>1700</b>
Ordinary Shares \$1 each	1000
8% Redeemable Preference Shares	300
General Reserve	250
Retained Profit	150
	<b>1700</b>

The company decides to redeem the Preference Shares out of the proceeds of a new share issue of 200 000 ordinary shares at a price of \$1,50 each.

#### **AFTER**

Fixed Assets	1000
Net Current Assets	700 (bank +300 and – 300)
	<b>1700</b>
Ordinary Shares \$1 each	<b>1200</b>
Share Premium	<b>100</b>
General Reserve	250
Retained Profit	150
	<b>1700</b>

Method 2 : **Redeeming Shares out of Reserves (NO NEW SHARE ISSUE)**

**BEFORE**

Fixed Assets	1000
Net Current Assets	700
	<b>1700</b>

Ordinary Shares \$1 each	1000
8% Redeemable Preference Shares	300
General Reserve	250
Retained Profit	150
	<b>1700</b>

Use the revenue reserves *Use \$ 250 of the General Reserve and \$ 50 from the Retained Profit*

**AFTER**

Fixed Assets	1000
Net Current Assets	400 (bank – 300)
	<b>1400</b>

Ordinary Shares \$1 each	1000
Capital Redemption Reserve	300
Retained Profit	100 (150 – 50)
	<b>1400</b>

**Step one – pay the preference shares out of the Bank**

Debit Preference Shares  
Credit Bank

**Step two – convert the reserves to the Capital Redemption Reserve**

Debit General reserve (and Retained Profit)  
Credit Capital Redemption reserve

## Redeeming Shares at a premium

Companies are allowed to redeem shares at a premium (eg \$1 shares redeemed for \$1,20)  
ONLY IF:

- a) the shares being redeemed were originally *issued at a premium* **AND**
- b) the shares are to be redeemed out of the proceeds of a *new share issue*

The amount of the premium that may be DEBITED to the Share premium must be the limited to:

- a) the amount of the premium received when the shares were originally issued
- b) the balance on the Share Premium account (a debit balance is not allowed)

### **BEFORE**

Fixed Assets	1100
Net Current Assets	600
	<b>1700</b>
Ordinary Shares \$1 each	1000
6% Redeemable Preference Shares	200
Share Premium	150
Retained Profit	350
	<b>1700</b>

The 6% redeemable preference share are to be redeemed at a premium of \$0.20 per share (total of \$ 240).

240 000 new shares were issued for this purpose AT PAR VALUE.

### **AFTER**

Fixed Assets	1100
Net Current Assets	<b>600 (BANK +240 AND -240)</b>
	<b>1700</b>
Ordinary Shares \$1 each	<b>1240 (1000 + 240)</b>
Share Premium	<b>110 (250 – 40)</b>
Retained Profit	350
	<b>1700</b>

If the shares being redeemed were NOT issued at a premium or NOT being redeemed out of the proceeds a new share issue, then the whole of the redemption including the premium must be debited to the PROFIT AND LOSS account.

**BEFORE**

Fixed Assets	1100
Net Current Assets	600
	<b>1700</b>
Ordinary Shares \$1 each	1000
6% Redeemable Preference Shares	200
Share Premium	150
Retained Profit	350
	<b>1700</b>

The 6% redeemable preference share are to be redeemed at a premium of \$0.20 per share (total amount of \$ 240). No new issue of shares is to be made for the purpose.

**AFTER**

Fixed Assets	1100
Net Current Assets	360 ( 600 – 240)
	<b>1460</b>
Ordinary Shares \$1 each	1000
Share Premium	150
Capital Redemption Reserve	200
Retained Profit	110 (350 – 240)
	<b>1460</b>

## **Redemption of Debentures**

A Debenture is a LOAN to a company. Therefore the redemption of a Debenture is simply the repayment of the loan by the company.

Entry will be in the Cash Book:

**DEBIT Debentures**

**CREDIT Bank**

Any premium paid to debenture holders may be charged to the SHARE PREMIUM account if there is one.

**DEBIT Debentures**

**Debit Share Premium** (with the amount of the premium)

**CREDIT Bank**

It is not necessary to create a Redemption Reserve account for Debentures. If the Directors decide that they want one, then the transfer should be made from the PROFIT AND LOSS account:

**DEBIT Profit and Loss**

**CREDIT Redemption Reserve**

## **Convertible Loan Stock**

These are Loans which can be converted into Shares at a previously agreed upon price when a pre-determined date arrives.

**DEBIT the convertible loan**

**CREDIT Ordinary Share Capital**

The holder of convertible loans has the right to exercise the option to convert the loan into shares or not. If, when the time arrives, the pre-determined price is LESS than the market price for the company's shares, then the holder will be wise to accept the option. The opposite is also true.