

Contents

Introduction

Background

Issue and Redemption of Redeemable Shares

Conversion of existing shares to redeemable shares

Purchase of own shares

Treasury Shares

Share Premium

Capital redemption Reserve Fund

Purchase of shares in holding companies

MISCELLANEOUS TECHNICAL STATEMENTS
ACCOUNTING FOR THE REDEMPTION AND PURCHASE OF OWN SHARES
BY COMPANIES IN THE REPUBLIC OF IRELAND

M31

INTRODUCTION

The purpose of this Miscellaneous Technical Statement (MTS 31) is to provide guidance on certain aspects of the redemption or acquisition by a company of its own shares and of shares in its holding company under Part XI of the Companies Act, 1990. MTS 31 deals with certain provisions of Part XI but is not intended to deal comprehensively with all aspects of the subject. In particular, taxation implications are not considered. MTS 31 should be read in conjunction with the Act. This Statement does not override the body of accounting regulation (SSAPs, FRSs and UITF Abstracts).

Background

1. Prior to the enactment of the Companies Act 1990 (1990 Act), the Companies Act 1963 (1963 Act) permitted the issue of redeemable preference shares, but there was no provision for redeemable ordinary shares (S.64). The 1963 Act prohibited a company from purchasing its own shares (S.72.1). A company could issue redeemable preference shares and fund any premium on redemption out of the share premium account before the shares were redeemed without any restriction (S.64.1(c)). A company was also required to transfer from distributable reserves to a Capital Redemption Reserve Fund (CRRF) an amount equal to the excess of the nominal value of the shares redeemed and the proceeds of a fresh issue, if any (S.64.1 (d))
2. The 1990 Act introduced a number of changes, the principal of which are:
 - 2.1 A company may issue redeemable shares of any class (S.207).
 - 2.2 Existing non-redeemable shares, can be converted into redeemable shares (S.210)
 - 2.3 A company may redeem or purchase its own shares (S.211).
 - 2.4. Having redeemed or purchased its shares, a company can either cancel them or hold them in treasury (S.208 and 209). Shares held in treasury can subsequently be re-issued.
 - 2.5. There is a limitation on the use of the share premium account to fund a premium on redemption (S.207.2).
 - 2.6. There is a limitation on the use of the proceeds from a fresh issue when computing any CRRF (S.208(b)(ii)).
 - 2.7. A company may purchase shares in its holding company (S.224).
3. The paragraphs which follow deal with each of these changes.

MISCELLANEOUS TECHNICAL STATEMENTS
ACCOUNTING FOR THE REDEMPTION AND PURCHASE OF OWN SHARES
BY COMPANIES IN THE REPUBLIC OF IRELAND

M31

Issue and Redemption of Redeemable Shares

4. Redeemable shares of any class may be issued provided the company is so permitted by its articles of association. Redeemable shares may on redemption be either cancelled or held in treasury.
5. Certain important conditions apply to the issue and redemption of redeemable shares. These include:
 - 5.1. Redeemable shares can be neither issued nor redeemed at a time when the nominal value of the non-redeemable issued share capital falls below 10% of the total nominal value of the issued share capital.
 - 5.2. Only fully paid-up shares may be redeemed.
 - 5.3. The terms of redemption must provide for payment - although the Act does not specify the form of payment.
 - 5.4. Where shares are being redeemed and cancelled, they must be funded out of the proceeds of a fresh issue or out of distributable profits.
 - 5.5. Where shares are being redeemed and held as treasury shares, they must be funded out of distributable profits.

Conversion of existing shares to redeemable shares

6. Existing non-redeemable shares may be converted into redeemable shares provided that, following the conversion, the nominal value of the issued non-redeemable shares equals or exceeds 10% of the total nominal value of the issued share capital.
7. An individual shareholder may, provided s/he notifies the company of objections prior to the conversion, retain her/his existing holding in its original non-redeemable form.

Purchase of own shares

8. In addition to the redemption of redeemable shares, a company may buy back its own non-redeemable shares and either cancel them or hold them in treasury (see par.11) provided it is so authorised by its articles of association. Again, the nominal value of the non- redeemable shares in issue must remain greater than or equal to 10% of the total issued share capital.
9. Shares may be purchased "on-market" by quoted PLCs or "off-market" by any company subject to certain conditions relating to resolutions at a general meeting.
10. The purchase of own shares is subject to similar conditions to those relating to the redemption of shares (see par. 5).

MISCELLANEOUS TECHNICAL STATEMENTS
ACCOUNTING FOR THE REDEMPTION AND PURCHASE OF OWN SHARES
BY COMPANIES IN THE REPUBLIC OF IRELAND

M31

Treasury Shares

11. Where a company either redeems or purchases its shares, it has two options: it may either cancel them or hold them as "treasury shares". There is no time limit on the holding of shares in treasury and a company may cancel them or re-issue them at any time or continue to hold them. If the shares are subsequently cancelled, the provisions relating to funding (see par. 5.4) apply. If they are re-issued "off-market", the re-issue must be within a range of prices approved by a special resolution of the company and must take place within 18 months of the passing of that resolution.
12. The votes attaching to treasury shares may not be exercised and no dividends or other payments may be made on such shares so long as they remain in treasury. Treasury shares should be excluded in the determination of the average number of shares in computing the earnings per share.
13. The nominal value of treasury shares outstanding together with the nominal value of shares of the company owned by its subsidiaries and nominees (see par. 20) may not exceed 10% of the nominal value of the company's issued share capital. For this purpose, shares held by a subsidiary before it became a subsidiary are excluded.
14. A company holding shares in treasury must not display the holding in its balance sheet as an asset. The Act requires that it must, on acquisition, show the deduction of the purchase price from the distributable profits. In practice this is best achieved by showing the deduction of the purchase price from the reserve which contains the distributable profit out of which the purchase was funded (par. 5.4.). In most cases this will entail a deduction from the profit and loss account reserve in the Reconciliation of Movements in Shareholders' Funds note in the year of acquisition.

In subsequent years, so long as the company, or its nominee, holds its own shares, the nominal value of the shares and the amount by which the distributable profits have been reduced (i.e. the cost of the shares acquired and still held in treasury) should be disclosed.

15. Although there is no specific legal requirement relating to the accounting for the re-issue of treasury shares, it may be inferred from S.209.5 of the 1990 Act that the proceeds from the re-issue of treasury shares should be credited to a reserve which is distributable through the Reconciliation of Movements in Shareholders' Funds. The price at which the shares were redeemed and the price at which they are being re-issued should be disclosed. If shares re-issued were redeemed at different times and different prices, companies should also disclose the method used for arriving at the price redeemed (for example, FIFO, average cost, etc .) .

MISCELLANEOUS TECHNICAL STATEMENTS
ACCOUNTING FOR THE REDEMPTION AND PURCHASE OF OWN SHARES
BY COMPANIES IN THE REPUBLIC OF IRELAND

M31

Share Premium

16. For redeemable preference shares issued before 1 July 1991: The provisions of the 1963 Act continue to apply. Where shares are redeemed at a premium, the premium on redemption may be charged against the share premium account or partly against the share premium account and partly against distributable profit.
17. For all other shares redeemed/purchased and cancelled: The premium on redemption or purchase may be funded out of the proceeds of a fresh issue and may be charged against the share premium account, but only to the extent of the lower of
 - the original premium at which those shares were issued and
 - the balance on the share premium account, including any premium on a fresh issue to fund the redemption.

All other premiums on redemption must be funded out of distributable profit and shown as reserve movements. It should be noted that if there is no fresh issue, even if there is a balance on the share premium account arising on the original issue of the shares, the premium must be charged against distributable profit.

Capital Redemption Reserve Fund

18. Where shares are redeemed/purchased and cancelled, the nominal value of the shares redeemed/purchased may be funded from the proceeds of a fresh issue of shares. If there is no fresh issue or insufficient proceeds to cover the redemption, a transfer must be made to a CRRF from the distributable profits to the extent of the deficit. However, in calculating the deficit, the proceeds of the fresh issue must be reduced by the amount (if any) of the premium on redemption which was offset against those proceeds (see par. 17). Figure 1 shows an example of this calculation.

MISCELLANEOUS TECHNICAL STATEMENTS

ACCOUNTING FOR THE REDEMPTION AND PURCHASE OF OWN SHARES BY COMPANIES IN THE REPUBLIC OF IRELAND

M31

Figure One

X PLC issued 34,000 £1 ordinary shares at a premium of £4,500 in January 1993.

It is now proposed to redeem those shares at a premium of £7,500 and then to cancel them, the redemption being funded by the issue of 24,000 £1 shares at a premium of £12,000. The balance on the share premium account following the fresh issue is £16,500

Journal entries

Bank	36,000	
Ordinary Share Capital		24,000
Share premium account		12,000
<i>Being the issue of shares at a premium</i>		

Ordinary Share Capital	34,000	
Share Premium Account	4,500*	
Profit and Loss Reserve	3,000	
Bank		41,500
<i>Redemption of shares at a premium</i>		

Profit and Loss Reserve	2,500**	
Capital Redemption Reserve		2,500
<i>Transfer to CRRF pursuant of S.208 CA 1990</i>		

*Since the shares were issued after July 1991, the premium on redemption of £7,500 cannot be written off in full against the share premium account. The amount of the write off is restricted to the lower of:

The original premium on issue	£4,500
The balance on the SP account including the premium on the fresh issue	£16,500

**The transfer to the CRRF is computed as follows:

Nominal value of shares redeemed		34,000
Less:		
Aggregate proceeds	36,000	
Part of proceeds used to pay premium	<u>4,500</u>	<u>31,500</u>
Capital redemption reserve fund		<u>£2,500</u>

MISCELLANEOUS TECHNICAL STATEMENTS
ACCOUNTING FOR THE REDEMPTION AND PURCHASE OF OWN SHARES
BY COMPANIES IN THE REPUBLIC OF IRELAND

M31

Purchase of shares in holding companies

19. An Irish registered subsidiary company may purchase shares in its own holding company provided the purchase price is met out of the subsidiary's post acquisition profits (this restriction will not apply where a combination was effected as a merger). Pre acquisition profits which are deemed to be distributable by virtue of S.149.5 of the 1963 Act are not available for this purpose.
20. In order that the users might be given a true and fair view of a material restriction of the subsidiary's distributable profits, an amount equal to the purchase price of the holding company's shares should be transferred from the profit and loss reserve to a "special reserve". In all cases, the restriction should be explained by way of note so long as the shares are held by the subsidiary.
21. In most cases the shares in the holding company will be shown as an asset in the financial statements of the subsidiary with a note clearly stating that they are shares in the holding company. However, it is necessary to consider the carrying value of the shares to ensure that the recoverable amount of the shares is sufficient to justify the amount at which they are carried. Where the shares are held as a fixed asset, they should be shown at the lower of cost less permanent diminutions in value and where they are held as a current asset, at the lower of cost and net realisable value.
22. On consolidation, holding company shares held by a subsidiary should be treated as if they were treasury shares held by the parent. Often the dividend is waived, but even if dividend is not waived, the underlying shares should be excluded from the calculation of earnings per share since there is no outflow from the group and, from the perspective of the group, the substance of a purchase of the shares by a subsidiary is the same as the purchase of the shares by the parent.

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