

## Case 92-5

### **Mandatorily Redeemable Preferred Stock**

Bigtown Bank Corporation is an SEC reporting bank holding company with one subsidiary operating bank, Hicktown Bank. As part of its acquisition of Hicktown in 1982, the holding company issued to the shareholders of Hicktown Bank stock in Bigtown Bank having a fair value at issue of \$7.00 per share. The redemption price of the stock, which was mandatorily redeemable on March 15, 1986, was \$11.00. In addition to the redemption feature, the stock was convertible to common stock and gave the shareholders all the rights of common shareholders. If the stock were tendered (presented back to Bigtown Bank) by the shareholders and not redeemed, holders would be entitled to cumulative dividends of \$1.10 per share per year and would continue to have all the rights of common shareholders.

Because banks are regulated entities, they have to maintain certain capital levels in order to pay dividends or provide other funding, such as the redemption of the exchange stock. During 1984, Hicktown's capital fell below the required amount so a cease and desist order was issued by the bank regulatory authority precluding Hicktown from providing Bigtown with the funding to redeem the exchange stock. Nevertheless, all exchange stock shareholders tendered their shares at the redemption date. Because Bigtown was unable to redeem the shares, the holders were entitled to start receiving cumulative dividends.

#### **Required:**

- At what amount should Bigtown have recorded the convertible redeemable preferred stock when it was issued?
- How should Bigtown have accounted for the stock before it was tendered?
- How should Bigtown have accounted for the redeemable stock after it was tendered?