4. ACCOUNTING FOR BUY-BACK OF SHARES

MODEL WISE ANALYSIS OF PAST EXAM PAPERS OF IPCC

MODEL NO.	N-11	M-12	N-12	M-13	N-13	M-14	N-14	M-15	N-15	M-16	N-16
Problems	-	8	12	-	-	-	-	-	-	12	8
Theory	-	-	-	-	-	4	-	-	-	-	-

THEORY

Meaning of Buy-back of shares: The term Buy-back of shares implies the act of purchasing its own shares and other specified securities by a company.

Three sources of funds for Buy-back:

As per Sec. 68 (1) a company may purchase its own shares or other specified securities out of –

1. Its free reserves; or
2. The securities premium account; or
3. The proceeds from the issue of any shares or other specified securities.

Note: No Buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

The buy-back may be:

1. from the existing security holder on a proportionate basis; or
2. from the open market; or
3. By purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

CONDITIONS FOR BUY-BACK: As per Sec 68 (2) Companies Act, 2013.

1. The buy-back must be **authorized by the Articles**
2. The buy-back should be made by passing **special resolution in the General Meeting** of shareholders. **(OR)**

Incase the buy-back is **up-to 10%** of paid up equity capital + free reserves, the same **may be done** with the **authorization of the board resolution**.

3. **No offer** of Buy-back must be made **within** a period of **365 days from the date of closure** of a previous offer of Buy-back if any.
4. The **buy-back** of the shares **must not exceed 25% of total paid-up equity capital**.
5. The **buy-back** of equity shares **in any financial year must not exceed 25% of its total paid-up equity capital and free reserves.**
6. The **debt-equity ratio** must **not be more than 2:1 after such buy-back**. But central government may prescribe higher ratio

   Here, Debt = Secured + Unsecured Debt and Equity = Equity share Capital + Free Reserves

   Free Reserves = Free Reserves as per Sec. 2(43) + Securities Premium as per Sec 52 (1).

   Equity = Equity & Preference share capital or paid up capital
7. All the shares for buy-back **must be fully paid-up**.

8. The company must file **solvency declaration** with the Registrar and SEBI (in case of listed companies) in the form of an affidavit signed by at least two directors of the company stating that opinion the company is capable of meeting its liabilities and will not render insolvent within a period of one- year from the date of declaration adopted by the Board.
9. As per sec. 69 (1) Where a company **purchases its own shares out of free reserves or securities premium account**, than a sum equal to the **nominal value of the shares so purchased shall be transferred to the capital redemption reserve account.**
10. **Where a company completes a buy-back** of its shares or other specified securities under this section, it **shall not make further issue of same kind** of shares or other specified securities **within a period of 6 months except by way of bonus issue or** in the discharge of subsisting obligations such as **conversion of warrants, stock option schemes,** sweat equity or conversion of preference shares or debentures into equity shares.

    SEBI Guidelines 1998 on Buy-back, applicable to listed companies or company which intends to get listed, in addition to the provisions of Companies Act 2013:
11. No offer of Buy-back for 15% or more of the paid up equity capital and free reserves of the company shall be made from the **open market**.
12. The company shall ensure that at least 50% of the amount earmarked for buy-back is utilized for buying back shares or other specified securities.

<u>**Some important terms:**</u>

Specified securities: It includes employees' stock option or other securities as may be notified by the central government from time to time.

Free Reserves: As per sec. 2(43) of the companies act 2013, free reserves means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend. Provided that –

1. Any amount representing unrealized gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or
2. Any change in carrying amount of an asset or of a liability recognized in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value, shall not be treated as free reserves.

How to calculate the maximum no. of shares that can be bought back:

Maximum number of equity shares that can be bought back is least of the following 3 tests.

1. Outstanding shares test : 25% of outstanding equity shares
2. Resource test : $\frac{25\% \text{ of (paid up capital} + \text{free reserves)}}{\text{buy back price per share}}$
3. Debt-Equity ratio test: **Debt-Equity ratio** must **not be more than 2:1 after such buy-back**.

As per section 68 of the Companies Act, 2013:

1. The ratio of debt owed by the company should not be more than twice the capital and its free reserve <u>after such buy - back.</u> and

As per Section 69(1) of the companies Act, 2013

1. A sum equal to the <u>nominal value</u> of the share bought back shall be transferred to Capital Redemption Reserve (CRR).
2. Utilization of CRR is restricted to issuance of <u>fully paid-up bonus shares</u> only.

It means CRR is <u>not</u> available <u>for</u> distribution as <u>dividend</u>. Hence, CRR is not a free reserve.

Based on the above provisions the following equations can be obtained:

It is presumed that the buy back is out of Free reserves or securities premium

Equation 1: Maximum permissible buy-back of equity = (Present equity – Nominal value of buy-back transfer to CRR) – Minimum equity to be maintained

Equation 2:

$\frac{\text{Maximum buy - back}}{\text{offer price for buy back}} \text{X Nominal value} =$ Nominal value of the shares bought back to be transferred to CRR

By solving the above two equations we get the value of Maximum permitted buy back of equity.

$$\text{Number of shares to be bought back} = \frac{\text{Maximum of permitted buy back of equity}}{\text{Buy back price}}$$

Simplified approach for Debt Equity Test:

Debt equity ratio is to be maintained after buy-back as 2:1. i.e. after adjustment of face value of buy-back share (CRR) and reduction in the capital & reserve for buy-back.

Assume 'x' be the maximum number of shares brought back.

Equity share capital+ Free reserves – x (buy-back price) – x (Face value) = (Debt x 50%)

$$x = \frac{\text{Equity share capital} + \text{Free reserves - (Debt x 50\%)}}{\text{Buy back price} + \text{Face value per shre}}$$

<u>Debt equity test when the Buyback is out of fresh Issue:</u>

Assume 'x' be the maximum number of shares brought back.

Equity share capital+ Free reserves – x (buy-back price) = (Debt x 50%)

$$x = \frac{\text{Equity share capital} + \text{Free reserves - (Debt x 50\%)}}{\text{Buy back price}}$$

Note: Minimum equity funds = loan funds/2 (Since Debt Equity ratio 2: 1)

For debt equity ratio, both secured and unsecured loans are considered.

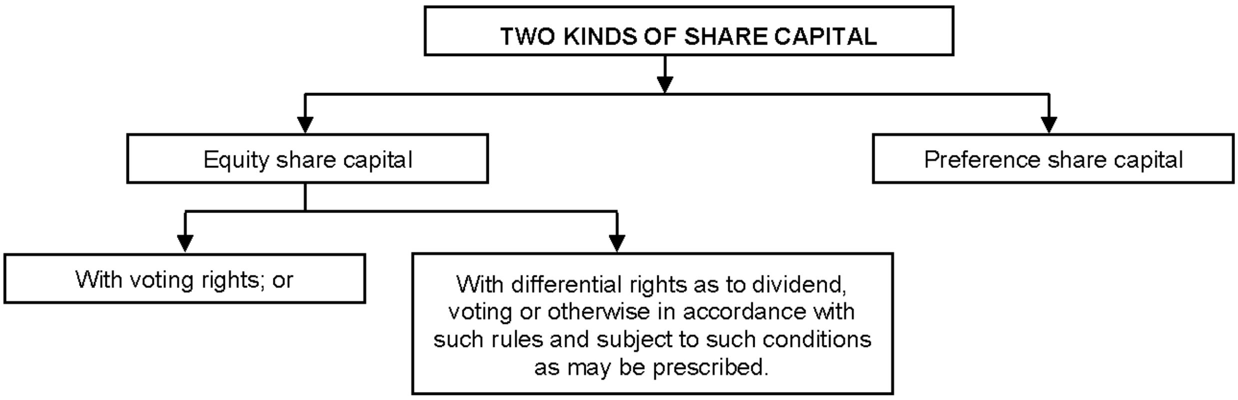
Penalty provision: If a company makes default in complying with the provisions of the section or any regulations made by SEBI in this regard, the company may be punishable with a fine of 1 lakh rupees to 3 lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for up-to 3 years or with fine of 1 lakh rupees to 3 lakh rupees or with both.

Accounting Entries:

The various journal entries to be passed on Buy-back are given as follows:

S. No.	Particulars
1.	**To make partly paid Equity Shares Fully paid up:** **a) On making Final Call** Equity share final call A/c Dr. To Equity Share Capital A/c **b) On Receipt of Final Call** Bank A/c Dr. To Equity share final call A/c
2.	**To realize investment to provide cash for Buy-back:** Bank A/c Dr. Profit and Loss A/c Dr. To Investments A/c To Profit and Loss A/c
3.	**To issue fresh other kind of shares or securities A/c (Say preference shares)** **a) On receipt of Application Money**

	Bank A/c Dr. To Pref. Share Application & Allotment A/c **b) On Allotment** **i) If at par** Pref. share application & Allotment A/c Dr. To Pref. Share Capital A/c **ii) If at Premium** Pref. Share Application & Allotment A/c Dr. To Pre. Share Capital A/c To Securities Premium A/c **iii) If a Discount** Pref. Share Application & Allotment A/c Dr. Discount on issue of Share A/c Dr. To Preference Share Capital A/c
4.	**To transfer Free Reserves to Capital Redemption Reserve Account to the extent the Buy-back is out of free reserves & securities premium:** Revenue Reserve Dr. Profit & Loss A/c Dr. To Capital Redemption Reserve A/c **Tutorial Note:** Capital Redemption Reserve can be utilized only for issuing fully paid bonus shares to members.
5.	**To Make payment to Equity shareholders on Buy-back:** Equity shares Buyback A/c Dr. [With Amount due] To Bank A/c
6.	**To make money due to equity shareholders on Buy-back:** **a) If the buy-back is at par** Equity Share Capital A/c Dr. [With Nominal Value] To Equity Share Buyback A/c **b) If the buy-back is at premium** Equity Share Capital A/c Dr. [With Nominal Value] Securities Premium A/c Dr. [With Premium] To Equity Share Buyback A/c [With Total] **c) If the buy-back is at discount** Equity Share Capital A/c Dr. [With Nominal Value] To Equity Share Buyback A/c [With Net Amount] To Capital Reserve A/c [With Discount]



PROBLEMS FOR CLASSROOM DISCUSSION

Problem 1: (PRINTED SOLUTION AVAILABLE) Sale of Investment & Bonus –Basic level: KG Limited furnishes the following summarized Balance Sheet as at 31st March, 2013:

Liabilities	(Rs. In lakhs)	Assets	(Rs. In lakhs)
Equity share capital (fully paid up shares of Rs.10 each)	1,200	Machinery	1,800
Securities premium	175	Furniture	226
General reserve	265	Investment	74
Capital redemption reserve	200	Inventory	600
Profit & loss A/c	170	Trade receivables	260
12% Debentures	750	Cash at bank	740
Trade payables	745		
Other current liabilities	195		
	3,700		**3,700**

On 1st April, 2013, the company announced the Buy-back of 25% of its equity shares @ Rs.15 per share. For this purpose, it sold all of its investments for Rs.75 lakhs.

On 5th April, 2013, the company achieved the target of Buy-back. On 30th April, 2013 the company issued one fully paid up equity share of Rs.10 by way of bonus for every four equity shares held by the equity shareholders.

You are required to:

(1) Pass necessary journal entries for the above transactions.

(2) Prepare Balance Sheet of KG Limited after bonus issue of the shares. **(PM)**

(Ans: Balance sheet Total Rs.3,251 lakhs)

(Solve problem no 1 and 2 of assignment problems as rework)

Note: ____

____

Problem 2: (PRINTED SOLUTION AVAILABLE) Maximum no of equity shares that can be bought back: Perrotte ltd. (a non-Listed company) has the following capital structure as on 31.03.2011 **(In crores)**

	Particulars	Rs.
1.	Equity share capital (shares of Rs.10 each fully paid)	330
2.	**Reserves and surplus:**	
	General reserve	240
	Securities premium account	90
	Profit and loss account	90
	Infrastructure development reserve	180
3.	Loan funds	1,800

The shareholders of perrotte ltd., on the recommendation of their board of directors, have approved on 12.09.2011 a proposal to Buy-back the maximum permissible number of equity shares considering the large surplus funds available at the disposal of the company.

The prevailing market value of the company's shares is Rs.25 per share and in order to induce the existing shareholders to offer their shares for Buy-back, it was decided to offer a price of 20% over market.

You are also informed that the infrastructure reserve is created to satisfy income tax Act requirements.

You are required to compute the maximum number of shares that can be bought back in the light of the above information and also under a situation where the loan funds of the company were either Rs.1,200 crores or Rs.1,500 crores.

Assuming that the entire Buy-back is completed by 09.12.2011, show the accounting entries in the company's book in each situation. **(SM)**

(Ans.: Maximum No. of shares that can be bought back 3.75 crores of shares)

Note: ____

____

Problem 3: Maximum no of equity shares that can be bought back And Balance sheet after Buy-back: Following is the Balance Sheet of M/s Competent Limited as on 31st March, 2013:

Name of the Company : M/S competent limited

Balance Sheet as at : 31st March 2013

			Particulars	Notes No.	Rs.
			1	2	3
1			**EQUITY AND LIABILITIES:**		
			Shareholder's funds		
	a		Share capital	1	12,50,000
	b		Reserves and Surplus	2	18,75,000
2			**Non-current liabilities:**		
	a		Long term borrowings	3	28,75,000
3			**Current liabilities**		16,50,000
			TOTAL		**76,50,000**
1			**ASSETS:**		
			Non -current assets		
	a		Fixed assets		46,50,000
2			**Current Assets:**		30,00,000
			TOTAL		**76,50,000**

Note to Accounts:

Particulars	Rs.
1. Share capital	
Share Cap. fully paid of Rs.10	12,50,000
2. Reserves and Surplus	
Securities Premium	2,50,000
Revenue Reserve	15,00,000
Profit and Loss A/c	1,25,000
3. Long Term Borrowings	
12% debentures	18,75,000
Unsecured loans	10,00,000

The company wants to Buy-back 25,000 equity shares of Rs.10 each, on 1st April, 2013 at Rs.20 per share. Buy-back of shares is duly authorized by its articles and necessary resolution passed by the company towards this. The payment for Buy-back of shares will be made by the company out of sufficient bank balance available as part of Current Assets. Comment with your calculations, whether Buy-back of shares by company is within the provisions of the companies Act, 2013. If yes, pass necessary journal entries towards buyback of shares and prepare the Balance Sheet after Buy-back of shares. **(PM)**

(Ans.: Total of Balance Sheet: Rs. 71,50,000)

Note: ____

____

Problem 4: Advanced (Comprehensive of Buy-back, ESOP, issue and redemption of debentures): Extra Ltd (a non-listed company) furnishes you with the following summarized balance sheet as on 31st march, 2012.

Name of the Company : Extra Limited

Balance Sheet as at : 31st March 2012 **(In Lakhs)**

			Particulars	Notes No.	Rs.
			1	**2**	**3**
1			**EQUITY AND LIABILITIES:**		
			Shareholder's funds		
	A		Share capital	1	120
	B		Reserves and Surplus	2	118
2			**Non-current liabilities**		
	A		Long term borrowings		
		(i)	10% Debentures		4
3			**Current liabilities**		70
			TOTAL		**312**
1			**ASSETS:**		
			Non-current assets		
	A		Fixed assets		
		(i)	Tangible assets	3	50
		(ii)	Non-current investment (Investments at cost)		120
2			**Current Assets:**		142
			TOTAL		**312**

Note to Accounts: **(In lakhs)**

Particulars	Rs.
1. Share capital	
Equity Shares of **Rs.**10 each fully paid	100
9% redeemable preference shares of **Rs.** 100 each fully paid	20
2. Reserves and Surplus	
Securities Premium	60
Capital Reserve	8
Revenue reserve	50
3. Tangible Assets	
Fixed Assets less depreciation	50

1. The company redeemed the preference shares at a premium of 10% on 1st april,2012
2. It also bought back 3 lakhs equity shares of Rs.10 each at Rs.30 per share.

   The payment for the above was made out of huge bank balances, which appeared as a part of the current assets.
3. Included in its investment were "investments in own debentures" costing Rs.2 lakhs (face value Rs.2.20 lakhs). These debentures were cancelled on 1st April, 2012.
4. The company had 1,00,000 equity stock options outstanding on the above mentioned date, to the employee at Rs.20 when the market price was Rs.30.(this was included under current liabilities). On 1.04.2012 employees exercised their options for 50,000 shares.
5. Pass the journal entries to record the above.
6. Prepare balance sheet as at 01.04.2012. **(SM) (Nov - 2010 Similar Problem)**

(Ans.: Total of Balance Sheet: Rs. 208L)

(Solve problem no 3 and 4 of assignment problems as rework)

Note: ____

ASSIGNMENT PROBLEMS

Problem 1: Basic level: Dee Limited (a non-listed company) furnishes the following summarized Balance Sheet as at 31st March, 2012:

Particulars	Rs.'000	Rs.Rs.'000
LIABILITIES:		
Share capital:		
Authorized capital		30,00
Issued and subscribed capital:		
2,50,000 Equity shares of Rs.10 each fully paid up	25,00	
2,000, 10% Preference shares of Rs.100 each	2,00	27,00
(Issued two months back for the purpose of Buy-back)		
Reserves and surplus:		
Capital reserve	10,00	
Revenue reserve	30,00	
Securities premium	22,00	
Profit and loss account	35,00	97,00
Current liabilities and provisions		14,00
		1,38,00
ASSETS:		
Fixed assets		93,00
Investments		30,00
Current assets, loans and advances (including cash and bank balance)		15,00
		1,38,00

The company passed a resolution to Buy-back 20% of its equity capital @ Rs.50 per share. For this purpose, it sold all of its investment for Rs.22,00,000.

You are required to pass necessary journal entries and prepare the Balance Sheet. **(SM)**

(Ans: Balance sheet Total Rs.10,500)

Problem 2: Accounting treatment for buy back of shares at premium: CAN Ltd. furnishes you with the following Balance Sheet as at 31st March, 2011: (This is a newly added problem from 34e Classroom discussion P.No:3; Also covered in RTP-May2012 and Study Material; added for practice) **(In crores of Rs.)**

Particulars	Rs.	Rs.
Source of funds:		
Share Capital:		
Authorized:		100
Issued:		
12% Redeemable Pref. Shares of Rs.100 each fully paid	75	
Equity shares of Rs.10 each fully paid	25	100
Reserves and Surplus:		
Capital reserve	15	
Securities premium	25	
Revenue Reserve	260	300
		400
Funds employed in:		
Fixed assets: Cost	100	
Less: Provision for depreciation	100	Nil
Investment at cost (Market value Rs.400 cr.)		100
Current assets	340	
Less: Current liabilities	40	300
		400

The company redeemed preference shares on 1st April, 2011. It also bought back 50 lakh equity shares of Rs.10 each at Rs.50 per share. The payments for the above were made out of the huge bank balances, which appeared as part of current assets

You are asked to:

a) Pass journal entries to record the above

b) Prepare balance sheet. **(SM) (RTP - M12)** *(Ans.: Total of Balance Sheet: Rs. 340C)*

Problem 3: On 31st March 2007, following was the balance sheet of FCS Limited:

Name of the Company : FCS Limited

Balance Sheet as at : 31st March 2007

			Particulars	*Notes No.*	Rs. *(in lakhs)*
			1	2	3
			EQUITY AND LIABILITIES:		
1			**Shareholder's funds**		
	a		Share capital	1	2,400
	b		Reserves and Surplus	2	1,620
			Non-current liabilities		
2	a		Long tem borrowings		
		(i)	12% Debentures		1,500
			Current liabilities		
3	a		Trade Payable(creditors)		750
	b		Short term provisions		390
			TOTAL		**6,660**
			ASSETS:		
			Non current assets:		
1			Fixed assets		
	a	(i)	Tangible assets	3	4,052
		(ii)	Non-current investment		148
			Current Assets:		
2	a		Inventories (Stock)		1,200
	b		Trade receivables(Debtors)		520
	c		Cash and cash equivalents (Cash at bank)		740
			TOTAL		**6,660**

Note to Accounts:

Particulars	Rs.
1. Share capital	
Share Cap. fully paid of Rs.10	2,400
2. Reserves and Surplus	
Securities Premium	350
General Reserve	930
Profit and Loss A/c	340
3. Tangible Assets	
Machinery	3,600
Furniture	452

On 1st April 2007 the company announced the buy-back of 25% of its equity shares @ 15 per share. For this purpose, it sold all of its investments for Rs.150 Lakhs and issued 2,00,000, 14% preference shares of Rs.100 each at par, the entire amount being payable with application.

The issue was fully subscribed. The company achieved the target of buy-back. Later the company issued one fully paid up equity share of Rs.10 by way of bonus shares for every four equity shares held by the equity shareholders.

Required: Show journal entries for all transactions including cash transactions

(Nov - 2009 Similar Problem)

Problem 4: Advanced (Comprehensive of Buy-back, ESOP, issue and redemption of debentures): M Ltd. furnishes the following summarized Balance Sheet as at 31st March, 2013:

Particulars	Rs.'000	Rs.'000
EQUITY & LIABILITIES:		
Share Capital:		
Authorized Capital:		5,000
Issued and Subscribed Capital:		
3,00,000 Equity shares of Rs.10 each fully paid up	3,000	
20,000 9% Preference Shares of 100 each (issued two months back for the purpose of Buy-back)	2,000	
		5,000
Reserve and Surplus:		
Capital reserve	10	
Revenue reserve	4,000	
Securities premium	500	
Profit and Loss account	1,800	6,310
Non-current liabilities - 10% Debentures		400
Current liabilities and provisions		40
		11,750
ASSETS:		
Fixed Assets: Cost	3,000	
Less: Provision for depreciation	250	2,750
Non-current investments at cost		5,000
Current assets, loans and advances (including cash and bank balances)		4,000
		11,750

1. The company passed a resolution to Buy-back 20% of its equity capital @ Rs.15 per share. For this purpose, it sold its investments of Rs.30 lakhs for Rs.25 lakhs.
2. The company redeemed the preference shares at a premium of 10% on 1st April, 2013.
3. Included in its investments were 'Investments in own debentures' costing Rs.3 lakhs (face value Rs.3.30 lakhs). These debentures were cancelled on 1st April, 2013.

You are required to pass necessary Journal entries and prepare the Balance Sheet on 01.04.2013. **(PM)** ***(Ans: Balance sheet Total Rs.7,850)***

ABC ANALYSIS

	A Category	B Category	C Category
Class Room Problems	1, 3	2, 4	-
Assignment Problems	-	2, 3, 4	1

Verified by: Hari Narayana Sir,
Manjunath Sir,
Executed by: Rajasekhar Sir.

THE END