CHAPTER 12

BUY-BACK OF SECURITIES

LEARNING OUTCOMES

After studying this chapter, you will be able to:

- Elucidate the meaning of buy-back of securities;
- Comprehend the Accounting Treatment buy-back of securities;
- Learn the provisions of the Companies Act regarding buy-back of securities.

CHAPTER OVERVIEW

Buy-Back of Shares

- As per Section 68 (1) of the Companies Act 2013, buy-back of shares can be made out of: its free reserves; or the securities premium account; or the proceeds of any shares or other specified securities.
- The buy-back of equity shares in any financial year shall not exceed twenty-five per cent of its total paid-up equity capital in that financial year.
- There shall be a minimum gap of one year in a buy-back offer from the date of closure of the previous buy-back.
- The ratio of the debt owed by the company is not more than twice the capital and its free reserves after such buy-back.

1. INTRODUCTION

Buy-back of shares means purchase of its own shares by a company. When shares are bought back by a company, they have to be cancelled by the company. Thus, shares buy-back results in decrease in share capital of the company. A company cannot buy its own shares for the purpose of investment. A company having sufficient cash may decide to buy-back its own shares. The following may be the objectives/advantages of Buy-back of shares:

(a) to increase earnings per share if there is no dilution in company's earnings as the buy-back of shares reduces the outstanding number of shares.

(b) to increase promoters holding as the shares which are bought back are cancelled.

(c) to discourage others to make hostile bid to take over the company as the buy-back will increase the promoters holding.

(d) to support the share price on the stock exchanges when the share price, in the opinion of company management, is less than its worth, especially in the depressed market.

(e) to pay surplus cash to shareholders when the company does not need it for business.

The Companies Act, 2013 under Section 68 (1) permits companies to buy-back their own shares and other specified securities out of:

(i) its free reserves; or

(ii) the securities premium account; or

(iii) the proceeds of 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. For example, if equity shares are to be bought-back, then, preference shares may be used for the purpose.

The other important provisions relating to the buy-back are:

(1) Section 68 (2) further states that no company shall purchase its own shares or other specified securities unless—

(a) the buy-back is authorised by its articles;

(b) a special resolution has been passed in general meeting of the company authorising the buy-back;

However, the above provisions do not apply where the buy-back is ten percent or less of the paid-up equity capital + free reserves and is authorized by a board resolution passed at a duly convened meeting of the directors. Hence, in case the buy-back is up to 10% of paid up equity + free reserves, the same may be done with the authorization of the Board Resolution without the necessity of its being authorized by the articles of association of the company and by a special resolution of its members passed at a general meeting of the company.

(c) the buy-back must be equal or less than twenty-five per cent of the total paid-up capital and free reserves of the company: (Resource Test)

(d) Further, the buy-back of shares in any financial year must not exceed 25% of its total paid-up capital and free reserves: (Share Outstanding Test)

(e) the ratio of the debt owed by the company (both secured and unsecured) after such buy-back is not more than twice the total of its paid-up capital and its free reserves: (Debt-Equity Ratio Test)

Note: Central Government may prescribe a higher ratio of the debt than that specified under this clause for a class or classes of companies. Debt here should include both long-term debt as well as short term debt.

(f) all the shares or other specified securities for buy-back are fully paid-up;

(g) the buy-back of the shares or other specified securities listed on any recognised stock exchange is in accordance with the regulations made by the Securities and Exchange Board of India in this behalf;

(h) the buy-back in respect of shares or other specified securities other than those specified in clause (f) is in accordance with the guidelines as may be prescribed.

Provided that no offer of the buy-back under this sub section shall be made within a period of one year reckoned from the date of closure of a previous offer of buy-back if any. This means that there cannot be more than one buy-back in one year.

(2) The notice of meeting at which special resolution is supposed to be passed must be accompanied by an explanatory statement stating-

(a) a full and complete disclosure of all material facts;

(b) the necessity of the buy-back;

(c) the class of security intended to be purchased under the buy-back;

(d) the amount to be invested under the buy-back;

(e) the time limit for completion of the buy-back.

(3) Every buy-back shall be completed within twelve months from the date of passing the special resolution, or the resolution passed by the board of directors.

(4) The buy-back may be—

(a) from the existing security holders on a proportionate basis; or

(b) from the open market; or

(c) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

(5) Where a company has passed a special resolution under clause (b) of Sub-section (2) to buy-back its own shares or other securities under this section, it shall, before making such buy-back, file with the Registrar and the Securities and Exchange Board of India a declaration of solvency in the form as may be prescribed and verified by an affidavit to the effect that the Board of Directors has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year of the date of declaration adopted by the Board of Directors. It must be signed by at least two directors of the company, one of whom shall be the managing director, if any:

Note: No declaration of solvency shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on any recognised stock exchange.

(6) Where a company buys-back its own securities, it shall extinguish and physically destroy the securities so bought-back within seven days of the last date of completion of buy-back.

(7) 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 (including allotment of further shares under clause (a) of Sub-section (1) of Section (62) or other specified securities within a period of six months except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option scheme, sweat equity or conversion of preference shares or debentures into equity shares.

(8) Where a company buy-back its securities under this section, it shall maintain a register of the securities so bought, the consideration paid for the securities bought-back, the date of cancellation of securities, the date of extinguishing and physically destroying of securities and such other particulars as may be prescribed.

(9) A company shall, after the completion of the buy-back under this section, file with the Registrar and the Securities and Exchange Board of India, a return containing such particulars relating to the buy-back within thirty days of such completion, as may be prescribed, provided that no return shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on any recognised stock exchange.

(10) If a company makes default in complying with the provisions of this section or any regulations made by SEBI in this regard, the company may be punishable with a fine which shall not be less than Rs One Lakh but which may extend to three lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for upto 3 years or with a fine of not less than one lakh rupees but which may extend to three lakh rupees or with both.

(11) Section 69 (1) states that where a company purchases its own shares out of the free reserves or securities premium account, a sum equal to the nominal value of shares so purchased shall be transferred to the Capital Redemption

Reserve Account and details of such account shall be disclosed in the Balance Sheet.

(12) The shares or other specified securities which are proposed to be bought-back must be fully paid-up.

(13) The Capital Redemption Reserve Account may be applied by the company in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

(14) Premium (excess of buy-back price over the par value) paid on buy-back should be adjusted against free reserves and/or securities premium account. Revaluation reserve represents unrealized profit and hence it cannot be used for buy-back of securities.

Some Important Terms

(a) "specified securities" includes employees' stock option or other securities as may be notified by the Central Government from time to time;

(b) "free reserves" means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend:

Provided that-

(i) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or

(ii) any change in carrying amount of an asset or a liability recognised 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.

2. PROVISIONS OF SECTION 70 OF THE COMPANIES ACT 2013

(1) No company shall directly or indirectly purchase its own shares or other specified securities—

(a) through any subsidiary company including its own subsidiary companies; or

(b) through any investment company or group of investment companies; or

(c) if a default is subsisting, in repayment of deposit or interest payable thereon, redemption of debentures or preference shares or payment of dividend to any shareholder or repayment of any term loan or interest payable thereon to any financial institutions or bank. Provided that the buy–back is not prohibited if the default is remedied and a period of three years has elapsed since the cessation of the default.

(2) In accordance with schedule III, no company shall directly or indirectly purchase its own shares or other specified securities in case such company has not complied with provisions of Sections 92 (filling of annual return), 123 (payment of dividend within 30 days of declaration), 127 (failure to distribute dividend) and 129 (preparation of financial statement of the company).

Explanation I.— For the purposes of Section 68 and Section 70 of the companies Act, 2013 "specified securities" includes employees' stock option or other securities as may be notified by the Central Government from time to time.

Explanation II. — For the purposes of Section 68, "free reserves" includes securities premium account.

Note: In exercise of the powers conferred under section 30 of the Securities and Exchange Board of India Act, 1992, SEBI made Securities and Exchange Board of India (Buy-back of Securities) (Amendment) Regulations, 2013 to amend the Securities and Exchange Board of India (Buy-back of Securities) Regulations, 1998. The important provisions of the new regulations are: (i) No offer of buy-back for fifteen per cent or more of the paid up capital and free reserves of the company shall be made from the open market. (ii)A company shall not make any offer of buy-back within a period of one year reckoned from the date of closure of the preceding offer of buy-back, if any. (iii)The company shall ensure that at least fifty per cent of the amount earmarked for buy-back is utilized for buying-back shares or other specified securities.

Illustration 1

M Ltd. furnishes the following Balance Sheet as at 31st March, 20X1:

		Particulars	Notes	₹ (in 000)
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	5,000
	B	Reserves and Surplus	2	6,310
2		**Non-current liabilities**		
		Long term borrowings	3	400
3		**Current liabilities**		
	A	Trade Payables		40
		Total		11,750
		Assets		
1		**Non-current assets**		
	A	Property, plant and Equipment	4	2,750
	B	Non-Current Investments (at cost)		5,000
2		**Current assets**		
	A	Inventories		1,000
	B	Trade receivables		2,000
	C	Cash and Cash equivalents		1,000
		Total		11,750

Notes to accounts

No.	Particulars		₹ in ('000)
1	**Share Capital**		
	Authorized, Issued and Subscribed Capital:		
	3,00,000 Equity shares of ₹ 10 each fully paid up		3,000
	20,000 9% Preference Shares of 100 each		2,000
	Total		5,000
2	**Reserves and Surplus**		
	Capital reserve		10

	Revenue reserve		*4,000*
	Securities premium		*500*
	Profit and Loss account		*1,800*
	Total		*6,310*
3	***Long term borrowings***		
	10% Debentures		*400*
4	***Property, Plant and Equipment (PPE)***		
	PPE: Cost		*3,000*
	Less: Provision for depreciation		*(250)*
	Net carrying value		*2,750*

The company passed a resolution to buy-back 20% of its equity capital @ ₹ 15 per share. For this purpose, it sold its investments of ₹ 30 lakhs for ₹ 25 lakhs.

You are required to pass necessary Journal entries.

Solution

Journal Entries in the books of M Ltd.

₹ in '000

	Particulars		**Dr.**	**Cr.**
1.	Bank A/c	Dr.	2,500	
	Profit and Loss A/c	Dr.	500	
	To Investment A/c			3,000
	(Being investment sold for the purpose of buy-back of Equity Shares)			
2.	Equity share capital A/c	Dr.	600	
	Premium payable on buy-back	Dr.	300	
	To Equity shares buy-back A/c			900
	(Being the amount due on buy-back of equity shares)			
3.	Equity shares buy-back A/c	Dr.	900	
	To Bank A/c			900
	(Being payment made for buy-back of equity shares)			

4.	Securities Premium A/c	Dr.	300	
	To Premium payable on buy-back			300
	(Being premium payable on buy-back charged from Securities premium)			
5.	Revenue reserve A/c	Dr.	600	
	To Capital Redemption Reserve A/c			600
	(Being creation of capital redemption reserve to the extent of the equity shares bought back)			

Illustration 2

Anu Ltd. (a non-listed company) furnishes you with the following balance sheet as at 31st March, 20X1: ***(in crores ₹)***

		Particulars	***Notes***	***₹***
		Equity and Liabilities		
1		***Shareholders' funds***		
	A	*Share capital*	*1*	*100*
	B	*Reserves and Surplus*	*2*	*300*
2		***Current liabilities***		
	A	*Trade Payables*		*40*
		Total		*440*
		Assets		
1		***Non-current assets***		
	A	*Property, plant and equipment*	*3*	*-*
	B	*Non-Current Investments*	*4*	*100*
2		***Current assets***		
	A	*Trade receivables*		*140*
	B	*Cash and Cash equivalents*		*200*
		Total		*440*

Notes to accounts

No.	Particulars		₹
1	***Share Capital***		
	Authorized, issued and subscribed share capital:		
	12% Redeemable preference shares of ₹ 100 each, fully paid up		*75*
	Equity shares of ₹ 10 each, fully paid up		*25*
	Total		*100*
2	***Reserves and Surplus***		
	Capital reserve		*15*
	Securities premium		*25*
	Revenue reserves		*260*
	Total		*300*
3	***Property, Plant and Equipment***		
	PPE Cost		*100*
	Less: Provision for depreciation		*(100)*
	Net carrying value		*NIL*
4	***Non-Current Investments***		
	Non-current investments at cost (Market value ₹ 400 Cr.)		*100*

The company redeemed preference shares on 1st April, 20X1. It also bought back 50 lakhs equity shares of ₹ 10 each at ₹ 50 per share. The payments for the above were made out of the huge bank balances, which appeared as a part of current assets.

You are asked to:

(i) Pass journal entries to record the above.

(ii) Prepare balance sheet as at 1.4.20X1.

Solution

(i) Journal entries in the books of Anu Ltd.

₹ in crores

	Particulars		**Dr.**	**Cr.**
1st April, 20X1	12% Preference share capital A/c	Dr.	75	
	To Preference shareholders A/c			75
	(Being preference share capital account transferred to shareholders account)			
	Preference shareholders A/c	Dr.	75	
	To Bank A/c			75
	(Being payment made to shareholders)			
	Shares buy-back A/c	Dr.	25	
	To Bank A/c			25
	(Being 50 lakhs equity shares bought back @ ₹ 50 per share)			
	Equity share capital A/c (50 lakhs x ₹ 10)	Dr.	5	
	Securities premium A/c (50 lakhs x ₹ 40)	Dr.	20	
	To Shares buy-back A/c			25
	(Being cancellation of shares bought back)			
	Revenue Reserve A/c	Dr.	80	
	To Capital Redemption Reserve A/c (75+5)			80
	(Being creation of capital redemption reserve to the extent of the face value of preference shares redeemed and equity shares bought back)			

(ii) Balance Sheet of Anu Ltd as at 1.4.20X1

(in crores ₹)

		Particulars	*Notes*	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	20
	B	Reserves and Surplus	2	280
2		**Current liabilities**		
	A	Trade Payables		40
		Total		340
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	3	-
	B	Non-Current Investments	4	100
2		**Current assets**		
	A	Trade receivables		140
	B	Cash and Cash equivalents	5	100
		Total		340

Notes to accounts

No.	*Particulars*		₹
1	**Share Capital**		
	Authorized, issued and subscribed share capital		
	200 lakhs Equity shares of ₹ 10 each fully paid		20
	Total		20
2	**Reserves and Surplus**		
	Capital reserve		15
	Capital redemption reserve		80

	Securities premium	25	
	Less: Utilization for buy-back of shares	(20)	5
	Revenue Reserve	260	
	Less: transfer to Capital redemption reserve	(80)	180
	Total		280
3	**Property, plant and Equipment**		
	PPE: cost		100
	Less: Provision for depreciation		(100)
	Net carrying value		**-**
4	**Non-Current Investments**		
	Non-current investments at cost		100
	(Market value ₹ 400 Crores)		
5	**Cash and Cash Equivalents**		
	Cash and Cash Equivalents as on 31.3.20X1		200
	Less: Bank payment for redemption and buy-back		(100)
	Total		100

Illustration 3

Dee Limited (a non-listed company) furnishes the following Balance Sheet as at 31st March, 20X1:

(in thousand ₹)

		Particulars	***Notes***	***₹***
		Equity and Liabilities		
1		***Shareholders' funds***		
	A	*Share capital*	*1*	*2,700*
	B	*Reserves and Surplus*	*2*	*9,700*
2		***Current liabilities***		
	A	*Trade Payables*		*1,400*
		Total		*13,800*

		Assets		
1		***Non-current assets***		
	A	*Property, plant and Equipment*		*9,300*
	B	*Non-Current Investments*		*3,000*
2		***Current assets***		
	A	*Inventories*		*500*
	B	*Trade receivables*		*200*
	C	*Cash and Cash equivalents*		*800*
		Total		*13,800*

Notes to accounts

No.	***Particulars***		***₹***
1	**Share Capital**		
	Authorized, issued and subscribed capital:		
	2,50,000 Equity shares of ₹ 10 each fully paid up		2,500
	2,000, 10% Preference shares of ₹ 100 each		200
	(Issued two months back for the purpose of buy-back)		
	Total		2,700
2	**Reserves and Surplus**		
	Capital reserve		1,000
	Revenue reserve		3,000
	Securities premium		2,200
	Profit and loss account		3,500
	Total		9,700

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

You are required to pass necessary journal entries and prepare the Balance Sheet.

Solution

Journal Entries in the books of Dee Limited

(in thousand ₹)

	Particulars		**Dr.**	**Cr.**
(i)	Bank Account	Dr.	2,200	
	Profit and Loss Account	Dr.	800	
	To Investment Account			3,000
	(Being the investments sold at loss for the purpose of buy-back)			
(ii)	Equity Share buy-back Account	Dr.	2,500	
	To Bank Account			2,500
	(Being the payment made on buy-back)			
(iii)	Equity Share Capital Account	Dr.	500	
	Premium Payable on Buy-Back Account	Dr.	2,000	
	To Equity Shares Buy-Back Account			2,500
	(Being the buy-back amount allocated to equity share capital)			
(iv)	Securities premium Account	Dr.	2,000	
	To Premium payable on buy-back Account			2,000
	(Being the premium payable on buy-back adjusted against securities premium account)			
(v)	Revenue reserve Account	Dr.	300	
	To Capital Redemption Reserve Account			300
	(Being the amount equal to nominal value of equity shares bought back out of free reserves transferred to capital redemption reserve account)			

Balance Sheet of Dee Limited as at 1st April, 20X1
(After buy-back of shares)

(in thousand ₹)

Particulars			Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	2,200
	B	Reserves and Surplus	2	6,900
2		**Current liabilities**		
	A	Trade Payables		1,400
		Total		10,500
		Assets		
1		**Non-current assets**		
	A	Property, plant and Equipment		9,300
2		**Current assets**		
	A	Inventories		500
	B	Trade receivables		200
	C	Cash and Cash equivalents		500
		Total		10,500

Notes to accounts

No.	Particulars		₹
1	**Share Capital**		
	Authorized, issued and subscribed capital:		
	2,50,000 Equity shares of ₹ 10 each fully paid up		2,000
	2,000, 10% Preference shares of ₹ 100 each		200
	(Issued two months back for the purpose of buy-back)		
	Total		2,200

2	**Reserves and Surplus**		
	Capital reserve		1,000
	Capital redemption reserve		300
	Securities Premium	2,200	
	Less: Premium payable on buy-back of shares	(2,000)	200
	Revenue reserve	3,000	
	Less: Transfer to Capital redemption reserve	(300)	2,700
	Profit and loss A/c	3,500	
	Less: Loss on investment	(800)	2,700
	Total		6,900

Illustration 4

Extra Ltd. (a non-listed company) furnishes you with the following Balance Sheet as at 31st March, 20X1:

(in lakhs ₹)

		Particulars	Notes	₹
		Equity and Liabilities		
1		***Shareholders' funds***		
	A	*Share capital*	*1*	*120*
	B	*Reserves and Surplus*	*2*	*118*
2		***Non-current liabilities***		
		Long term borrowings	*3*	*4*
3		***Current liabilities***		
	A	*Trade Payables*		*70*
		Total		*312*
		Assets		
1		***Non-current assets***		
	A	*Property, plant and Equipment*		*50*
	B	*Non-current Investments*		*120*
2		***Current assets***		
	A	*Cash and Cash equivalents*		*142*
		Total		*312*

Notes to accounts

No.	Particulars		₹
1	***Share Capital***		
	Authorized, issued and subscribed capital:		
	Equity shares of ₹ 10 each fully paid		*100*
	9% Redeemable preference shares of ₹ 100 each fully paid		*20*
	Total		*120*
2	***Reserves and Surplus***		
	Capital reserves		*8*
	Revenue reserves		*50*
	Securities premium		*60*
	Total		*118*
3	***Long term borrowings***		
	10% Debentures		*4*

(i) *The company redeemed the preference shares at a premium of 10% on 1st April, 20X1.*

(ii) *It also bought back 3 lakhs equity shares of ₹ 10 each at ₹ 30 per share. The payment for the above was made out of huge bank balances.*

(iii) *Included in its investment were "investments in own debentures" costing ₹ 2 lakhs (face value ₹ 2.20 lakhs). These debentures were cancelled on 1st April, 20X1.*

(iv) *The company had 1,00,000 equity stock options outstanding on the above-mentioned date, to the employees at ₹ 20 when the market price was ₹30 (This was included under current liabilities) On 1.04.20X1 employees exercised their options for 50,000 shares.*

(v) *Pass the journal entries to record the above.*

(vi) *Prepare Balance Sheet as at 01.04.20X1.*

Solution

(₹ in lakhs)

Date	Particulars		Debit	Credit
20X1				
1st April	9% Redeemable preference share capital A/c	Dr.	20.00	
	Premium on redemption of preference shares A/c	Dr.	2.00	
	To Preference shareholders A/c			22.00
	(Being preference share capital transferred to shareholders account)			
	Preference shareholders A/c	Dr.	22.00	
	To Bank A/c			22.00
	(Being payment made to shareholders)			
	Equity shares buy-back A/c	Dr.	90.00	
	To Bank A/c			90.00
	(Being 3 lakhs equity shares of ₹ 10 each bought back @ ₹30 per share)			
	Equity share capital A/c	Dr.	30.00	
	Securities premium A/c	Dr.	60.00	
	To Equity Shares buy-back A/c			90.00
	(Being cancellation of shares bought back)			
	Revenue reserve A/c	Dr.	50.00	
	To Capital redemption reserve A/c			50.00
	(Being creation of capital redemption reserve account to the extent of the face value of preference shares redeemed and equity shares bought back as per the law)			

	10% Debentures A/c	Dr.	2.20	
	To Investment (own debentures) A/c			2.00
	To Profit on cancellation of own debentures A/c			0.20
	(Being cancellation of own debentures costing ₹ 2 lakhs, face value being ₹ 2.20 lakhs and the balance being profit on cancellation of debentures)			
	Bank A/c	Dr.	10.00	
	Employees stock option outstanding (Current liabilities) A/c	Dr.	5.00	
	To Equity share capital A/c			5.00
	To Securities premium A/c			10.00
	(Being the allotment to employees, of 50,000 shares of ₹ 10 each at a premium of 20 per share in exercise of stock options by employees)			
	Securities premium A/c	Dr.	2.00	
	To Premium on redemption of preference shares A/c			2.00
	(Being premium on redemption of preference shares adjusted through securities premium)			

Balance Sheet of Extra Ltd. as at 01.04.20X1

(in lakhs ₹)

		Particulars	***Notes***	***₹***
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	75.00
	B	Reserves and Surplus	2	66.20

2		**Non-current liabilities**		
		Long term borrowings	3	1.80
3		**Current liabilities**		
	A	Other Current Liabilities	4	65.00
		Total		208
		Assets		
1		**Non-current assets**		
	A	Property, plant and Equipment		50.00
	B	Non-current Investments	5	118.00
2		**Current assets**		
	A	Cash and Cash equivalents	6	40.00
		Total		208

Notes to accounts

No.	***Particulars***		***₹***
1	**Share Capital**		
	Equity shares of ₹ 10 each fully paid		100
	Less: Cancellation of bought back shares		(30)
	Add: Shares issued against ESOP		5
	Total		75
2	**Reserves and Surplus**		
	Capital Reserve		
	Opening balance	8.00	
	Add: Profit on cancellation of debentures	0.20	8.20
	Revenue reserves		
	Opening balance	50.00	
	Less: Creation of Capital Redemption Reserve	(50.00)	-

	Securities Premium		
	Opening balance	60.00	
	Less: Adjustment for cancellation of equity shares	(60.00)	
	Less: Adjustment for premium on redemption of preference shares	(2.00)	
	Add: Shares issued against ESOP at premium	10.00	8.00
	Capital Redemption Reserve		50.00
	Total		66.20
3	**Long term borrowings**		
	10% Debentures		4.00
	Less: Cancellation of own debentures		(2.20)
	Total		1.80
4.	**Other Current liabilities**		
	Opening balance		70.00
	Less: Adjustment for ESOP outstanding		(5.00)
	Total		65.00
5.	**Non-current investments**		
	Opening balance		120.00
	Less: Investment in own debentures		(2.00)
	Total		118.00
6.	**Cash and Cash Equivalents**		
	Opening balance		142.00
	Less: Payment to preference shareholders		(22.00)
	Less: Payment to equity shareholders		(90.00)
	Add: Share price received against ESOP		10.00
	Total		40.00

Illustration 5

Pratham Ltd. (a non-listed company) has the following Capital structure as on 31st March, 20X1:

Particulars	**₹**	**₹**
Equity Share Capital (shares of ₹ 10 each fully paid		*30,00,000*
Reserves & Surplus		
General Reserve	*32,50,000*	
Security Premium Account	*6,00,000*	
Profit & Loss Account	*4,30,000*	
Revaluation Reserve	*6,20,000*	*49,00,000*
Loan Funds		*42,00,000*

You are required to compute by Debt Equity Ratio Test, the maximum number of shares that can be bought back in the light of above information, when the offer price for buy-back is ₹ 30 per share.

Solution

Debt Equity Ratio Test

	Particulars	**₹**
(a)	Loan funds	42,00,000
(b)	Minimum equity to be maintained after buy-back in the ratio of 2:1 (₹ in crores)	21,00,000
(c)	Present equity shareholders fund (₹ in crores)	72,80,000
(d)	Future equity shareholder fund (₹ in crores) (See Note 2)	59,85,000 (72,80,000-12,95,000)
(e)	Maximum permitted buy-back of Equity (₹ in crores) [(d) – (b)] (See Note 2)	38,85,000 (by simultaneous equation)
(f)	Maximum number of shares that can be bought back @ ₹ 30 per share (shares in crores) (See Note 2)	1,29,500 (by simultaneous equation)

Working Note:

1. Shareholders' funds

Particulars	**₹**
Paid up capital	30,00,000
Free reserves (32,50,000 +6,00,000+4,30,000)	42,80,000
	72,80,000

2. As per section 68 of the Companies Act, 2013, amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

   Suppose amount equivalent to nominal value of bought back shares transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'.

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

(72,80,000 –x)-21,00,000 = y (1)

Since 51,80,000 – x = y

Equation 2: $\left(\frac{\text{Maximum buy-back}}{\text{Offer price for buy-back}} \times \text{Nominal Value}\right)$

= Nominal value of the shares bought –back to be transferred to CRR

$= \left(\frac{y}{30} \times 10\right) = x$

3x = y (2)

x = ₹ 12,95,000 crores and y

= ₹ 38,85,000 crores

Illustration 6

Perrotte Ltd. (a non-listed company) has the following Capital Structure as on 31.03.20X1:

	Particulars		**(₹ in crores)**
(1)	Equity Share Capital (Shares of ₹ 10 each fully paid)	-	330
(2)	Reserves and Surplus		
	General Reserve	240	-
	Securities Premium Account	90	-
	Profit & Loss Account	90	-
	Infrastructure Development Reserve	180	600
(3)	Loan Funds		1,800

The Shareholders of Perrotte Ltd., on the recommendation of their Board of Directors, have approved on 12.09.20X1 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 ₹ 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 Development 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 ₹ 1,200 crores or ₹ 1,500 crores.

Assuming that the entire buy-back is completed by 09.12.20X1, show the accounting entries in the company's books in each situation.

Solution

Statement determining the maximum number of shares to be bought back

Number of shares

Particulars	When loan fund is		
	₹ 1,800 crores	₹ 1,200 crores	₹ 1,500 crores
Shares Outstanding Test (W.N.1)	8.25	8.25	8.25
Resources Test (W.N.2)	6.25	6.25	6.25
Debt Equity Ratio Test (W.N.3)	Nil	3.75	Nil
Maximum number of shares that can be bought back [least of the above]	Nil	3.75	Nil

Journal Entries for the Buy-Back
(applicable only when loan fund is ₹ 1,200 crores)

₹ in crores

	Particulars		Debit	Credit
(a)	Equity share buy-back account	Dr.	112.5	
	To Bank account			112.5
	(Being buy-back of 3.75 crores equity shares of ₹ 10 each @ ₹ 30 per share)			
(b)	Equity share capital account	Dr.	37.5	
	Securities premium account	Dr.	75	
	To Equity share buy-back account			112.5
	(Being cancellation of shares bought back)			

(c)	General reserve account	Dr.	37.5	
	To Capital redemption reserve account			37.5
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of share capital bought back out of redeemed through free reserves)			

Working Notes:

1. Shares Outstanding Test

Particulars	***(Shares in crores)***
Number of shares outstanding	33
25% of the shares outstanding	8.25

2. Resources Test

Particulars	
Paid up capital (₹ in crores)	330
Free reserves (₹ in crores)	420
Shareholders' funds (₹ in crores)	750
25% of Shareholders fund (₹ in crores)	₹ 187.5 crores
Buy-back price per share	₹ 30
Number of shares that can be bought back (shares in crores)	6.25 crores shares

3. Debt Equity Ratio Test

	Particulars	***When loan fund is***		
		₹ 1,800 crores	***₹ 1,200 crores***	***₹ 1,500 crores***
(a)	Loan funds (₹ in crores)	1,800	1,200	1,500
(b)	Minimum equity to be maintained **after** buy-back in the ratio of 2:1 (₹ in crores)	900	600	750

(c)	Present equity shareholders fund (₹ in crores)	750	750	750
(d)	Future equity shareholder fund (₹ in crores) **(See Note 2)**	N.A.	712.5 (750-37.5)	N.A.
(e)	Maximum permitted buy-back of Equity (₹ in crores) [(d) – (b)] **(See Note 2)**	Nil	112.5 (by simultaneous equation)	Nil
(f)	Maximum number of shares that can be bought back @ ₹ 30 per share (shares in crores) (**See Note 2)**	Nil	3.75 (by simultaneous equation)	Nil

Note:

1. Under Situations 1 & 3 the company does not qualify for buy-back of shares as per the provisions of the Companies Act, 2013.

2. As per section 68 of the Companies Act, 2013, the ratio of debt owed by the company should not be more than twice the capital and its free reserve after such buy-back. In the question, it is stated that the company has surplus funds to dispose of therefore, it is presumed that buy- back is out of free reserves or securities premium and hence a sum equal to the nominal value of the share bought back shall be transferred to Capital Redemption Reserve (CRR). Utilization of CRR is restricted to issuance of fully paid-up bonus shares only. It means CRR is not available for distribution as dividend. Hence, CRR is not a free reserve. Therefore, for calculation of future equity i.e. share capital and free reserves, amount transferred to CRR on buy-back has to be excluded from present equity.

   Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

   Suppose amount equivalent to nominal value of bought back shares transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'.

Then

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

$$(750 - x) - 600 = y \qquad (1)$$

Since $150 - x = y$

Equation 2: $\left(\frac{\text{Maximum buy - back}}{\text{Offer price for buy - back}} \text{x Nominal Value}\right)$

= Nominal value of the shares bought –back to be transferred to CRR

$= \left(\frac{y}{30} \times 10\right) = x$

[here (30 = 25% x 120]

Or $3x = y \qquad (2)$

by solving the above two equations we get

x = ₹ 37.5 crores

y = ₹ 112.5 crores

SUMMARY

- Buy-back of shares can be made out of:

  (i) its free reserves; or

  (ii) the securities premium account; or

  (iii) the proceeds of any shares or other specified securities.

- No company shall purchase its own shares or other specified securities unless—

  ➢ The buy-back is authorized by the Articles of Association and by a special resolution passed at a general meeting. However, in case the buy-back is for a sum less than or equal to ten percent of the paid-up equity shares + free reserves the same may be authorized by the resolution of the directors passed at a duly convened Board Meeting.

- the buy-back is or less than or equal to twenty-five per cent of the total paid-up capital and free reserves of the company:
- Partly paid shares cannot be bought back by a company;
- the buy-back of equity shares in any financial year shall not exceed twenty-five per cent of its total paid-up equity capital in that financial year.
- No offer of buy-back will be made within a period of one year from the date of closing of the previous buy-back if any. Hence, there can be a maximum of one buy-back in one year.
- the ratio of the debt owed by the company (both secured and unsecured) is not more than twice the paid-up capital and its free reserves after such buy-back:

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. *As per section 68(1) of the Companies Act, buy-back of own shares by the company, shall not exceed*

   (a) 25% of the total paid-up capital and free reserves of the company.

   (b) 20% of the total paid-up capital and free reserves of the company.

   (c) 15% of the total paid-up capital and free reserves of the company.

   (d) 10% of the total paid-up capital and free reserves of the company.

2. *The companies are permitted to buy-back their own shares out of*

   (a) Free reserves and Securities premium

   (b) Proceeds of the issue of any shares.

   (c) Both (a) and (b)

   (d) Neither (a) nor (b).

3. *When a company purchases its own shares out of free reserves; a sum equal to nominal value of shares so purchased shall be transferred to*

   (a) Revenue redemption reserve.

   (b) Capital redemption reserve.

   (c) Buy-back reserve

   (d) Special reserve

4. *State which of the following statements is true?*

   (a) Buy-back is for more than twenty-five per cent of the total paid-up capital and free reserves of the company.

   (b) Partly paid shares cannot be bought back by a company.

   (c) Buy-back of equity shares in any financial year shall exceed twenty-five per cent of its total paid-up equity capital in that financial year.

   (d) Partly paid shares can be bought back by a company.

5. *Premium (excess of buy-back price over the par value) paid on buy-back should be adjusted against*

   (a) Free reserves.

   (b) Securities premium.

   (c) Both (a) and (b).

   (d) Neither (a) nor (b).

6. *Advantages of Buy-back of shares include to*

   (a) Encourage others to make hostile bid to take over the company.

   (b) Decrease promoters holding as the shares which are bought back are cancelled.

   (c) Discourage others to make hostile bid to take over the company as the buy-back will increase the promoters holding.

   (d) All of the above.

7. *What are the conditions to be fulfilled by a Joint Stock Company to buy-back its equity shares as per Companies Act, 2013? Explain in brief.*

Scenario based Questions

8. *SMM Ltd. has the following capital structure as on 31st March, 20X1:*

₹ in crore

	Particulars	Situation I	Situation II
(i)	Equity share capital (shares of ₹ 10 each)	1,200	1,200
(ii)	Reserves:		
	General Reserves	1,080	1,080
	Securities Premium	400	400
	Profit & Loss	200	200
	Infrastructure Development Reserve (Statutory Reserve)	320	320
(iii)	Loan Funds	3,200	6,000

The company has offered buy-back price of ₹ 30 per equity share. You are required to calculate maximum permissible number of equity shares that can be bought back in both situations and also required to pass necessary Journal Entries.

9. *KG Limited furnishes the following Balance Sheet as at 31st March, 20X1:*

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	1,200
	B	Reserves and Surplus	2	810
2		**Non-current liabilities**		
		Long term borrowings		750
			3	

3		***Current liabilities***		
	A	*Trade Payables*		*745*
	B	*Other Current Liabilities*		*195*
		Total		*3,700*
		Assets		
1		***Non-current assets***		
	A	*Property, plant and equipment*	*4*	*2,026*
	B	*Non-current Investments*		*74*
2		***Current assets***		
	A	*Inventories*		*600*
	B	*Trade receivables*		*260*
	C	*Cash and Cash equivalents*		*740*
		Total		*3,700*

Notes to accounts

No.	Particulars		₹
1	***Share Capital***		
	Authorized, issued and subscribed capital		
	Equity share capital (fully paid up shares of ₹ 10 each)		*1,200*
2	***Reserves and Surplus***		
	Securities premium		*175*
	General reserve		*265*
	Capital redemption reserve		*200*
	Profit & loss A/c		*170*
	Total		*810*

3	***Long term borrowings***		
	12% Debentures		*750*
4	***Property, plant and equipment***		
	Land and Building		*1,800*
	Plant and machinery		*226*
	Net carrying value		*2,026*

On 1st April, 20X1, 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 ₹ 75 lakhs.

On 5th April, 20X1, the company achieved the target of buy-back. On 30th April, 20X1 the company issued one fully paid up equity share of ₹ 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.

10. *Following is the Balance Sheet of Competent Limited as at 31st March, 20X1:*

		Particulars	***Notes***	***₹***
		Equity and Liabilities		
1		***Shareholders' funds***		
	A	*Share capital*	*1*	*12,50,000*
	B	*Reserves and Surplus*	*2*	*18,75,000*
2		***Non-current liabilities***		
		Long term borrowings	*3*	*28,75,000*
3		***Current liabilities***		
	A	*Other Current Liabilities*		*16,50,000*
		Total		*76,50,000*
		Assets		
1		***Non-current assets***		
	A	*Property, plant and Equipment*	*4*	*46,50,000*

2		**Current assets**		
	A	Other Current Assets		30,00,000
		Total		76,50,000

Notes to accounts

No.	Particulars		₹
1	**Share Capital**		
	Authorized, issued and subscribed capital:		
	Equity share capital (fully paid up shares of ₹ 10 each)		12,50,000
2	**Reserves and Surplus**		
	Securities premium		2,50,000
	Profit and loss account		1,25.000
	Revenue reserve		15,00,000
	Total		18,75,000
3	**Long term borrowings**		
	14% Debentures		18,75,000
	Unsecured Loans		10,00,000
	Total		28,75,000
4	**Property, plant and equipment**		
	Land and Building		19,30,000
	Plant and machinery		18,00,000
	Furniture and fitting		9,20,000
	Net carrying value		46,50,000

The company wants to buy-back 25,000 equity shares of ₹ 10 each, on 1st April, 20X1 at ₹ 20 per share. Buy-back of shares is duly authorized by its articles and necessary resolution has been 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 shown 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 buy-back of shares and prepare the Balance Sheet after buy-back of shares.

11. The following information from Balance Sheet of Z Ltd. as on 31st March ,20X1:

	₹ Lakhs
Share Capital:	
Equity shares of ₹ 10 each Fully Paid Up	*16,000*
10% Redeemable Pref. Shares of ₹ 10 each Fully Paid Up	*5,000*
Reserves & Surplus	
Capital Redemption Reserve	*2,000*
Securities Premium	*1,600*
General Reserve	*12,000*
Profit & Loss Account	*600*
Secured Loans:	
9% Debentures	*10,000*
Current Liabilities:	
Trade payables	*4,600*
Sundry Provisions	*2,000*
Fixed Assets	*28,000*
Investments	*4,700*
Cash at Bank	*4,600*
Other Current Assets	*16,500*

On 1st April, 20X1 the Company redeemed all its Preference Shares at a Premium of 10% and bought back 10% of its Equity Shares at ₹ 20 per Share. In order to make cash available, the Company sold all the Investments for ₹ 5,000 lakhs.

You are required to pass journal entries for the above and prepare the Company's Balance sheet immediately after buyback of equity shares and redemption of preference shares.

ANSWERS/HINTS

Answer to the Multiple Choice Questions

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

Answer to the Theoretical Questions

7. Section 68 to 70 of the Companies Act, 2013 lays down the provisions for a company to buy-back its own equity shares. For details, refer Para 1.1 and 1.2 of the chapter.

Answer to the Scenario based Questions

8. Statement determining the maximum number of shares to be bought back

Number of shares (in crores)

Particulars	**When loan fund is**	
	₹ 3,200 crores	**₹ 6,000 crores**
Shares Outstanding Test (W.N.1)	30	30
Resources Test (W.N.2)	24	24
Debt Equity Ratio Test (W.N.3)	32	Nil
Maximum number of shares that can be bought back [least of the above]	24	Nil

Journal Entries for the Buy-Back

(applicable only when loan fund is ₹3,200 crores)

				₹ in crores
	Particulars		**Debit**	**Credit**
(a)	Equity shares buy-back account	Dr.	720	
	To Bank account			720
	(Being payment for buy-back of 24 crores equity shares of ₹ 10 each @ ₹ 30 per share)			

(b)	Equity share capital account	Dr.	240	
	Premium Payable on buy-back account	Dr.	480	
	To Equity share buy-back account			720
	(Being cancellation of shares bought back)			
	Securities Premium account	Dr.	400	
	General Reserve / Profit & Loss A/c	Dr.	80	
	To Premium Payable on buy-back account			480
	(Being Premium Payable on buy-back account charged to securities premium and general reserve/Profit & Loss A/c)			
(c)	General Reserve / Profit & Loss A/c	Dr.	240	
	To Capital redemption reserve account			240
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of share capital bought back out of redeemed through free reserves)			

Working Notes:

1. Shares Outstanding Test

Particulars	**(Shares in crores)**
Number of shares outstanding	120
25% of the shares outstanding	30

2. Resources Test

Particulars	
Paid up capital (₹ in crores)	1,200
Free reserves (₹ in crores) (1,080 + 400 +200)	1,680
Shareholders' funds (₹ in crores)	2,880

25% of Shareholders fund (₹ in crores)	₹ 720 crores
Buy-back price per share	₹ 30
Number of shares that can be bought back	24 crores shares

3. Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy-Back

Particulars		When loan fund is	
		₹ 3,200 crores	₹ 6,000 crores
(a)	Loan funds (₹)	3,200	6,000
(b)	Minimum equity to be maintained after buy-back in the ratio of 2:1 (₹) (a/2)	1,600	3,000
(c)	Present equity shareholders fund (₹)	2,880	2,880
(d)	Future equity shareholders fund (₹) (see W.N.4)	2,560 (2,880-320)	N.A.
(e)	Maximum permitted buy-back of Equity (₹) [(d) – (b)]	960	Nil
(f)	Maximum number of shares that can be bought back @ ₹ 30 per share	32 crore shares	Nil
	As per the provisions of the Companies Act, 2013, company	Qualifies	Does not Qualify

4. Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method

Suppose amount transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y' Then

Equation 1: (Present Equity - Transfer to CRR)- Minimum Equity to be maintained = Maximum Permitted Buy-Back

= (2,880 – x) – 1,600 = y

= 1280 – x =y (1)

Equation 2: Maximum Permitted Buy-Back *X* Nominal Value Per Share/Offer Price Per Share

y/30 x 10 = x

or

3x = y (2)

by solving the above two equations we get

x= ₹ 320

y = ₹ 960

9. **In the books of KG Limited**

Journal Entries

Date 20X1	Particulars		Dr.	Cr. (₹ in lakhs)
April 1	Bank A/c	Dr.	75	
	To Investment A/c			74
	To Profit on sale of investment			1
	(Being investment sold on profit)			
April 5	Equity share capital A/c	Dr.	300	
	Securities premium A/c	Dr.	150	
	To Equity shares buy-back A/c			450
	(Being the amount due to equity shareholders on buy-back)			
	Equity shares buy-back A/c	Dr.	450	
	To Bank A/c			450
	(Being the payment made on account of buy-back of 30 Lakh Equity Shares)			
April 5	General reserve A/c	Dr.	265	
	Profit and Loss A/c	Dr.	35	
	To Capital redemption reserve A/c			300

	(Being amount equal to nominal value of buy-back shares from free reserves transferred to capital redemption reserve account as per the law)		
April 30	Capital redemption reserve A/c Dr.	225	
	To Bonus shares A/c (W.N.1)		225
	(Being the utilization of capital redemption reserve to issue bonus shares)		
	Bonus shares A/c Dr.	225	
	To Equity share capital A/c		225
	(Being issue of one bonus equity share for every four equity shares held)		

Balance Sheet (After buy-back and issue of bonus shares)

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	1,125
	B	Reserves and Surplus	2	436
2		**Non-current liabilities**		
		Long term borrowings	3	750
3		**Current liabilities**		
	A	Trade Payables		745
	B	Other Current Liabilities		195
		Total		3,251
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	4	2,026
2		**Current assets**		
	A	Inventories		600

	B	Trade receivables		260
	C	Cash and Cash equivalents		365
		Total		3,251

Notes to accounts

No.	Particulars		₹
1	**Share Capital**		
	Authorized, issued and subscribed capital:		
	Equity share capital (fully paid up shares of ₹ 10 each)		1,125
2	**Reserves and Surplus**		
	General Reserve	265	
	Less: Transfer to CR	(265)	-
	Capital Redemption Reserve	200	
	Add: Transfer due to buy-back of shares from P/L	35	
	Add; Transfer due to buy-back of shares from General Reserve	265	
	Less: Utilisation for issue of bonus shares	(225)	275
	Securities premium	175	
	Less: Adjustment for premium paid on buy-back	(150)	25
	Profit & Loss A/c	170	
	Add: Profit on sale of investment	1	
	Less: Transfer to CRR	(35)	136
	Total		436
3	**Long term borrowings**		
	12% Debentures		750
4	**Property, Plant and Equipment**		
	Land and Building		1,800
	Plant and machinery		226
	Net carrying value		2,026

Working Notes:

1. Amount of bonus shares = 25% of (1,200 – 300) lakhs = ₹ 225 lakhs

2. Cash at bank after issue of bonus shares

Particulars	₹ in lakhs
Cash balance as on 1st April, 20X1	740
Add: Sale of investments	75
	815
Less: Payment for buy-back of shares	(450)
	365

Note: In the given solution, it is possible to adjust transfer to capital redemption reserve account or capitalization of bonus shares from any other free reserves or securities premium (to the extent available) also.

10. Determination of Buy-back of maximum no. of shares as per the Companies Act, 2013

1. Shares Outstanding Test

Particulars	(Shares)
Number of shares outstanding	1,25,000
25% of the shares outstanding	31,250

2. Resources Test: Maximum permitted limit 25% of Equity paid up capital + Free Reserves

Particulars	
Paid up capital (₹)	12,50,000
Free reserves (₹) (15,00,000 + 2,50,000 + 1,25,000)	18,75,000
Shareholders' funds (₹)	31,25,000
25% of Shareholders fund (₹)	7,81,250
Buy-back price per share	₹ 20
Number of shares that can be bought back (shares)	39,062
Actual Number of shares for buy-back	25,000

3. Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy-Back

	Particulars	₹
(a)	Loan funds (₹) (18,75,000 + 10,00,000 + 16,50,000)	45,25,000
(b)	Minimum equity to be maintained after buy-back in the ratio of 2:1 (₹) (a/2)	22,62,500
(c)	Present equity/shareholders fund (₹)	31,25,000
(d)	Future equity/shareholders fund (₹) (see W.N.) (31,25,000 – 2,87,500)	28,37,500*
(e)	Maximum permitted buy-back of Equity (₹) [(d) – (b)]	5,75,000
(f)	Maximum number of shares that can be bought back @ ₹ 20 per share	28,750 shares
(g)	Actual Buy-Back Proposed	25,000 Shares

Summary statement determining the maximum number of shares to be bought back

Particulars	Number of shares
Shares Outstanding Test	31,250
Resources Test	39,062

**As per Section 68 (2) (d) of the Companies Act 2013, the ratio of debt owed by the company should not be more than twice the capital and its free reserves after such buy-back. Further under Section 69 (1), on buy-back of shares out of free reserves a sum equal to the nominal value of the share bought back shall be transferred to Capital Redemption Reserve (CRR). As per section 69 (2) utilization of CRR is restricted to fully paying up unissued shares of the Company which are to be issued as fully paid-up bonus shares only. It means CRR is not available for distribution as dividend. Hence, CRR is not a free reserve. Therefore, for calculation of future equity i.e. share capital and free reserves, amount transferred to CRR on buy-back has to be excluded from the present equity.*

Debt Equity Ratio Test	28,750
Maximum number of shares that can be bought back [least of the above]	28,750

Company qualifies all tests for buy-back of shares and came to the conclusion that it can buy maximum 28,750 shares on 1st April, 20X1.

However, company wants to buy-back only 25,000 equity shares @ ₹ 20. Therefore, buy-back of 25,000 shares, as desired by the company is within the provisions of the Companies Act, 2013.

Journal Entries for buy-back of shares

	Particulars		Debit (₹)	Credit (₹)
(a)	Equity shares buy-back account	Dr.	5,00,000	
	To Bank account			5,00,000
	(Being buy-back of 25,000 equity shares of ₹ 10 each @ ₹ 20 per share)			
(b)	Equity share capital account	Dr.	2,50,000	
	Securities premium account	Dr.	2,50,000	
	To Equity shares buy-back account			5,00,000
	(Being cancellation of shares bought back)			
(c)	Revenue reserve account	Dr.	2,50,000	
	To Capital redemption reserve account			2,50,000
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of capital bought back through free reserves)			

Balance Sheet of M/s. Competent Ltd.
as at 31st March, 20X1

		Particulars	*Notes*	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	10,00,000
	B	Reserves and Surplus	2	16,25,000
2		**Non-current liabilities**		
		Long term borrowings	3	28,75,000
3		**Current liabilities**		
	A	Other Current Liabilities		16,50,000
		Total		71,50,000
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	4	46,50,000
2		**Current assets**		
	A	Other Current Assets (30,00,000 – 5,00,000)		25,00,000
		Total		71,50,000

Notes to accounts

No.	*Particulars*		₹
1	**Share Capital** Authorized, issued and subscribed capital: Equity share capital (fully paid up shares of ₹ 10 each)		10,00,000

2	**Reserves and Surplus**		
	Profit and Loss A/c		1,25,000
	Revenue reserves	15,00,000	
	Less: Transfer to CRR	(2,50,000)	12,50,000
	Securities premium	2,50,000	
	Less: Utilization for share buy-back	(2,50,000)	-
	Capital Redemption Reserves		2,50,000
	Total		16,25,000
3	**Long term borrowings**		
	14% Debentures		18,75,000
	Unsecured Loans		10,00,000
	Total		28,75,000
4	**Property, plant and equipment**		
	Land and Building		19,30,000
	Plant and machinery		18,00,000
	Furniture and fitting		9,20,000
	Net carrying value		46,50,000

Working Note:

Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

Suppose amount transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'.

Then

$$(31{,}25{,}000 - x) - 22{,}62{,}500 = y \qquad (1)$$

$$\left(\frac{y}{20}\times 10\right) = x \qquad \text{or} \qquad 2x = y \qquad (2)$$

by solving the above equation, we get

x = ₹2,87,500

y = ₹ 5,75,000

11. (i) Journal Entries in the books of Z Ltd. (₹ in lakhs)

	Particulars			
1	Bank A/c	Dr.	5,000	
	To Investments A/c			4,700
	To Profit and Loss A/c			300
	(Being investment sold on profit for the purpose of buy-back)			
2	10% Redeemable Preference Share Capital A/c	Dr.	5,000	
	Premium on Redemption of Preference Shares A/c	Dr.	500	
	To Preference Shareholders A/c			5,500
	(Being redemption of preference share capital at premium of 10%)			
3	Profit and Loss A/c	Dr.	500	
	To Premium on Redemption of Preference Shares A/c			500
	(Being premium on redemption of preference shares adjusted through securities premium)			
4	Equity Share Capital A/c	Dr.	1,600	
	Premium on buyback	Dr.	1,600	
	To Equity buy-back A/c			3,200
	(Being Equity Share bought back, Share Capital cancelled, and Premium on Buyback accounted for)			
5	Securities Premium A/c (1,600)	Dr.	1,600	
	To Premium on Buyback A/c			1,600
	(Being premium on buyback provided out of securities premium)			

6.	Preference Shareholders A/c Equity buy-back A/c To Bank A/c (Being payment made to preference shareholders and equity shareholders)		5,500 3,200	 8,700
7	General Reserve Account To Capital Redemption Reserve Account (Being amount transferred to capital redemption reserve account towards face value of preference shares redeemed and equity shares bought back)		6,600	 6,600

(ii) Balance Sheet of C Ltd. (after Redemption and Buyback)

(₹ Lakhs)

	Particulars	Note No	Amount
	EQUITY AND LIABILITIES		₹
(I)	Shareholders' Funds:		
	(a) Share Capital	1	14,400
	(b) Reserves and Surplus	2	14,400
(2)	Non-Current Liabilities:		
	(a) Long Term Borrowings	3	10,000
(3)	Current Liabilities:		
	(a) Trade payables		4,600
	(b) Short Term Provisions		2,000
	Total		45,400
(II)	ASSETS		
(1)	Non-Current Assets		
	PPE		28,000

	Current Assets:		
	(a) Cash and Cash equivalents (W N)		900
	(b) Other Current Assets		16,500
			45,400

Notes to Accounts

				₹ in Lakhs
1.	**Share Capital**			
	1,440 lakh Equity Shares of ₹ 10 each Fully Paid up (160 lakh Equity Shares bought back)			14,400
2.	**Reserves and Surplus**			
	General Reserve	12,000		
	Less: Transfer to CRR	(6,600)	5,400	
	Capital Redemption Reserve	2,000		
	Add: Transfer due to buy-back of shares from Gen. res.	6,600	8,600	
	Securities premium	1,600		
	Less: Adjustment for premium paid on buy back	(1,600)		
	Profit & Loss A/c	600		
	Add: Profit on sale of investment	300		
	Less: Adjustment for premium paid on redemption of preference shares	(500)	400	14,400
3.	**Long-term borrowings**			
	Secured			
	9 % Debentures			10,000

Working Note:

Bank Account

	Amount (₹ Lakhs)		Amount (₹ Lakhs)
To balance b/d	4,600	By Preference Shareholders A/c	5,500
To Investment A/c (sale Proceeds)	5,000	By Equity buy back A/c	3,200
		By Balance c/d (Balancing figure)	900
	9,600		9,600