Indian Accounting Association

Subject: Corporate Accounting

Topic

Buy-back of Shares

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Corporate Accounting

Buy-back of Shares

LEARNING OBJECTIVES OF THIS UNIT:

After going through this unit, you will be able to:

- Understand the concept of buy back of shares,
- Explain the motives of buy back of shares,
- Identify the conditions for buy back of shares,
- Describe the methods of buy back of shares,
- State the advantages of buy back of shares, and
- Discuss the accounting procedures of buy back of shares.

1. MEANING OF BUY-BACK OF SHARES

Buy-back of shares means purchase of its own shares by a company from its shareholders. When a company has substantial cash resources, it may like to buy its own shares from the market particularly when the prevailing rate of its shares in the market is much lower than the book value; or what the company perceives to be its true value. Shares buy-back results in decrease in share capital of the company. Thus buy-back of Securities is a very important tool for companies that wants to reduce their Share Capital. The price at which the company offers to buy-back the shares usually become more than the price prevailing in the market.

2. SOURCES OF BUY-BACK

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 bemade out of the proceeds of an earlier issue of the same kind of shares or samekind of other *specified securities. For example, if equity shares are to be bought- back, then, preference shares may be used for the purpose.*

3. OBJECTIVES/ ADVANTAGES OF BUY-BACK OF SHARES

The objectives of buy-back of shares can be discussed as follows:

1. To increase the earnings per share as the buy-back of shares reduces the outstanding number of shares unless there is any fall in the earnings of the company.
2. To discourage others to make hostile bid to take over the company as the buy-back will increase the promoters holding.
3. The dividend payout ratio can be safely controlled.
4. 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.
5. To pay surplus cash to shareholders when the company does not need it for business. Thus, it helps in controlling capital base of the company.

4. CONDITIONS FOR BUY-BACK

According to Section 68 (2), following conditions must be satisfied in order to buy-back the shares:

a) It must be authorized by its articles;

b) A special resolution has been passed at a general meeting of the company authorizing the buy-back, but the same is not required when:

    i. the buy-back is **10%** or less of the total paid up equity capital and free reserves of the company; and

    ii. such buy-back has been authorized by the Board by means of a resolution passed at its meeting;

c) The buy-back is **twenty-five percent** or less of the aggregate of paid up capital and free reserves of the company.

d) The Debt Equity ratio should be 2:1. Where, Debt is aggregate of secured and unsecured debts owed by the company after buy-back and Equity is the aggregate of the paid-up capital and its free reserves;

e) All the shares or other specified securities for buy-back are fully paid up;

f) If shares or securities are listed, buy-back will be in accordance with the regulations made by the Securities and Exchange Board in this behalf;

g) The buy-back in respect of unlisted shares or other specified securities will be in accordance with Share Capital and Debentures Rules, 2014.

h) No offer of buy-back shall be made within a period of one year from the date of the closure of the preceding offer of buy-back, if any.

5. MODES OF BUY-BACK

A company may buy-back its shares or other specified securities by any one of the following methods:

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

(ii) from the open market, through -

(a) book-building process, (b) stock exchange;

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

6. SHORT NOTES

(a) Capital Redemption Reserve (Section 69) – As per section 69 of the Companies Act, 2013, Where a company purchases its own shares out of free reserves or securities premium account, a sum equal to the nominal value of the shares so purchased shall be transferred to the Capital Redemption Reserve Account and details of such transfer shall be disclosed in the balance sheet. 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.

(b) Escrow Account - Regulation 9(xi) of SEBI (Buy back of Securities) Regulations, 2018 provides that a company shall, as and by way of security for performance of its obligations under the regulations, on or before the opening of the offer, deposit in an escrow account such sum as specified below:

(i) if the consideration payable does not exceed rupees 100 crores; 25 per cent of the consideration payable;

(ii) if the consideration payable exceeds Rupees 100 crores; 25 per cent upto rupees 100 crores and 10 per cent thereafter.

7. PROHIBITION ON BUY-BACK IN FOLLOWING CIRCUMSTANCES (SECTION 70)

- No company shall directly or indirectly purchase its own shares or other specified securities –

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

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

  (c) if a default, is made by the company, in the repayment of deposits accepted either before or after the commencement of this Act, interest payment 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 institution or banking company. Provided that the buy-back is not prohibited, if the default is remedied and a period of three years has lapsed after such default ceased to subsist.

- No company shall, directly or indirectly, purchase its own shares or other specified securities in case such company has not complied with the provisions of:
  (a) Sections 92: Annual Return
  (b) Section 123: Declaration and Payment of Dividend
  (c) Section 127: Failure to pay Dividend
  (d) Section 129: Failure to give True and Fair Statement

8. ACCOUNTING ENTRIES RELATED TO BUY-BACK

Date	Particulars	L.F.	Amount ₹	Amount ₹
	For amount payable on Buy-back			
	Equity Share Capital A/c ………………………… Dr.		***	
	Premium on Buy-Back of Shares A/c ……………. Dr.		***	
	To Equity Shareholders A/c			***
	For actual payment made for Buy-back			
	Equity Shareholders A/c………………………….. Dr.		***	
	To Bank A/c			***
	For making provisions for premium payable on Buy-back			
	Reserves / Premium A/c…………………………. Dr.		***	
	To Premium on Buy-Back of Shares A/c			***
	For transferring necessary amount to Capital Redemption Reserve Account [as per section 69]			
	Reserves / Premium A/c …………………………… Dr.		***	
	To Capital Redemption Reserve A/c			***

<u>Illustration 1.</u>

Sun Ltd. wants to buy-back 10,000 equity shares of ₹ 100 each at par. It decides to issue 7% Preference Shares of ₹ 50 each of equivalent amount for this purpose.

Solution:

Books of Sun Ltd.

Journal Entries

Date	Particulars	L.F.	Amount ₹	Amount ₹
	Bank A/c …………………………………… Dr.		10,00,000	
	To 7 % Preference Share Capital A/c			10,00,000
	[Being 20,000, 7% Preference shares of Rs. 50 each issued at par]			
	Equity Share Capital A/c …………………… Dr.		10,00,000	
	To Equity Shareholders A/c			10,00,000
	[Being the amount due on buy-back of equity shares]			
	Equity Shareholders A/c…………………… Dr.		10,00,000	
	To Bank A/c			10,00,000
	[Being the amount due on buy-back of equity shares]			

Illustration 2.

Delight Ltd. decided to buy back 60,000 of its equity shares of ₹ 10 each at a premium of 25%. For this, it issues 5,000, 7.5% Preference Shares of ₹ 100 each at par. The company have ₹ 90,000 in General Reserve, ₹ 80,000 in Profit & Loss Account (cr), ₹ 1,20,000 in Capital Reserve and ₹ 1,00,000 in Security Premium. It decided to utilise profits and reserves also. Give Journal Entries assuming that the transactions have been duly carried out.

Solution:

Books of Delight Ltd.

Journal Entries

Date	Particulars	L.F.	Amount	Amount

			₹	₹
	Bank A/c …………………………………… Dr. To 7.5 % Preference Share Capital A/c [Being 5,000, 7.5% Preference shares of Rs. 100 each issued at par]		5,00,000	 5,00,000
	Equity Share Capital A/c …………………… Dr. Premium on Buy-Back of Shares A/c ………. Dr. To Equity Shareholders A/c [Being the amount due on buy-back of equity shares]		6,00,000 1,50,000	 7,50,000
	Equity Shareholders A/c.…………………… Dr. To Bank A/c [Being the amount due on buy-back of equity shares]		7,50,000	 7,50,000
	Securities Premium A/c ..…………………… Dr. General Reserve A/c ..……………………… Dr. To Premium on Buy-Back of Shares A/c [Being premium payable on buy-back charged from Securities premium A/c and general reserve A/c]		1,00,000 50,000	 1,50,000
	General Reserve A/c ..……………………… Dr. Profit & Loss A/c ……………………………Dr. To Capital Redemption Reserve A/c [Being creation of capital redemption reserve to the extent of the equity shares bought back]		30,000 70,000	 1,00,000

Illustration 3

ABC Limited, a non-listed company has the following Capital structure as on 31st March, 2024:

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:

Calculation of Debt Equity Ratio Test

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

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: $[\frac{Maximum\ buy\text{-}back}{Offer\ price\ for\ buy\text{-}back} \times Nominal\ Value]$

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

= $[\frac{y}{30} \times 10]$ = x

3x = y ...………………………………………………………………….. (2)

x = ₹ 12,95,000

y = ₹ 38,85,000

Illustration 4

The Balance Sheet of Moon Ltd. as on 31st March, 2024 was as follows:

Particulars	Note No.	Amount ₹
I. EQUITY AND LIABILITIES		
1. Shareholders' Funds		
(a) Share Capital	1	2,00,00,000
(b) Reserves & Surplus	2	62,00,000
2. Non-Current Liabilities		
(a) Long-term Borrowings – 9% Debentures		1,55,00,000
3. Current Liabilities		
(a) Trade Payable		29,00,000
(b) Provision for Tax		6,00,000
Total		**4,52,00,000**

II. ASSETS		
1. **Non-Current Assets**		
(a) Fixed Assets – Tangible		2,73,60,000
(b) Non-Current Investments		75,00,000
2. Current Assets		
(a) Inventories		47,80,000
(b) Trade Receivable		40,20,000
(c) Cash and Cash Equivalents		15,40,000
Total		**4,52,00,000**

Notes to Accounts:

Particulars	Amount ₹	Amount ₹
1. Share Capital		
20,00,000 Equity Shares of ₹ 10 each, fully paid		2,00,00,000
2. Reserves & Surplus		
General Reserve		
Securities Premium	25,00,000	
Balance in Statement of Profit and Loss	22,00,000	
	15,00,000	
		62,00,000

A shareholders meeting was held on that date of the Balance Sheet and the following decisions were taken there:

1. The company would buy-back 15% of the paid-up equity shares @ ₹ 16 each.

2. 7% Debentures of ₹20,00,000 would be issued at a premium of 15% for the above purpose.

3. General Reserve would be used leaving a balance of ₹10,00,000.

4. Investments worth ₹ 20,00,000 would be sold out for ₹ 28,00,000

Show the necessary journal entries to record the above transactions and prepare the Balance Sheet after the buy-back.

Solution:

Books of Moon Ltd.

Journal Entries

Date	Particulars	L.F.	Amount ₹	Amount ₹
31.03. 2024	Bank A/c …………………………………… Dr.		28,00,000	
	To Investments A/c			20,00,000
	To Profit and Loss A/c			8,00,000
	[Being Investments sold at a profit]			
	Bank A/c …………………………………… Dr.		23,00,000	
	To 7% Debenture A/c			20,00,000
	To Securities Premium A/c			3,00,000
	[Being 7% Debenture issued at a premium of 15%]			
	Equity Share Capital A/c …………………… Dr.		30,00,000	
	Premium on Buy-Back of Shares A/c ………. Dr.		18,00,000	
	To Equity Shareholders A/c			48,00,000
	[Being the amount due on buy-back of equity shares]			
	Equity Shareholders A/c ……………………. Dr.		48,00,000	
	To Bank A/c			48,00,000
	[Being the amount due on buy-back of equity shares]			
	Securities Premium A/c ..…………………… Dr.		18,00,000	
	To Premium on Buy-Back of Shares A/c			18,00,000
	[Being premium payable on buy-back charged from Securities premium A/c]			
	General Reserve A/c ..……………………… Dr.		15,00,000	
	Profit & Loss A/c ……………………………Dr.		15,00,000	
	To Capital Redemption Reserve A/c			30,00,000
	[Being creation of capital redemption reserve to the extent of the equity shares bought back]			

Balance Sheet of Moon Ltd. as on 01.04.2024

Particulars	Note	Amount

	No.	₹
I. EQUITY AND LIABILITIES		
1. Shareholders' Funds		
(a) Share Capital	1	1,70,00,000
(b) Reserves & Surplus	2	55,00,000
2. Non-Current Liabilities		
(a) Long-term Borrowings – 9% Debentures		1,55,00,000
(b) 7% Debentures		20,00,000
3. Current Liabilities		
(a) Trade Payable		29,00,000
(b) Provision for Tax		6,00,000
Total		**4,35,00,000**
II. ASSETS		
1. **Non-Current Assets**		
(a) Fixed Assets – Tangible		2,73,60,000
2. Current Assets		
(a) Short-term Investments		55,00,000
(a) Inventories		47,80,000
(b) Trade Receivables		40,20,000
(c) Cash and Cash Equivalents	3	18,40,000
Total		**4,35,00,000**

Notes to Accounts:

Particulars	Amount ₹	Amount ₹
1. Share Capital		
17,00,000 Equity Shares of ₹ 10 each, fully paid		1,70,00,000
2. Reserves & Surplus		
Capital Redemption Reserve	30,00,000	
General Reserve	25,00,000	
Securities Premium	22,00,000	
Balance in Statement of Profit and Loss	15,00,000	62,00,000

3. Cash and Cash Equivalents		
Previous Balance	15,40,000	
Add: Sale proceeds of investment	28,00,000	
Proceeds from issue of Debenture	23,00,000	
	66,40,000	
Less: Payment made on Buy-back of share	48,00,000	18,40,000

Multiple Choice Questions (MCQ)

1. As per the section 68 of the companies Act, 2013, a company can buy-back its own shares out of:
    a. Free reserves.
    b. Securities premium.
    c. Proceeds of fresh issue of shares or any other specified securities
    d. All of the above

    Answer: d. All of the above

2. Which of the following statement is false?
    a. Buy back must be authorized by articles of company
    b. A special resolution must be passed for buy back.
    c. Shares can be partly paid up
    d. The ratio of debt owed by the company is not more than twice the capital and its free reserves after such buy back.

    Answer: c. Shares can be partly paid up

3. According to companies act, a company can pay back share capital which is in excess of need if:
    a. Special resolution is passed to that effect
    b. Confirmation of the court
    c. Authorized by articles
    d. All of the above

    Answer: d. All of the above

4. If shares are bought back out of free reserves, then a sum equal to nominal value of the shares bought back is transferred to:
    a. General reserve account
    b. Capital reserve account

c. Capital redemption reserve account (CRR)
d. None of the above

Answer: c. Capital redemption reserve account (CRR)

5. Maximum buy back limit in any year is ______ of total paid up equity capital and free reserves.
    a. 25%
    b. 10%
    c. 20%
    d. No limit

    Answer: a. 25%

6. Which of the following cannot be used for the purpose of creation of capital redemption reserve account?
    a. Profit and loss account (credit balance)
    b. General reserve account
    c. Dividend equalization reserve account
    d. Unclaimed dividends account

    Answer: d. Unclaimed dividends account

7. The Capital Redemption reserve is created for the following reasons:
    a. To safeguard the interest of creditors of the organization
    b. To Maintain the capital intact
    c. Both of the above
    d. None of the above

    Answer: c. Both of the above

8. Which of the following accounts can be transferred to capital redemption reserve account?
    a. Forfeited shares account
    b. General reserve account
    c. Securities premium account
    d. None of the above

    Answer: b. General reserve account

9. 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. All of the above

Answer: b. Partly paid shares cannot be bought back by a company.

10. Advantages of buy-back of shares is/are:
    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

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

11. According to Section 68(5) of the Companies Act, 2013, the buy-back can be made from:
    a. Open Market
    b. Existing shareholder on a proportionate basis
    c. Shares issued under stock option or sweat equity share
    d. All of the above

    Answer: d. All of the above

12. __________ bank account should be open by a company to provide fund for buy-back.
    a. Escrow Account
    b. Demat Account
    c. Bank account with merchant banker
    d. None of the above

    Answer: a. Escrow Account

13. In which of the following cases a company cannot buy-back its shares?
    a. Through investment or group of investment companies
    b. Through its subsidiary
    c. If default in repayment of debt or interest is subsist.
    d. All of the above

    Answer: d. All of the above

14. Premium payable on buy-back cand be adjusted out of:
    a. Free Reserve
    b. Securities Premium
    c. Both of the above
    d. None of the above

    Answer: c. Both of the above

15. After buy-back a company cannot issue same kind of shares within a period of ________ .

a. 3 Months
b. 6 Months
c. 1 Year
d. 2 Year

Answer: b. 6 Months

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