

4. BUY - BACK OF SECURITIES AND EQUITY SHARES WITH DIFFERENTIAL RIGHTS

NO. OF PROBLEMS IN 39e OF CA INTER: CLASSROOM - 6, ASSIGNMENT - 6

NO. OF PROBLEMS IN 40e OF CA INTER: CLASSROOM - 6, ASSIGNMENT - 6

NO. OF PROBLEMS IN 41e OF CA INTER: CLASSROOM - 5, ASSIGNMENT - 6

MODEL WISE ANALYSIS OF PAST EXAM PAPERS OF IPCC AND CA INTER

MODEL NO.	N-11	M-12	N-12	M-13	N-13	M-14	N-14	M-15	N-15	M-16	N-16	M-17	N-17	M-18 (O)	M-18 (N)	N-18 (O)	N-18 (N)
Problems	-	8	12	-	-	-	-	-	-	12	6	8	-	-	-	-	-
Theory	-	-	-	-	-	4	-	-	-	-	-	-	-	-	-	-	-

SIGNIFICANCE OF EACH PROBLEM COVERED IN THIS MATERIAL

Problem No. in this material	Problem No. in NEW SM	Problem No. in OLD SM	Problem No. in OLD PM	RTP	MTP	Previous Exams	Remarks
CR 1	PQ - 1	-	9	-	-	-	-
CR 2	ILL - 3	ILL - 7	-	-	-	-	-
CR 3	ILL - 5	ILL - 4	-	M18 (N&O)	-	-	-
CR 4	PQ - 2	-	10	-	-	-	-
CR 5	Ex - 1	-	-	-	-	-	-
ASG 1	ILL - 2	ILL - 5	-	-	-	-	-
ASG 2	-	-	-	N16	-	-	-
ASG 3	-	-	-	-	-	M17	-
ASG 4	-	-	-	-	-	-	-
ASG 5	ILL - 1	-	11	-	-	-	-
ASG 6	PQ - 3	-	-	-	-	-	-

THEORY

Meaning of Buy-back of shares: The term Buy-back of shares implies the act of purchasing its own shares with an intention to cancel them by a company.

Objectives/Advantages of Buy-Back of shares:

- To improve earnings per share.
- To increase promoters holding as the shares which are bought back are cancelled.
- To prevent unwelcome takeover bids
- To support the share price during periods of sluggish or depressed market conditions
- To pay surplus cash to shareholders when the company does not need it for business
- To improve return on capital, return on net worth and to enhance the long term shareholders value

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 -

- Its free reserves; or
- The securities premium account; or
- 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.

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

- a) The buy-back must be **authorized by the Articles**
- b) The buy-back should be made by passing **special resolution in the General Meeting of shareholders** but the same is not required when;

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.**

- c) **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.**

- d) The buy-back of the shares must not exceed 25% of total paid-up capital and free reserves. (**Resource Test**)
- e) The buy-back of equity shares in any financial year must not exceed 25% of its total paid-up equity capital (**Share outstanding Test**)
- f) The debt-equity ratio must not be more than 2:1 after such buy-back. But central government may prescribe higher ratio (**Debt equity ratio test**)
Here, Debt = Secured + Unsecured Debt and includes long term as well as short term
Equity = Capital + Free Reserves
Free Reserves = Free Reserves as per Sec 8(43) + Securities Premium as per Sec 52 (1).
Equity = Equity & Preference share Capital or paid up capital.
Therefore, maximum number of shares to be bought back as per companies Act, 2013= Least of the above three tests.

- g) All the shares or other specified securities for buy-back **must be fully paid-up.**
2. 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.
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. 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 (Buy-back of securities) (Amendment) Regulations, 2013, applicable to listed companies or company who intends to get listed, in addition to the provisions of Companies Act 2013:

5. No offer of Buy-back for 15% or more of the paid up capital and free reserves of the company shall be made from the **open market.**
6. 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.
7. 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:

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.

Transfer to CRR:

- As per sec. 69 (1) Where a company **purchases its own shares out of free reserves or securities premium account**, then a sum equal to the **nominal value of the shares so purchased shall be transferred to the capital redemption reserve account**.
- 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.

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:

$$\frac{\text{Maximum buy-back}}{\text{Offer price for buyback}} \times \text{Nominal value} = \text{Nominal value of the shares bought back to be transferred to CRR.}$$

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

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

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.
2.	To Equity share final call A/c
	To realize investment to provide cash for Buy-back:
	Bank A/c Dr.
	Profit and Loss A/c Dr.
	To Investments A/c
3.	To Profit and Loss A/c
	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	
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]

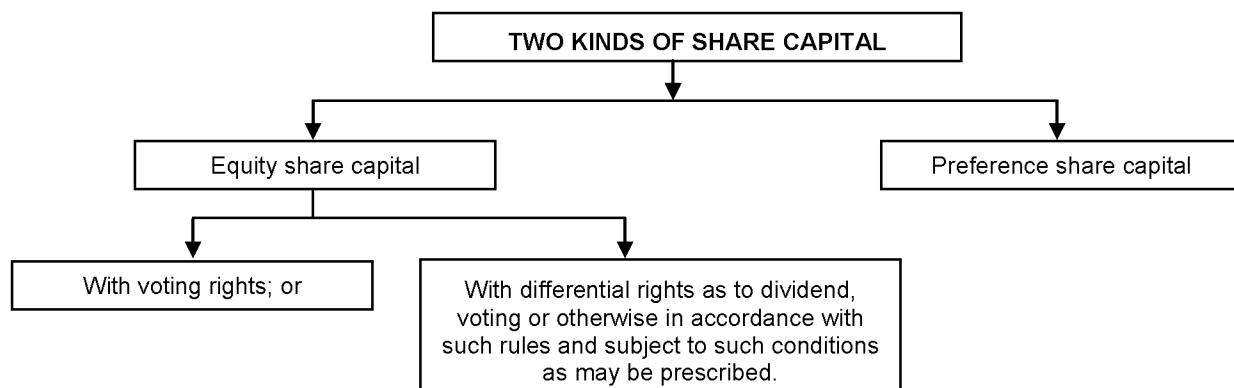
EQUITY SHARES WITH DIFFERENTIAL RIGHTS

Section 43(a) of the Act defines equity share capital to include of two types viz.

- With voting rights; or
- With differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed

It must be appreciated that preference shares are not issued with differential rights. It is only the equity shares, which are issued.

Thus new issues of share capital shall be only two kinds only, as depicted in the chart given below:-



1. Equity shareholder voting rights:

- a) Every member of a company limited by shares and holding equity share capital therein, shall have a right to vote on every resolution placed before the company; and
- b) His voting right on a poll shall be in proportion to his share in the paid-up equity share capital of the company.

2. Preference shareholder restrictive voting rights: Normally preference shareholders have superior financial rights but less management control rights. Every member of a company limited by shares and holding any preference share capital therein shall, in respect of such capital, have a restrictive right to vote only on resolutions placed before the company

- a) Which directly affect the rights attached to his preference shares and,
- b) Any resolution for the winding up of the company or
- c) For the repayment or
- d) Reduction of its equity or preference share capital.

In these situations, preference shareholders voting right on a poll shall be in proportion to his share in the paid-up preference share capital of the company.

Release of Preference shareholder restrictive voting rights: It is provided further that where the dividend in respect of a class of preference shares has not been paid for a period of two years or more, such class of preference shareholders shall have a right to vote on *all the resolutions* placed before the company.

Relative weight of equity and preference share capital, when entitled to vote: It is further provided that the proportion of the voting rights of equity shareholders to the voting rights of the preference shareholders shall be in the same proportion as the paid-up capital in respect of the equity shares bears to the paid-up capital in respect of the preference shares.

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.

(A) (NEW SM)

(ANS.: BALANCE SHEET TOTAL RS.3,251 LAKHS) (SOLVE PROBLEM NO 1 OF ASSIGNMENT PROBLEMS AS REWORK)

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
	Reserves and surplus:	
	General reserve	240
2.	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. (B) (NEW SM, SIMILAR: N18 (O))

(ANS.: MAXIMUM NO. OF SHARES THAT CAN BE BOUGHT BACK 3.75 CRORES OF SHARES)

(SOLVE PROBLEM NO 2, 3 OF ASSIGNMENT PROBLEMS AS REWORK)

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.
		EQUITY AND LIABILITIES:		
		Shareholder's funds		
1	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 maturities of long term borrowings		16,50,000
		TOTAL		76,50,000
		ASSETS:		
1		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.

(A) (NEW SM, SIMILAR: RTP M18 (N&O)) (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.
			EQUITY AND LIABILITIES:		
			Shareholder's funds		
1		A	Share capital	1	120
		B	Reserves and Surplus	2	118
			Non-current liabilities		
2		A	Long term borrowings		
		(i)	10% Debentures		4
3			Current liabilities		70
				TOTAL	312
			ASSETS:		
			Non-current assets		
1		A	Fixed assets		
		(i)	Tangible assets	3	50
		(ii)	Non-current Investment (Investments at cost)		120
2			Current Assets:		142
				TOTAL	312

Notes 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 01.04.2012 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. (B) (NEW SM, MTP N17) (ANS.: TOTAL OF BALANCE SHEET: RS. 208L)
(SOLVE PROBLEM NO 4 AND 5 OF ASSIGNMENT PROBLEMS AS REWORK)

Note: _____

PROBLEM 5: Voting rights of preference and equity share holders: Equity capital is held by X, Y and Z in the proportion of 40:40:20. A, B and C hold preference share capital in the proportion of 50:30:20. If the paid up equity share capital of the company is Rs.1 Crore and Preference share capital is Rs.50 Lakhs, then find their voting rights in case of resolution of winding up of the company.

(B) (NEW SM) (ANS.: THE RESPECTIVE VOTING RIGHTS OF SHAREHOLDERS ARE X-26.67%, Y-26.67%, Z-13.33%, A-16.67%, B-10%, C-6.67%) (SOLVE PROBLEM NO 6 OF ASSIGNMENT PROBLEMS AS REWORK)

Note: _____

ASSIGNMENT PROBLEMS

PROBLEM 1: Accounting treatment for buy back of shares at premium: CAN Ltd. furnishes you with the following Balance Sheet as at 31st March, 2011: (In crore 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:

- Pass journal entries to record the above
- Prepare balance sheet.

(B) (NEW SM, RTP M12) (ANS.: TOTAL OF BALANCE SHEET: RS. 340CRORES)

PROBLEM 2: Buy-back of shares from fresh issue: Umesh Ltd. resolves to buy back 4 Lakhs of its fully paid equity shares of Rs.10 each at Rs.22 per share. For the purpose, it issues 1 lakh 11 % preference shares of Rs.10 each at par, the entire amount being payable with applications. The company uses Rs.16 Lakhs of its balance in Securities Premium Account apart from its adequate balance in General Reserve to fulfill the legal requirements regarding buy-back. Give necessary journal entries to record the above transactions.

(C) (RTP N16)

PROBLEM 3: Maximum no of equity shares that can be bought back: SMM Ltd. has the following capital structure as on 31st March, 2017:

(Rs. in crore)

Particulars	Situation 1	Situation 2
(i) Equity share capital (shares of Rs. 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 Rs. 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.

(B) (M 17)

(ANS.: MAXIMUM NO. OF SHARES THAT CAN BE BOUGHT BACK - 24 CRORE)

PROBLEM 4: 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
1	a	EQUITY AND LIABILITIES:		
		Shareholder's funds		
		Share capital	1	2,400
	b	Reserves and Surplus	2	1,620
2	A	Non-current liabilities		
		Long tem borrowings		
		12% Debentures		1,500
3	a	Current liabilities		
		Trade Payable(creditors)		750
		Short term provisions		390
	b	TOTAL		6,660
1	A	ASSETS:		
		Non current assets:		
		Fixed assets	3	4,052
	(i)	Tangible assets		148
	(ii)	Non-current investment		
2	a	Current Assets:		
		Inventories (Stock)		1,200
		Trade receivables(Debtors)		520
	b	Cash and cash equivalents (Cash at bank)		740
	c	TOTAL		6,660

Note to Accounts:

<i>Particulars</i>	<i>Rs.</i>
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.

(B) (SIMILAR: N09)

PROBLEM 5: Advanced (Comprehensive of Buy-back, redemption of preference shares and cancellation of debentures): M Ltd. furnishes the following Summarized Balance Sheet as at 31st March, 2013:

<i>Particulars</i>	<i>Rs.'000</i>	<i>Rs.'000</i>
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)	<u>2,000</u>	
		5,000
Reserve and Surplus:		
Capital reserve	10	
Revenue reserve	4,000	
Securities premium	500	
Profit and Loss account	<u>1,800</u>	6,310
Non-current liabilities - 10% Debentures		400
Current liabilities and provisions		<u>40</u>
		<u>11,750</u>
ASSETS:		
Fixed Assets: Cost	3,000	
Less: Provision for depreciation	<u>250</u>	2,750
Non-current investments at cost		5,000
Current assets, loans and advances (including cash and bank balances)		<u>4,000</u>
		<u>11,750</u>

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.

You are required to pass necessary Journal entries

(B) (NEW SM)

PROBLEM 6: Voting rights of preference and equity share holders: W, X, Y and Z hold Equity capital is held by in the proportion of 40:30:10:20. A, B, C and

D hold preference share capital in the proportion of 30:40:20:10. If the paid up capital of the company is Rs.40 Lakhs and Preference share capital is Rs.20 Lakhs, Find their voting rights in case of resolution of winding up of the company. **(B) (NEW SM, SIMILAR: MTP2 N18 (N) - 5M, N18 (N) - 5M)**

(ANS.: THE RESPECTIVE VOTING RIGHTS OF SHAREHOLDERS ARE 26.67%, 20%, 6.67%, 13.33%, 10%, 13.33%, 6.67% & 3.33%)

PRINTED SOLUTIONS FOR SOME SELECTIVE PROBLEMS

PROBLEM NUMBERS TO WHICH SOLUTIONS ARE PROVIDED: 1, 2

PROBLEM NO: 1

In the books of KG Limited

Journal Entries

Date 2013	Particulars	Dr. (Rs.in lakhs)	Cr. (Rs.in lakhs)
April 1	Bank A/c To Investment A/c To Profit on sale of investment (Being investment sold on profit)	Dr. 75	74 1
April 5	Equity share capital A/c Securities premium A/c To Equity shares buy back A/c (Being the amount due to equity shareholders on buy back) Equity shares buy back A/c To Bank A/c (Being the payment made on account of buy back of 30 Lakh Equity Shares)	Dr. 300 Dr. 150 Dr. 450	450 450
April 5	General reserve A/c Profit and Loss A/c To Capital redemption reserve A/c (Being amount equal to nominal value of buy back shares from free reserves transferred to capital redemption reserve account as per the law)	Dr. 265 Dr. 35	300
April 30	Capital redemption reserve A/c To Bonus Issue A/c (W.N.1) (Being the utilization of capital redemption reserve to issue bonus shares)	Dr. 225	225
	Bonus Issue A/c To Equity share capital A/c (Being issue of one bonus equity share for every four equity shares held)	Dr. 225	225

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

Particulars	Note No.	Amount (Rs.in Lakhs)
I. EQUITY AND LIABILITIES:		
(1) Shareholder's Funds		
(a) Share Capital	1	1,125
(b) Reserves and Surplus	2	436
(2) Non-Current Liabilities		
(a) Long-term borrowings - 12% Debentures		750
(3) Current Liabilities		
(a) Trade payables		745
(b) Other current liabilities		195
	TOTAL	3,251
II. ASSETS:		
(1) Non-current assets		
(a) Fixed assets		

(i) Tangible assets	3	2,026
(2) Current assets		
(a) Current investments		
(b) Inventory		600
(c) Trade receivables		260
(d) Cash and cash equivalents (W.N. 2)		365
	TOTAL	3,251

Notes to Accounts:

Particulars	Rs.	Rs.
1. Share Capital		
Equity share capital (Fully paid up shares of Rs.10 each)		1125
2. Reserves and Surplus		
General Reserve 265		
Less: Transfer to CRR (265)	-	
Capital Redemption Reserve 200		
Add: Transfer due to buy-back of shares from P/L 35		
Transfer due to buy-back of shares from Gen. res. 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	436
3. Tangible assets		
Machinery	1800	
Furniture	226	2026

Working Notes:

- Amount of bonus shares = 25% of (1,200 – 300) lakhs = Rs.225 lakhs
- Cash at bank after issue of bonus shares

Particulars	Rs. in lakhs
Cash balance as on 1st April, 2013	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.

PROBLEM NO:2**Statement determining the maximum number of shares to be bought back Number of shares**

Particulars	When loan fund is		
	Rs.1,800 crores	Rs.1,200 crores	Rs.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 Rs.1,200 crores)**Rs. in crores**

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

	(Being cancellation of shares bought back)		
c)	General reserve account To Capital redemption reserve account (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)	Dr.	37.5 37.5

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 (Rs. in crores)	330
Free reserves (Rs. in crores)	420
Shareholders' funds (Rs. in crores)	750
25% of Shareholders fund (Rs. in crores)	Rs.187.5 crores
Buy back price per share	Rs.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		
	Rs.1,800 crores	Rs.1,200 crores	Rs.1,500 Crores
Loan funds (Rs. in crores)	1,800	1,200	1,500
Minimum equity to be maintained after buy back in the ratio of 2:1 (Rs. in crores)	900	600	750
Present equity shareholders fund (Rs. in crores) (See Note 2)	750	750	750
Future equity shareholder fund (Rs. in crores) (See Note 2)	N.A	712.5 (750 - 37.5)	N.A.
Maximum permitted buy back of Equity (Rs. in crores) [(d) - (b)] (See Note 2)	Nil	112.5 (by simultaneous equation)	Nil
Maximum number of shares that can be bought back @ Rs.30 per share (shares in crores) (See Note 2)	Nil	3.75 (by simultaneous equation)	Nil

Note:

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

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

$$\text{Since } 150 - x = y$$

Equation 2:

$\frac{\text{Maximum buy - back}}{\text{Offer price for buy back}} \times \text{Nominal value}$

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

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

Or $3x = y$ (2)

by solving the above equation we get

$$x = \text{Rs.}37.5 \text{ crores}$$

$$y = \text{Rs.}112.5 \text{ crores}$$

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THE END

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