

# Buy Back of Equity Shares (8 marks)

- 1) Buy Back means **repayment** of amount of Share Capital by Company to Equity Shareholders.
- 2) Buy Back **reduces the Share Capital** of Company.
- 3) Maximum Buy Back allowed is **25%**. Buy Back is not mandatory.
- 4) Preference Share Capital :- For PSC, Company can **redeem** the amount to PSH.  
(repayment)

Redemption also reduces the Share Capital & it is mandatory for Redeemable PSC.

**Redemption Limit = 100%**

## 5) Journal Entries :-

**Buy Back**

**Redemption**

1) Eq. Share Capital Dr. Face value  
(exp.) Premium on BB Dr. Prem. (exp)  
To Equity Share BB a/c (BB price)

2) Equity Share BB Dr.  
To Bank a/c

1) Pref. Share Cap. A/c Dr. FV  
Premium on Redemp Dr. Prem.  
To PSH a/c Redemp. price

2) PSH a/c Dr.  
To Bank

3) Security Premium Dr. 1st priority  
General Reserve Dr. 2nd priority  
P&L Dr. 3rd priority  
To Premiums on BB a/c

4) Sale of Investment for the purpose of BB :-

Bank a/c Dr.  
To Investment  
(Difference Gain/Loss - P&L)

5) Creation of CRR :-

GR a/c Dr. 1st Priority  
P&L a/c Dr. 2nd — —  
SP a/c Dr. 3rd — —  
To CRR

6) Fresh issue of Securities

Bank a/c Dr.  
To PSC a/c  
To Security Prem. a/c

7) Buy Back exp.

a) BB exp. a/c Dr.  
To Bank a/c

b) P&L a/c Dr.  
GR a/c Dr.  
To BB exp.

3) Security Premium Dr. 1st priority  
FR [ General Reserve Dr. 2nd priority  
P&L Dr. 3rd priority  
To Premiums on Redemption A/c

4) Creation of CRR :-

GR a/c Dr. 1st Priority  
P&L a/c Dr. 2nd — —  
SP a/c Dr. 3rd — —  
To CRR

5) Fresh issue of Securities

Bank a/c Dr.  
To PSC a/c  
To Security Prem. a/c

6) Redemption Exp.

Redemp. exp. Dr.  
To Bank

P&L a/c Dr.  
GR a/c Dr.  
To Redemption Exp.

## 8) Issue of Bonus

CRR a/c Dr. (1st Priority)  
SP a/c Dr. (2nd)  
GR a/c Dr. (3rd)  
P&L a/c Dr. (4th)  
To ESC a/c

## 9) Cancellation of Investm. in own Deb<sup>n</sup>

1. Debentures Dr. Face Value  
To Invest. in own Debt Cost  
To Profit on Cancellation (B/F)

## 6) Source of Buy Back & Redemption:-

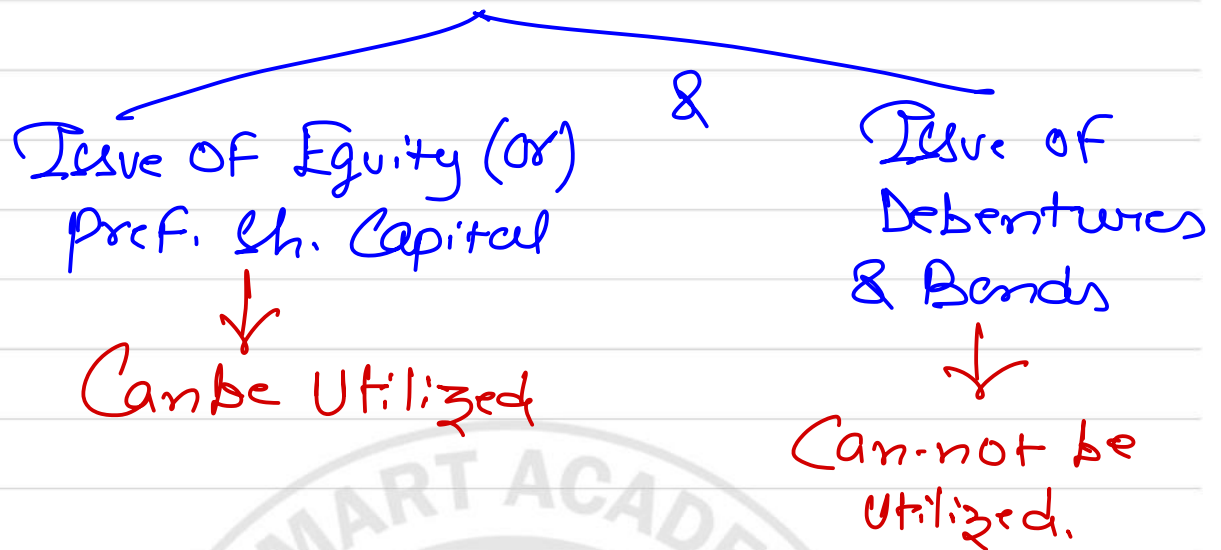
a) Out of Fresh issue proceeds of Other Securities. (eg. Pref. Shares)  
issue of Deb<sup>n</sup>/Loan is not allowed.

Cash is available b) Out of Securities Premium Balance Available;

Cash is available c) Out of General Reserves & P&L Credit Balance.

Note:- Sale of any Investment/Asset for the purpose of Buy Back means Company

7) Securities Premium Generated out of :-



8) Creation of CRR :- (Capital Redemption Reserve)

CRR shall be created if Buy Back / Redemption is out of SP/GR/P&L.

(No CRR in case of fresh issue)

Amnt of CRR = Face value of BB shares Utilized out of SP/GR/P&L

CRR shall be created out of SP/GR/P&L.

Class Ex 1:- Total Equity Shares = 2,00,000 no.  
Fv = 10/-

General Reserve = 5,00,000

P&L a/c = 4,00,000

SP Bal. = 4,50,000 (Cr.)

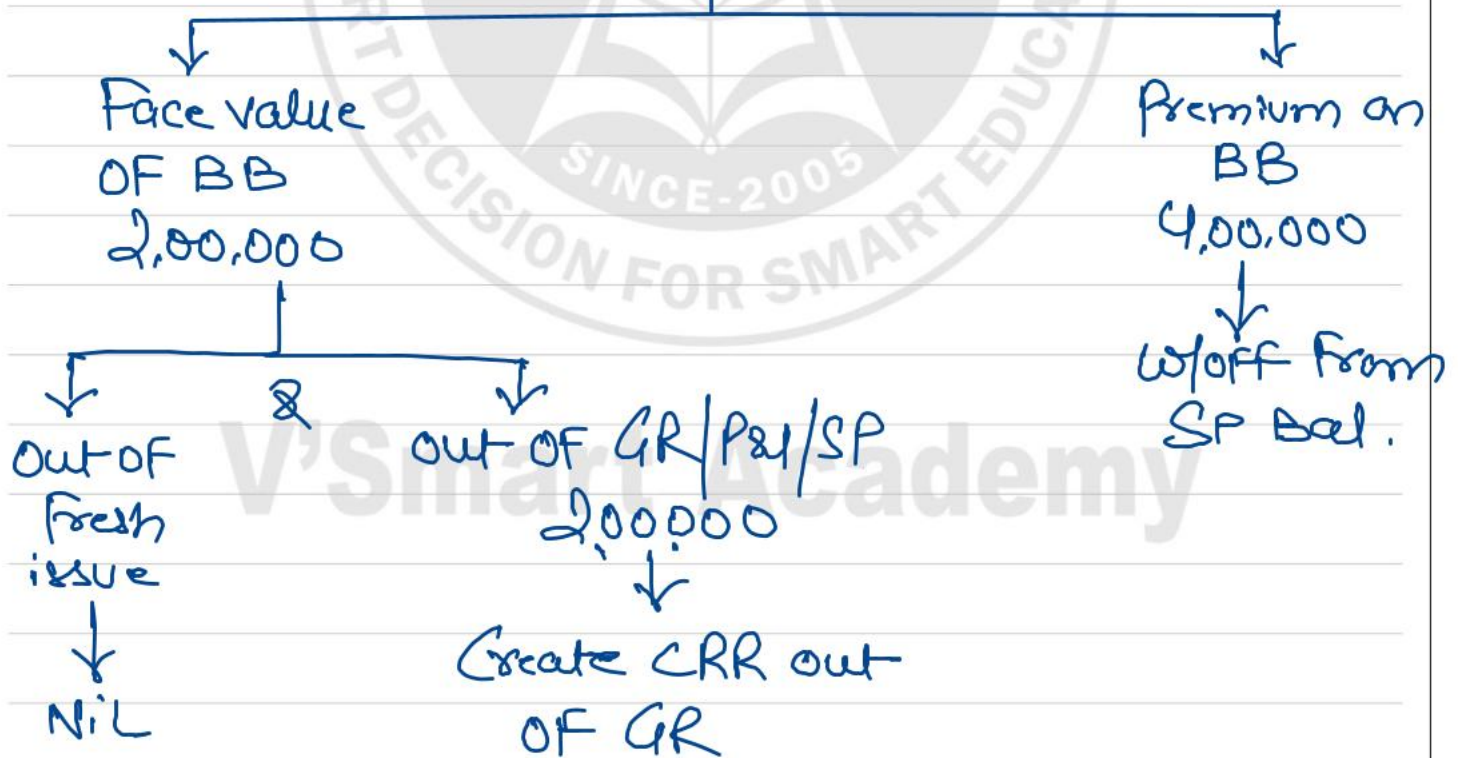
Company decided to buyback 10% equity shares at 30/- each

Solution:-

Total No. of Buy Back = 20,000 no.  
@ 10%.

BB price = 30/-

Total amount of Buy Back = 6,00,000



1) Esc a/c Dr.	200000
Premium Dr.	400000

To Eq. Sh. BB a/c 600000

2) Eq. Ch. BB a/c Dr. 600000  
     To Bank a/c 600000

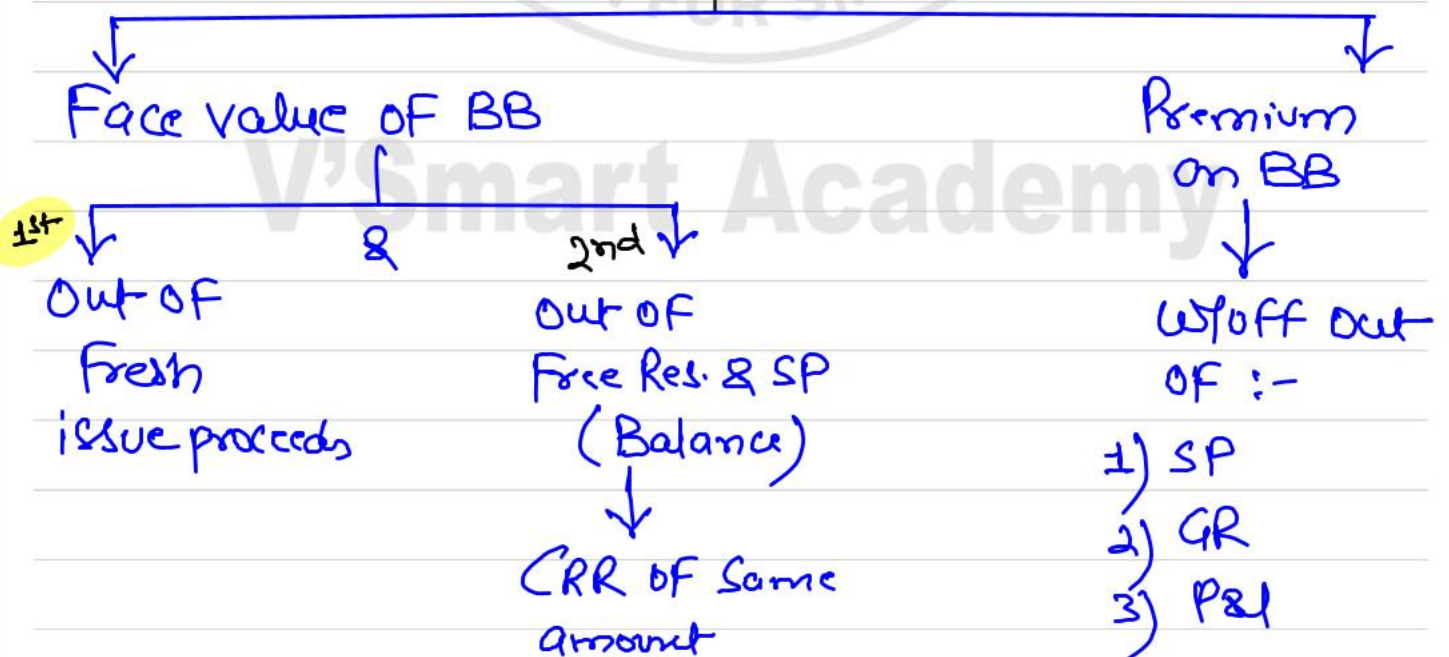
3) Securities Prem. a/c Dr. 400000  
     To Premium on BB 400000

4) General Reserve a/c Dr. 200000  
     To CRR a/c 200000

### 9) Important Working for BB/Redemption

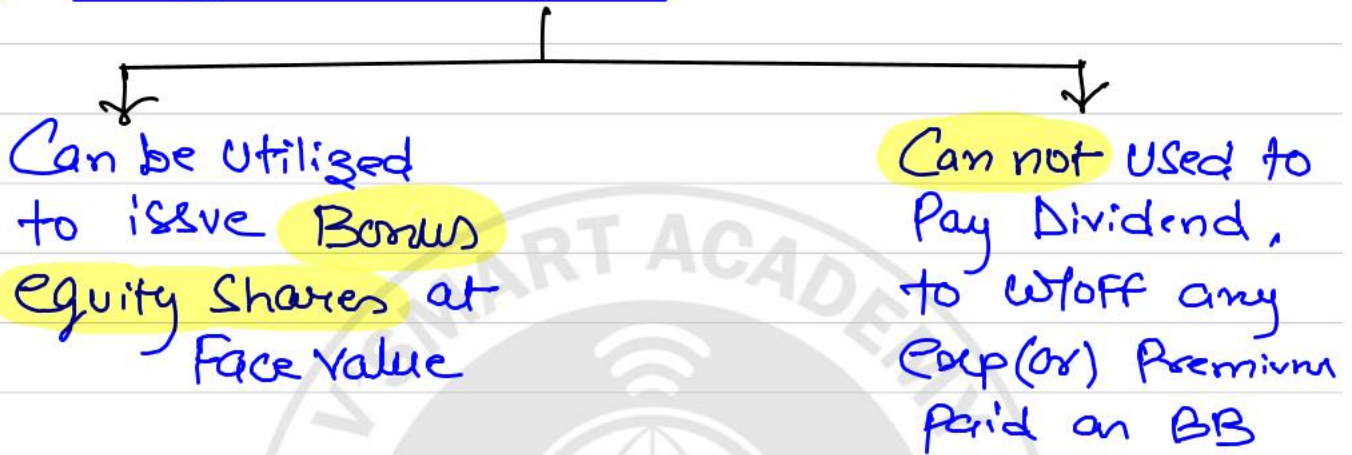
Total no. of Shares to be bought back	—	xxx
(x) Buy Back Price	—	xx

Total <b>Amnt.</b> of Buy Back	—	<b>xxxx</b>
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10) **Buy Back Expenses** Such as Legal & document Charges, if paid then Charge to P&L (or) GR.

11) Utilization of CRR :-



12) These are not Free Reserves and Can not be Utilized For BuyBack/Redemption :-

- Capital Reserve
- Revaluation Reserve
- Debtenture Redemption Reserve
- CRR
- or any other Statutory Reserve

13) Final Equity Share Capital after BuyBack & Bonus :-

25000	Original Equity Share Capital	_____	xxx
	Less:- Face Value of Buy Back (62500)	_____	(xx)
	Add:- Face value of Bonus issue	_____	xx

$$\frac{187500}{15} \times 3 = +37500$$

$$\text{Revised ESC} = \frac{225000}{20}$$

#### 14) Buy Back and Redemption is Same Question

Always solve Redemption working in first priority and then solve Buy Back working with remaining Balances of Reserves. (Refer Q203 & Q204)

#### 15) Maximum Permissible Buy Back **V. Imp.**

We have to apply following Test to Calculate maximum no. of Buy Back allowed :-

##### a) Shares O/s Test

Max. Buy Back No. = 25% of Total Issued Equity Shares.

##### b) Resources Test

Maximum Buy Back Amt. = 25% of (Total Paid up Capital + Free Reserves + SP)   
 ESC + PSC   
 GR P&L

Max. BB No. =  $\frac{\text{Max. BB Amt.}}{\text{BB price}}$

c) Debt Equity Test Debt Equity Ratio after the Buy Back should not exceed 2:1

$$\frac{D}{E} = \frac{2}{1}$$

Note:- a)  $\text{Equity} = \text{Esc} + \text{Psc} + \text{FR} + \text{SP}$

b)  $\text{Debt} = \text{LT} + \text{ST Borrowings}$

eg. Debentures / Bonds / Loans

$$\begin{array}{l} \text{Current} \\ \text{Equity} \\ \text{(before BB)} \end{array} \quad \text{Less} \quad \begin{array}{l} \text{Buy Back} \\ \text{effect} \\ \text{(Reduction of} \\ \text{Equity)} \end{array} = \begin{array}{l} \text{Minimum Equity} \\ \text{after BB} \\ \text{(as per 2:1 D/E)} \end{array}$$

Class Example Current Structure of a Company:-

Esc = ₹ 80 lacs. - 10% (10/- each)

Psc = ₹ 25 lacs.

GR = ₹ 30 lacs. - 10%

P&L = ₹ 50 lacs.

SP = ₹ 15 lacs. - 40%

LT Borrowings = ₹ 1,60,00,000

ST Borrowings = ₹ 90,00,000

NO effect

Proposed Buy Back price = 50/- Per Share

Solution Suppose "x" is maximum no. of BB

a) BB effect :- Reduction of Esc = 10x

Creation of CRR = 10x

W/OFF premium = 40x

out of FR/SP

60x

b) Current Equity

$$\begin{aligned}
 E_{se} &= 80,00,000 \\
 PSC &= 25,00,000 \\
 SP &= 15,00,000 \\
 CR &= 30,00,000 \\
 P&L &= 50,00,000 \\
 \hline
 &= 2,00,00,000
 \end{aligned}$$

c) Minimum equity (2:1) =  $\frac{\text{Debt}}{2} = \frac{2,50,00,000}{2}$   
 $= 1,25,00,000$

Current Equity - BB effect = Minimum Equity after BB

$$\begin{aligned}
 2,00,00,000 - 60x &= 1,25,00,000 \\
 x &= 125000 \text{ no.}
 \end{aligned}$$

Maximum Permissible BuyBack will be Lower of following Test:-

- a) Shares of Test
- b) Resource Test
- c) Debt Equity Test