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ACCOUNTING FOR BUY-BACK OF SHARES

Meaning: The term Buy Back means the act of **purchasing its own shares** by a company.

Buy-back (Why ????)

When the company is **not able to utilize shareholders fund** in a justifiable manner, it adopts the option of buying back its equity shares and refund back equity share money. Buy-back of securities is similar to a company purchasing its own debentures for cancellation or redemption of preference shares. In the case of buy-back, the company, which has issued shares to the public, **repurchases its own shares**.

Buy-back(How ????)

As shares may be issued at par, at a premium, re-purchase may also be done at **par**, at a **premium** or at a **discount**. This method may also be resorted to in order to increase the share value, by enhancing the earning per share.

Important provisions relating to Buy back

- i. The company's **articles** should authorize the buy-back. If not, the same has to be amended to include a provision to that effect;
- ii. **Special resolution** should be passed in the general meeting authorizing the buy-back; (if buy back **above 10% of the paid up equity capital and free reserves**)
Or
Board resolution required where the buy-back does **not exceed 10%** of the total equity paid up capital and free reserves of the company.
- iii. The buy-back in any financial year should be
(a) **25% or less** of the **total paid-up capital and free reserves** of the company; but in case of (b) equity shares the same is taken as 25% of Paid up equity capital.
- iv. **Debt-equity** ratio shall **not exceed 2:1** after such buy-back.
- v. All the shares or other specified securities are **fully paid up**;
- vi. Buy back of any kind of shares or other specified securities shall not be made **out of proceeds** of an **earlier issue** of the **same kind** of shares or same kind of other specified securities.
- vii. The buy-back of the shares or other securities **listed** on any recognized stock exchange is in accordance with the regulations made by the **SEBI** in this behalf;
- viii. the buy-back in respect of **unlisted** shares or other specified securities is in accordance with **Share Capital and Debentures Rules, 2014**.
- ix. **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.
- x. When a company purchases its own shares **out of free reserves**. Then 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 should be disclosed in the balance sheet.
- xi. Where a company has passed a special resolution or the Board has passed resolution to buy-back its own shares or other securities, it shall before making such buyback, File with the **Registrar** and the Securities and Exchange Board of India. a **declaration of solvency** in the form as may be prescribed; . and
- xii. Every buy-back should be **completed within 12 months** from the date of passing the special resolution
- xiii. After completing buy back of shares or other securities, a Company **cannot make further**

issue of the same kind of shares including by way of rights or other specified securities within a period of **six months**. rule is not applicable in case 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.

- xiv. The Company should maintain a **register of the securities** so bought under this scheme, the consideration paid for Buy Back.
- xv. Company shall extinguish and **physically destroy** the shares or securities so bought back within **7 days** of the last date of completion of buy-back Section.

Sources of Buy-Back. [68(1)]

Permits a company to buy its own shares or other specified securities out of:

- (i) **Free reserves**: or
- (ii) Securities **premium** account; or
- (iii) **Proceeds** of any shares or other specified securities.

Free reserves' means those reserves which, as per the latest audited balance sheet of the company, are free for distribution as dividend and shall include balance to the credit of securities premium account but shall not include share application money.

Adjustments against free reserves

To arrive at the net amount of free reserves that can be utilized for the purpose of buyback.

- ✓ Unamortized **miscellaneous** expenses
- ✓ Unamortized **deferred** revenue expenses.
- ✓ **Contingent liabilities** likely to mature and not provided for.
- ✓ Purchased **goodwill**.
- ✓ Any **diminution** of **long term investments** not provided for.

Determination of quantum for buy-back.

The maximum number of shares to be bought back is determined as the least number of shares arrived by performing the following tests :

- (1) Share outstanding test
- (2) Resource test
- (3) Debt-Equity Ratio test.

(1) Share Outstanding test :

- (a) Ascertain the number of equity shares
- (b) **25% of the number of equity shares** is eligible for buy back with the approval of shareholders.

(2) Resource test :

- (a) Ascertain shareholders fund (Capital (equity and preference) + Free Reserves)
- (b) No. of shares held for buyback

25% of Shareholders' funds

=

Buy back price

Debt means Secured and unsecured debt.

Free Reserve includes Securities Premium, General Reserve, Revenue Reserves, Profit & Loss A/c (Cr. Balance)

Excludes Revaluation Reserve, any other specific reserves.

(3) Debt equity test

- (a) Calculate minimum equity to maintain debt equity ratio 2:1

(b) Calculate maximum dilution in equity to maintain above equity

(c) Divide the dilution in equity by Buy back price to get no. of shares to be bought back.

Journal entries

(i) Shares held for buy-back

Equity Share Capital A/c Dr.

Premium on Buyback A/c Dr.

**To Equity Shareholders A/c
or Shares bought back A/c**

(ii) Adjustment of premium on buyback

Securities Premium A/c Dr.

General Reserve A/c Dr.

To Premium on Buyback A/c

(iii) Transferring reserves to the extent of capital redeemed

Reserves A/c Dr.

Profit Loss A/c Dr.

To Capital Redemption Reserve

(iv) On buy-back of shares

Equity Shareholders A/c Dr.

or Shares bought back A/c Dr.

To Bank A/c