

company shall, as and by way of security for performance of its obligations on or before the opening of the offer (of purchase of its securities), deposit in an escrow account 25% of the amount payable if the payment does not exceed ₹ 100 crores. In case the amount payable exceeds ₹ 100 crores, the deposit in escrow account shall be 25% upto 100 crores and 10% thereafter. **The escrow account shall consist of :**

- (a) Cash deposit with a scheduled commercial bank;
- (b) Bank guarantee in favour of merchant banker;
- (c) Deposit of acceptable securities with appropriate (i.e. proportionate) margin with the merchant banker;
- (d) A combination of (a), (b) and (c).

On payment of consideration to the shareholders, the escrow amount, guarantees or securities shall be released to the company. SEBI may forfeit the escrow amount either in full or part in case of non-fulfilment of obligations under the regulations by the company. The amount forfeited may be distributed *pro-rata* among the security holders who accepted the offer and the balance, if any, shall be utilised for investor protection.

ACCOUNTING PROCEDURE

The accounting procedure regarding buy-back of shares is based on the provisions of Section 68 of the Companies Act 2013 as given below :

- I Only fully paid equity shares and other specified securities :** It means that a company cannot purchase its shares *etc.*, unless they are fully paid up. The implication of this provision is that if in an examination problem, partly paid shares are given for buy-back, the following journal entries will have to be made to make them fully paid up even when the question is silent on this point:

- | | |
|--|-------------------------------------|
| (a) Share Final Call Account | Dr. [With the amount of final call] |
| To Equity / Preference Share Capital Account | |
| (b) Bank Account | Dr. |
| To Share Final Call Account | |

NOTE

Shares with calls-in-arrears (i.e. partly paid) cannot be bought back.

- II Proceeds from fresh issue of shares (other kind)**

- | | |
|--|-----|
| (A) Issued at par : | Dr. |
| (i) Bank Account | |
| To Share Application and Allotment Account | |
| (ii) Share Application and Allotment Account | Dr. |
| To (Relevant) Share Capital Account | |

(B) Issued at premium

- (i) Bank Account (with the total amount) Dr.
To Share Application and Allotment Account
- (ii) Share Application and Allotment Account Dr.
To (Relevant) Share Capital Account
To Securities Premium Account

FOR YOUR ATTENTION

- (i) The term Relevant means either equity or preference
- (ii) Equity shares can be bought back out of an earlier issue of preference shares made for the specific purpose of getting funds for buy back.
- (iii) Preference shares can be bought back out of the proceeds of an earlier issue of equity shares made specifically for the purpose of getting funds for the buy-back
- (iv) Equity and/or preference shares can be bought back out of the proceeds of an earlier issue of debentures/bonds.

III Sale of Assets/Investments

- Bank Account Dr. (Sale proceeds)
Profit and Loss Account Dr. (Loss on Sale, if any)
To (Relevant) Asset/Investment Account (Book value)
To Profit and Loss Account (Profit on sale, if any)

NOTE

There will be either loss on sale or profit on sale of asset. Accordingly Profit and Loss Statement or Surplus Account will be debited or credited, as the case may be.

IV Issue of Debentures**(a) At Par**

- Bank Account Dr. (Amount Received)
To Debentures Account (Face Value)

(b) At Discount

- Bank Account Dr. (Amount Received)
Discount on Issue of Debentures Account Dr. (Amount of Discount)
To Debentures Account (Face Value)

(c) At Premium

- Bank Account Dr. (Amount Received)
To Debentures Account (Face Value)
To Securities Premium Account (Amount of premium)

V Buy-back from free reserves and security premium : creation of Capital Redemption Reserve Account

If there is no earlier fresh issue of shares (or other securities) or the company intends to buy back partially or fully out of free reserves and securities premium account, the following points must be kept in mind :

- (a) There must be sufficient balance in free reserves account(s) or securities premium account.
- (b) An amount equal to the nominal value of equity bought back from free reserves and securities premium account shares must be transferred to Capital Redemption Reserve Account. The journal entry is :

Securities Premium Account	Dr.
Surplus Account	Dr.
General Reserve Account	Dr.
Any other Divisible Profit Account	Dr.
To Capital Redemption Reserve Account	

FOR YOUR ATTENTION

- (i) 'Free reserves' means those reserves which, as per latest audited balance sheet of the company are free for distribution as dividend and shall include balance to the credit of the securities premium account but shall not include application money.
- (ii) Securities premium account should be used for buy back only if (a) specifically mentioned in the problem or (b) Free reserves are all utilized or used up.
- (iii) If security premium account is used then like the use of free reserves, it must be reduced by transfer to Capital Redemption Reserve Account

VI Recording the Amount Payable on Buy-Back

A company can purchase its own shares at par or at premium or at discount. The respective journal entries in each case are as under:

- (i) When buy-back is at par
- | | | |
|--------------------------------|-----|--------------|
| Equity Share Capital Account | Dr. | (Face Value) |
| To Equity Shareholders Account | | (Face Value) |
- (ii) When buy-back is at premium
- | | | |
|-------------------------------------|-----|---------------|
| Equity Share Capital Account | Dr. | (Face Value) |
| Premium Payable on Buy-Back Account | Dr. | (Premium) |
| To Equity Shareholders Account | | (Total Claim) |
- (iii) When buy-back is at discount
- | | | |
|--------------------------------|-----|----------------------|
| Equity Share Capital Account | Dr. | (Face Value) |
| To Equity Shareholders Account | | (Net Amount Payable) |
| To Capital Reserve Account | | (Discount) |

As per Rule 17(8) of the Companies (Share Capital and Debentures) Rules 2014, the payment (on account of buy back of share) shall be made through a separate bank account opened for the purpose. The company shall immediately after the date of closure of the offer open a separate bank account and deposit therein, such sum, as would make up the entire sum due and payable as consideration for the shares as tendered for buy back. In short Rule 17 requires:

- (a) Opening of a separate bank account for payment.
- (b) It will be credited with the total amount payable on buy-back.
- (c) The account shall be opened immediately after the date of closure of the offer of buy-back

Note

This new bank account may be named as Buy-Back Bank Account for convenience sake.

Accordingly the following entry shall be made :

- | | | |
|--------|--|---|
| (iv) | For opening separate Bank Account, namely: Buy-back Bank Account | Dr. (Being the opening of buy-back bank account for buy-back of shares) |
| | Buy-Back Bank Account | |
| | To Bank Account | |
| (v) | Payment to Equity Shareholders | Dr. (Actual Payment) |
| | Equity Shareholders Account | |
| | To Buy-Back Bank Account | |
| (vi) | Adjustment of Premium Payable | |
| | Securities Premium Account | Dr. [|
| | General Reserve Account | Dr. As the case may be |
| | Profit and Loss Account | Dr.] |
| | To Premium Payable on Buy-Back A/c | |
| (vii) | Payment of buy-back expenses | |
| | Buy-Back Expenses Account | Dr. |
| | To Bank Account | |
| (viii) | Adjustment of buy-back expenses | |
| | Profit and Loss Account | Dr. |
| | To Buy-back Expenses Account | |

FOR YOUR ATTENTION

Buy-back expenses may be treated as deferred revenue expenditures and may be written off over a period of time especially when there is not enough balance in the surplus account.

IMPORTANT

Creation of Capital Redemption Reserve Account is not required at all when buy-back is done out of the proceeds of the securities.

BONUS ISSUE

Capital Redemption Reserve Account is similar to one given in Section 80 (Refer to Chapter on Redemption of Preference Shares). Accordingly Capital Redemption Reserve Account can be utilised only for issuing fully paid bonus shares to the equity shareholders:

- | | | |
|------|------------------------------------|-----|
| (i) | Capital Redemption Reserve Account | Dr. |
| | To Bonus Issue Account | |
| (ii) | Bonus Issue Account | Dr. |
| | To Equity Share Capital Account | |

OBLIGATIONS OF THE COMPANY

A company which intends to buy-back its shares etc. is under obligation in respect of following matters :

- (i) The company should provide true information in publicity material or advertisements relating to buy-back.

Solution**Jaikishan Ltd.
Journal Entries**

S.No.	Particulars		Debit (₹)	Credit (₹)
(i)	Buy-Back Bank Account To Bank Account (Being the opening of buy-bank account for back of shares)	Dr.	16,00,000	16,00,000
(ii)	General Reserve Account Securities Premium Account To Capital Redemption Reserve Account (Being the transfer of ₹ 15,00,000 to Capital Redemption Reserve Account, being the nominal value of equity shares bought back out of free reserves)	Dr. Dr.	14,00,000 1,00,000	15,00,000
(iii)	Equity Share Capital Account To Equity Shareholders Account To Capital Reserve Account (Being the amount payable to equity shareholders on 2,00,000 equity shares of ₹ 10 each @ ₹ 8 per share, on buy-back of shares; the profit on buy-back transferred to capital reserve Account)	Dr.	20,00,000	16,00,000 <u>4,00,000</u>
(iv)	Equity Shareholders Account To Buy-Back Bank Account (Being payment made to equity shareholders on buy-back of their shares.)	Dr.	16,00,000	16,00,000

LEGAL NOTES

- (i) Total issued equity capital is ₹ 1,00,00,000
- (ii) The company is buying back 20% of its share capital i.e. ₹ 20,00,000.
- (iii) The company had issued 10% Preference Shares for the purpose of buy-back to the extent of ₹ 5 Lakhs. Section 68 prohibits the use of the same kind of shares for buy-back, that is, equity shares in this case.
- (iv) The buy-back of shares out of free reserves is for ₹ 15 lakhs (20 lakhs - ₹ 5 lakhs)
- (v) Since shares have been bought at a discount, the profit on buy-back has been directly transferred to capital reserve account.
- (vi) The utilisation of free reserves to the extent of ₹ 15 lakhs has been responsible for the capitalisation of these free reserves by transfer to Capital Redemption Reserve Account.

Illustration 6 (Making Shares Fully Paid Before Buying-Back)

Following are the balances of Ruchika Ltd. as on 31-3-2017 :

Credit	₹	Debit	₹
Equity Shares of ₹ 20 each, ₹ 15 paid up.	7,50,000	Fixed Assets	12,00,000
11% Preference		Investments	1,50,000
Share Capital (₹ 100 share)	12,00,000	Current Assets	8,00,000
		Cash at Bank	1,50,000

General Reserve Account	45,000	
Surplus Account	1,25,000	
Capital Reserve	25,000	
Security Premium	50,000	
Sundry Creditors	1,05,000	
	<u>23,00,000</u>	<u>23,00,000</u>

The company complied with all the requirements of Companies Act to buy-back the equity shares. The company issued ₹ 1,00,000 preference shares and the issue was fully subscribed. The company also issued ₹ 1,50,000, 10% secured debentures at par and the full money was received on application.

Investments were sold at 80% of the cost price. After the issue of shares and debentures, the company bought back 20% equity share capital at a premium of 10%. Pass journal entries and prepare the post buy-back balance sheet.

Solution

Ruchika Ltd. Journal Entries

S.No.	Particulars	Debit (₹)	Credit (₹)
(i)	Buy-Back Bank Account Dr. To Bank Account (Being the opening of buy-back bank account for buy-back of shares)	2,20,000	2,20,000
(ii)	Share Final Call Account Dr. To Equity Share Capital Account (Being final call money due on 50,000 shares @ ₹ 5 each)	2,50,000	2,50,000
(iii)	Bank Account Dr. To Share Final Call Account (Being the receipt of final call)	2,50,000	2,50,000
(iv)	Bank Account Dr. To Preference Share Application and Allotment Account (Being application money received on preference shares)	1,00,000	1,00,000
(v)	Preference Share Application and Allotment Account Dr. To Preference Share Capital Account (Being allotment of preference shares)	1,00,000	1,00,000
(vi)	Bank Account Dr. To 10% Debentures Account (Being full amount received on application)	1,50,000	1,50,000
(vii)	Bank Account Dr. Surplus Account Dr. To Investments Account (Being sale of investments at 80% of cost price and loss on sale transferred to statement of profit and loss)	1,20,000 30,000	1,50,000