

FINAL C.A. ACCOUNTS HOMEWORK ASSIGNMENT- 7(SOL.)

Buy Back of Shares

Sol.1. Journal Entries (Rs. Lakhs)

| | Particulars | Debit | Credit |
|----|--|-----------------------|--------------|
| 1. | Bank A/c Dr. To Investments A/c To Profit & Loss A/c (Being sale of investments, profit thereon credited to Profit and Loss Account) | 3,150 | 3,000 150 |
| 2. | 10% Redeemable Preference Share Capital A/c Dr. Premium on Redemption of Preference Shares A/c Dr. To Sundry Preference Shareholders A/c (Being amount payable to Pref. Shareholders on redemption at a premium of 10%) | 2,500 250 | 2,750 |
| 3. | Securities Premium A/c Dr. To Premium on Redemption of Preference Shares A/c (Being Securities Premium used to provide Premium on Redemption of Pref. Shares) | 250 | 250 |
| 4. | Equity share Capital A/c Dr. Securities Premium A/c (800 – 250) Dr. General Reserve A/c (balancing figure) Dr. To Sundry Equity Shareholders A/c (Being Equity Shares bought back; Share Capital cancelled; excess paid on buyback first provided out of Securities Premium and the balance out of General Reserves) | 2,000 550 1,450 | 4,000 |
| 5. | Bank A/c Dr. To Bank Loan A/c (Being loan taken from Bank to finance buyback and redemption of shares) | 2,000 | 2,000 |
| 6. | Sundry Preference Shareholders A/c Dr. Sundry Equity shareholders A/c Dr. To Bank A/c (Being payment made to Sundry Preference Shareholders and Equity Shareholders) | 2,750 4,000 | 6,750 |
| 7. | General Reserve Account A/c (2,500 + 2,000) Dr. To Capital Redemption Reserve Account (Being amount transferred to Capital Redemption Res. A/c) | 4,500 | 4,500 |

2. Bank Account

| Particulars | Rs. Lakhs | Particulars | Rs. Lakhs |
|----------------------|--------------|----------------------------------|--------------|
| To Balance b/d | 1,650 | By Sundry Pref. Shareholders A/c | 2,750 |
| To Investments A/c | 3,000 | By Sundry Eq. Shareholders A/c | 4,000 |
| To Profit & Loss A/c | 150 | By balance c/d | 50 |
| To Bank Loan A/c | 2,000 | | |
| Total | 6,800 | Total | 6,800 |

3. General Reserve Account

| Particulars | Rs. Lakhs | Particulars | Rs. Lakhs |
|-----------------------------------|--------------|----------------|--------------|
| To Sundry Equity Shareholders A/c | 1,450 | By balance b/d | 6,000 |
| To Capital Redemption Reserve A/c | 4,500 | | |
| To Balance c/d | 50 | | |
| Total | 6,000 | Total | 6,000 |

4. Balance Sheet of Diamond Ltd. (after redemption and buyback)

| Liabilities | Rs. Lakhs | Assets | Rs. Lakhs |
|--|---------------|---|---------------|
| Share Capital : Eq. Sh. of Rs.10 each, fully paid up | 6,000 | Fixed Assets | 14,000 |
| Reserves and Surplus : Capital Redemption Reserve | 5,500 | Current Assets, Loans & Advances : | |
| General Reserve (as per WN 3) | 50 | Cash at Bank (as per WN 2) | 50 |
| P & L A/c (Rs. 300 + Rs.150) | 450 | | |
| Secured Loans : 9% Debentures | 5,000 | | |
| Bank Loan | 2,000 | | |
| Current Liabilities & Provisions : | | | |
| (A) Current Liabilities : Sundry Cr. | 2,300 | | |
| (B) Provisions : Sundry Provisions | 1,000 | | |
| Total | 22,300 | Total | 22,300 |

Sol.2.

1. Analysis of Companies Act Provisions

Rule 1 : Percentage of Shares Bought Back = 25% of Shares Outstanding

- Since the buyback is approved by the Shareholders in their General Meeting, the maximum permissible percentage of shares is 25% of the total shares outstanding i.e. 25% of 30 Crores = 7.5 Crore Shares.
- (**Note :** If the Buyback) is as per Board Resolution only and not authorized by the Shareholders, the maximum buyback can be only 10%)

Rule 2 : Distributable Assets = 25% of Assets representing Capital and Free Reserves

- Cash Available with the Co. = 25% of paid up Capital and free reserves = 25% x (300 + 270 + 100 + 50) = 25% of 720 = Rs.180 Crores.
- Offer Price for buyback = Market Price + 20% = Rs.25 + 20% thereon = Rs.30 per share.
- Maximum Permissible Buyback = Rs.180 Crores ÷ Rs.30 per share = **6 Crore Shares.**

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Rule 3 : Debt Equity Ratio to be 2 : 1

| | Situation | I | II | III |
|------------|--|----------|-----------|------------|
| (a) | Desired Debt Equity Ratio after buy back | 2.1 | 2.1 | 2.1 |
| (b) | Debt (given in the question) | 800 | 1200 | 1500 |
| (c) | Equity to be maintained after Buyback = $b \div 2$ | 400 | 600 | 750 |
| (d) | Existing Equity (Share Capital & All Free Reserves) | 720 | 720 | 720 |
| (e) | Permissible Dilution in Equity = $c - d$ | 320 | 120 | NIL |
| (f) | Buyback price as calculated above | 30 | 30 | 30 |
| (g) | Maximum Permissible Buyback in Crores of Shares = $e \div f$ | 10.67 | 4.00 | NIL |

2. Summary of above for determining the maximum number of shares that can be bought back

| | Particulars (in Crore Shares) | Situation I | Situation II | Situation III |
|------------|---|--------------------|---------------------|----------------------|
| (a) | Rule 1 : Percentage of Shares Bought Back | 7.50 | 7.50 | 7.50 |
| (b) | Rule 2 : Cash Availability | 6.00 | 6.00 | 6.00 |
| (c) | Rule 3 : Debt Equity Ratio to be 2 : 1 | 10.67 | 4.00 | NIL |
| (d) | Maximum Permissible Buyback = Least of a, b, c | 6.00 | 4.00 | NIL |

3A. Journal Entries in respect of Situation I is given below

| | Particulars | Debit | Credit |
|-----------|---|---------------------------|----------------------------|
| 1. | Equity Share Capital A/c Security Premium A/c General Reserve A/c (balancing figure) To Bank A/c (Being Equity Shares bought back vide resolution dated ..., Share Capital cancelled and excess payment adjusted against securities Premium and General Reserve) | Dr. Dr. Dr. | 60 100 20 180 |
| 2. | Capital Reduction A/c To Capital Redemption Reserve (Being transfer to Capital Redemption Reserve on account of shares being bought back) | Dr. | 60 60 |

3B. Journal Entries in respect of Situation II is given below

| | Particulars | Debit | Credit |
|-----------|---|--------------------|---------------------|
| 1. | Equity Share Capital A/c Security Premium A/c To Bank A/c (Being Equity Shares bought back vide resolution dated ..., Share Capital cancelled and excess payment adjusted against securities Premium) | Dr. Dr. | 40 80 120 |
| 2. | General Reserve A/c To Capital Redemption Reserve (Being transfer to Capital Redemption Reserve on account of shares being bought back) | Dr. | 40 40 |