EMPLOYEE'S STOCK OPTIONS PLANS

Employees Stock Options Plans (ESOP'S)

Meaning

As per section 2(37) of the Companies Act,2013 "employees' stock option" means the option given to the directors, officers or employees of a company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined price.

ESOP or employee stock option plan refers to a basket of instruments and incentive schemes that find favour with the new upward mobile salary class and which are used to motivate, reward, remunerate and hold on to achievers.

Issue of Employee Stock Options

A company, other than a listed company, which is not required to comply with SEBI (Share Based Employee Benefits) Regulations, 2014 shall offer shares to its employees under this scheme after complying of following requirements:

(1) the issue of Employees Stock Option Scheme has been approved by the shareholders of the company by passing a special resolution.

For the purpose of above statement the word "Employee'' means –

(a) a permanent employee of the company who has been working in India or outside India; or

(b) a director of the company, but excluding an independent director; or

(c) an employee as defined in 1(a) or (b) above of a subsidiary, in India or outside India, or of a holding company of the company or of an associate company,

Excluding –

(i) an employee who is a promoter or a person belonging to the promoter group; or

(ii) a director who either himself or through his relative or through any body corporate, directly or indirectly, holds more than ten percent of the outstanding equity shares of the company.

(2) The company shall make the following disclosures in the explanatory statement annexed to the notice for passing of the resolution –

- a) the total number of stock options to be granted;
- b) identification of classes of employees entitled to participate in the ESOP;
- c) the appraisal process for determining the eligibility of employees to the ESOP;
- d) the requirements of vesting and period of vesting;
- e) the maximum period within which the options shall be vested;
- f) the exercise price or the formula for arriving at the same;
- g) the exercise period and process of exercise;
- h) the Lock-in period, if any ;
- i) the maximum number of options to be granted per employee and in aggregate
- j) the method which the company shall use to value its options;
- k) the conditions under which option vested in employees may lapse e.g. in case of termination of employment for misconduct;
- l) the specified time period within which the employee shall exercise the vested options in the event of a proposed termination of employment or resignation of employee; and
- m) a statement to the effect that the company shall comply with the applicable accounting standards .

(3) The companies granting option to its employees pursuant to Employees Stock Option Scheme will have the freedom to determine the exercise price in conformity with the applicable accounting policies, if any.

(4) The approval of shareholders by way of separate resolution shall be obtained by the company in case of

a) grant of option to employees of subsidiary or holding company; or

b) grant of option to identified employees, during any one year, equal to or exceeding one percent of the issued capital of the company at the time of grant of option.

(5) (a) The company may by special resolution, vary the terms of ESOP not yet exercised by the employees

(b) The notice for passing special resolution for variation of terms of ESOP shall disclose full details of the variation, the rationale therefore, and the details of the employees who are beneficiaries of such variation.

(6) (a) There shall be a minimum period of one year between the grant of options and vesting of option. However, in a case where options are granted by a company under its Employees Stock Option Scheme in lieu of option held by the same person under an Employees Stock Option Scheme in another company, which has merged or amalgamated with the first mentioned company, the period during which the options granted by the merging or amalgamating company were held by him shall be adjusted against the minimum vesting period required (i.e; 1 year)

(b) The company shall have the freedom to specify the lock-in period for the shares issued pursuant to exercise of option.

(c) The Employees shall not have right to receive any dividend or to vote or in any manner enjoy the benefits of a shareholder in respect of option granted to them, till shares are issued on exercise of option.

(7) The amount, payable by the employees, at the time of grant of option – a) may be forfeited by the company if the option is not exercised by the employees within the exercise period; or

b) the amount may be refunded to the employees if the options are not vested due to non-fulfillment of conditions relating to vesting of option as per the Employees Stock Option Scheme.

(8) (a) The option granted to employees shall not be transferable.

(b) The option granted to the employees shall not be pledged, hypothecated, mortgaged or otherwise encumbered or alienated in any other manner.

(c) Subject to clause (d), no person other than the employees to whom the option is granted shall be entitled to exercise the option.

(d) In the event of the death of employee while in employment, all the options granted to him till such date shall vest in the legal heirs or nominees of the deceased employee.

(e) In case the employee suffers a permanent incapacity while in employment, all the options granted to him as on the date of permanent incapacitation, shall vest in him on that day.

(f) In the event of resignation or termination of employment, all options not vested in the employee as on that day shall expire. However, the employee can exercise the options granted to him which are vested within the period specified in this behalf, subject to the terms and conditions under the scheme granting such options as approved by the Board.

(9) The Board of directors, shall, inter alia, disclose in the Directors' Report for the year, the following details of the Employees Stock Option Scheme:

(a) options granted;

(b) options vested;

(c) options exercised;

(d) the total number of shares arising as a result of exercise of option;

(e) options lapsed;

(f) the exercise price;

(g) variation of terms of options;

(h) money realized by exercise of options;

(i) total number of options in force;

(j) employee wise details of options granted to;-

(i) key managerial personnel;

(ii) any other employee who receives a grant of options in any one year of option amounting to five percent or more of options granted during that year.
(iii) identified employees who were granted option, during any one year, equal to or exceeding one percent of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant;
(10) (a) The company shall maintain a Register of Employee Stock Options in **Form No. SH.6** and shall forthwith enter therein the particulars of option granted to employees under a scheme of ESOP subject to above conditions.
(b) The Register of Employee Stock Options shall be maintained at the registered office of the company or such other place as the Board may decide.
(c) The entries in the register shall be authenticated by the company secretary of the company or by any other person authorized by the Board for the purpose.
(11) Where the equity shares of the company are listed on a recognized stock exchange, the Employees Stock Option Scheme shall be issued, in accordance with the regulations made by the Securities and Exchange Board of India in this behalf.

STUDY MATERIAL THEORY

EMPLOYEES STOCK OPTION PLAN

Under Section 62 (1) (b) of the Companies Act 2013, where at any time a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares may be offered to employees under a scheme of employees' stock option, subject to a special resolution passed by the company and subject to such conditions as may be prescribed.
Earlier Securities and Exchange Board of India (SEBI) issued Employees Stock Option Scheme and Employee Stock Purchase Scheme Guidelines (applicable for listed companies) in 1999 under section 11 of the Securities and Exchange Board of India Act, 1992. This guideline has now been replaced by the SEBI (Share Based Employee Benefits) Regulations, 2014*(applicable for listed companies). It covers the provisions regarding accounting policies, pricing, disclosures, administration and implementation process of various schemes and other issues relating to Employee Stock Option Scheme (ESOS), Employee Stock Purchase Scheme (ESPS), Stock Appreciation Rights Scheme (SRS), General Employee Benefits Scheme (GEBS) and Retirement Benefit Scheme (RBS). The Regulation stipulate to follow the requirements of the 'Guidance Note on Accounting for Employee Share Based Payments or Accounting Standards as may be prescribed by the ICAI from time to time including the disclosure requirements prescribed therein.

Important terms to be remembered
1. *Grant*: Grant means issue of option to the employees under ESOS.
2. *Vesting:* It is the process by which the employee is given the right to apply for shares of the company against the option granted to him in pursuance of employee stock option scheme.
3. *Vesting Period*: It is the time period between grant date and the date on which all the specified vesting conditions of an employee share based payment plan are to be satisfied.
4. *Option*: Option means a right but not an obligation granted to an employee for a specified period of time in pursuance of ESOS to purchase or subscribe to the shares of the company at a pre-determined price.
5. *Exercise Period:* It is the time period after vesting within which the employee should exercise his right to apply for shares against the option vested in him in pursuance of the ESOS.
6. *Exercise Price:* It is the price payable by the employee for exercising the option granted to him in pursuance of ESOS.
7. *Intrinsic Value:* It is the excess of the market price of the share under ESOS over the exercise price of the option (including up-front payment, if any).

8. Fair Value: It is the amount for which stock option granted or a share offered for purchase could be exchanged between knowledgeable, willing parties in an arm's length transaction.

Provisions of Guidance Note on Employee Share-Based Payments

The Guidance Note on Accounting for Employee Share-based Payments establishes financial accounting and reporting principles for employee share-based payment plans, viz., employee stock option plans, employee stock purchase plans and stock appreciation rights. For the purposes of this Guidance Note, the term 'employee' includes a director of the enterprise, whether whole time or not.

For **accounting purposes**, employee share-based payment plans are classified into the following categories:

- **Equity-settled**: Under these plans, the employees receive shares.
- **Cash-settled**: Under these plans, the employees receive cash based on the price (or value) of the enterprise's shares.
- **Employee share-based payment plans with cash alternatives**: Under these plans, either the enterprise or the employee has a choice of whether the enterprise settles the payment in cash or by issue of shares.

An enterprise should measure the fair value of shares or stock options granted at the grant date, based on market prices, if available, taking into account the terms and conditions upon which those shares or stock options were granted. If market prices are not available, the enterprise should estimate the fair value of the instruments granted using a valuation technique to estimate what the price of those instruments would have been on the grant date in an arm's length transaction between knowledgeable, willing parties. The valuation technique should be consistent with generally accepted valuation methodologies for pricing financial instruments (e.g., use of an option pricing model for valuing stock options) and should incorporate all factors and assumptions that knowledgeable, willing market participants would consider in setting the price. Vesting conditions, other than market conditions, should not be taken into account when estimating the fair value of the shares or stock options at the grant date. Instead, vesting conditions should be taken into account by adjusting the number of shares or stock options included in the measurement of the transaction amount so that, ultimately, the amount recognized for employee services received as consideration for the shares or stock options granted is based on the number of shares or stock options that eventually vest. Hence, on a cumulative basis, no amount is recognized for employee services received if the shares or stock options granted do not vest because of failure to satisfy a vesting condition (i.e., these are forfeited), e.g., the employee fails to complete a specified service period, or a performance condition is not satisfied.

Accounting Procedure

Equity-settled Employee Share-based Payment Plans

An enterprise should recognize as an expense (except where service received qualifies to be included as a part of the cost of an asset) the services received in an equity-settled employee share-based payment plan when it receives the services, with a corresponding credit to an appropriate equity account, say, 'Stock Options Outstanding Account'. This account is transitional in nature as it gets ultimately transferred to another equity account such as share capital, securities premium account and/or general reserve as recommended in the Guidance Note.

If the shares or stock options granted vest immediately, the employee is not required to complete a specified period of service before becoming unconditionally entitled to those instruments. In the absence of evidence to the contrary, the enterprise should presume that services rendered by the employee as consideration for the instruments have been received. In this case, on the grant date, the enterprise should recognize services received in full with a corresponding credit to the equity account.

If the shares or stock options granted do not vest until the employee completes a specified period of service, the enterprise should presume that the services to be rendered by the employee as consideration for those instruments will be received in the future, during the vesting period. The enterprise should account for those services as they are rendered by the employee during the vesting period, on a time proportion basis, with a corresponding credit to the equity account.

To apply the requirements of the Guidance Note on Employee Share Based Payments, the enterprise should recognize an amount for the employee servicesreceived during the vesting period based on the best available estimate of the number of shares or stock options expected to vest and should revise that estimate, if necessary, if subsequent information indicates that the number of shares or stock options expected to vest differs from previous estimates. On vesting date, the enterprise should revise the estimate to equal the number of shares or stock options that ultimately vest. Market conditions, such as a target share price upon which vesting (or right to exercise) is conditioned, should be taken into account when estimating the fair value of the shares or stock options granted. On exercise of the right to obtain shares or stock options, the enterprise issues shares on receipt of the exercise price. The shares so issued should be considered to have been issued at the consideration comprising the exercise price and the corresponding amount standing to the credit of the relevant equity account (e.g., Stock Options Outstanding Account). In a situation where the right to obtain shares or stock option expires unexercised, the balance standing to the credit of the relevant equity account should be transferred to general reserve.

Cash-settled Employee Share-based Payment Plans

For cash-settled employee share-based payment plans, the enterprise should measure the services received and the liability incurred at the fair value of the liability. Until the liability is settled, the enterprise is required to re-measure the fair value of the liability at each reporting date and at the date of settlement, with any changes in fair value recognized in profit or loss for the period.

Employee Share-based Payment Plans with Cash Alternatives

For employee share-based payment plans in which the terms of the arrangement provide either the enterprise or the employee with a choice of whether the enterprise settles the transaction in cash or by issuing shares, the enterprise is required to account for that transaction, or the components of that transaction, as a cash-settled share-based payment plan if, and to the extent that, the enterprise has incurred a liability to settle in cash (or other assets), or as an equity-settled share-based payment plan if, and to the extent that, no such liability has been incurred.

Accounting for employee share-based payment plans is based on the fair value method. There is another method known as the 'Intrinsic Value Method' for valuation of employee share-based payment plans. Intrinsic value, in the case of a listed company, is the amount by which the quoted market price of the underlying share exceeds the exercise price of an option. In the case of a non-listed company, since the shares are not quoted on a stock exchange, value of its shares is determined on the basis of a valuation report from an independent valuer.

Apart from the above, the Guidance Note also deals with various other significant aspects of the employee share-based payment plans including those related to performance conditions, modifications to the terms and conditions of the grant of shares or stock options, reload feature, graded vesting, earnings-per-share implications, accounting for employee share-based payments administered through a trust, etc. The Guidance Note also recommends detailed disclosure requirements.

Variation in Vesting Period

The vesting period, i.e. the time taken to satisfy the vesting conditions can be uncertain. For example, if employees are granted ESOP subject to the condition that the company achieves a 50% market share, the vesting period can be known only when the market share of the company actually reaches the specified 50% level. In these cases, allocation of option value for recognition as expense in a particular accounting period should be based on estimated vesting period. The initial estimate of vesting period on grant date should be reviewed and revised if necessary, at the end of each accounting period. In case of revision of vesting period, the basis of allocation of option value to a particular accounting period should be based on revised estimate of vesting period.

Where the vesting condition is a market condition, e.g. when an option is granted subject to condition that the market price of the share reaches a specified level, the fair value of option is reduced due to the possibility that the vesting condition may not be satisfied. Such fair values are recognised as expense whether or not the market condition is satisfied, over the vesting period estimated on grant date. The estimates of vesting periods are not revised subsequently in these cases.

Graded Vesting

Graded vesting refers to a situation where options under a plan vest on different dates. For example, a plan may provide that shares offered to an employee shall vest in proportion of 2:3:5 in three years commencing from fourth year. Thus if an employee is offered 100 shares under the plan, 20 shares shall vest in year 4, 30 shares shall vest in year 5 and 50 shares shall vest in year 6. In these cases, based on vesting dates, the plan is segregated in into different groups. Each of these groups is then treated as a separate plan with specific vesting period and expected life.

As an alternative to the accounting treatment specified above, in case the options/shares are granted under graded vesting plan with only service conditions, an enterprise has an option to recognise the share based compensation cost on a

straight-line basis over the requisite service period for the entire award (i.e., over the requisite service period of the last separately vesting portion of the award). However, the amount of compensation cost recognised at any date must at least equal the portion of the grant-date value of the award that is vested at that date.

An enterprise should make a policy decision as to which accounting treatment to be followed in respect of graded vesting.

Since one of the factors affecting fair value of an option is expected life, the fair value for each group should be computed separately. Fair value of a group is then allocated to accounting periods and recognised as expense for the period with reference to vesting period for the group.

Intrinsic value of an option does not depend on its expected life. Intrinsic value of option per share shall therefore be same for each group. In the same way as fair value, intrinsic value of a group is allocated to accounting periods and recognised as expense for the period with reference to vesting period.

PRACTICAL QUESTION

Ques.1 X Ltd., offered 15,000 ESOP'S to its employees on April 1, 2001, Exercisable on 31st March, 2004. On 1st January 2002, 1,000 options were withdrawn from employee X. On 31st March, 2003, 8000 options were cancelled due to resignation of employees. Rest of the options were availed by employees on due date. Market Price on 1-4-2001 for equity shares of company is ₹40 (face value ₹10). However, market price on 31-3-2004 is ₹80 per share. Journalize entries.

Ans: ₹ 1,86,667; (26,667) ; 80,000

Ques.2 A company grants 500 options on 1-4-1999 at ₹40 when the market price is ₹160 the vesting period is two and half year, the maximum exercise period is one year. Also 150 unvested options lapsed on 1-5-2001, 300 options are exercised on 30-6-2002 and 50 vested options lapsed at the end of the exercise period. Journalize.

Ans: ₹24,000; 24,000; 6,000

Ques.3 A Company has its share capital divided into shares of ₹10 each. On 1st April, 2010 it granted 10,000 employees' stock options at ₹40, when the market price was ₹130. The options were to be exercised between 16th December, 2010 and 15th March, 2011.The employees exercised their options for 9,500 shares only; the remaining options lapsed. The company closes its books on 31st March every year. Show Journal Entries.

Ans: Employee Compensation Expenses ₹8,55,000.

Ques.4 ABC Ltd. grants 1,000 employees stock options on 1.4.2007 at ₹40, when the market price is ₹160.The2½ years and the maximum exercise period is one year. 300 unvested options lapse on 1.5.2009. 600 options are exercised on 30.6.2010. 100 vested options lapse at the end of the exercise period. Pass Journal Entries giving suitable narrations.

Ques.5 Choice Ltd. grants 100 stock options to each of its 1,000 employees on 1.4.2008 for ₹20, depending upon the employees at the time of vesting of options. The market price of the share is ₹50.These options will vest at the end of year 1 if the earning of Choice Ltd. increases 16%, or it will vest at the end of the year 2 if the average earning of two years increases by 13%, or lastly it will vest at the end of the third year if the average earning of 3 years will increase by 10%. 5,000 unvested options lapsed on 31.3.2009. 4,000 unvested options lapsed on 31.3.2010 and finally 3,500 unvested options lapsed on 31.3.2011. Following is the earning of Choice Ltd. :

Year ended on	Earning (in %)
31.3.2009	14%
31.3.2010	10%
31.3.2011	7%

850 employees exercised their vested options within a year and remaining options were unexercised at the end of the contractual life. Pass Journal entries for the above.

Ans: 14,25,000; 3,95,000; 8,05,000

Ques.6 What is employee stock option plan? Explain the importance of such plans in the modern time. **(Nov 2010)**

Ans: Employee Stock Option Plan: It is a plan under which the enterprise grants employee stock options is a contract that gives the employees of the enterprise the 'right, but not the obligation, for a specified period of time to purchase or subscribe the shares of the company at a fixed or determinable price.

Employee stock option plans encourage employees to have higher participation in the 'company. The importance of these 'plans is as follows:

1) Stock options provide an opportunity to employees to contribute in the growth of the company.
2) Stock option creates long term wealth in the hands of the employees.
3) They are important means to attract, retain and motivate the best available talent for the company.
4) It creates a common sense of ownership between the company and its employees.

Ques.7 X Co. Ltd. has its share capital divided into equity shares of ₹10 each. On 1.10.2010 it 'granted 20,000 employees' stock 'option at ₹50 per share, when the market price was ₹120 'per share. The options were to be exercised between 10thDecember, 2010and 31st March, 2011. The employees exercised their options for 16,000 shares only and the remaining options lapsed. The company closes its books on 31st March every year. Show Journal entries (with narration) as would appear 'in the books of the company up to 31st March. **(Nov 2009)**

Ans: ₹11,20,000

Ques.8 S Ltd. grants 1,000 options to its employees on 1.4.2008 at ₹60. The vesting period is two and a half years. The maximum period is one year. Market price on that date is ₹90.All the options were exercised on 31.7.2011.Journalize, if the face 'value of equity share is ₹10 per share. **(June 2009)**

Ans: 12,000; 12,000; 6,000

Ques.9 A Co. has its share capital divided into equity shares of ₹10 each. On 1.4.2012 it 'granted 5,000 employees stock options at ₹50 per share, when the market price was ₹140 per share. The options were to be exercised between 1-3-2013 to 31-3-2013. The employees exercised their options for 4,800 shares only; and the remaining options lapsed. The company closes its books on 31st March. Show Journal entries (with narration) as would appear in the books of the company up to' 31st March.

Ans: ₹4,32,000

Ques.10 On 1st April 2012, a company offered 100 shares to each of its 500 employees at ₹50 per share. The employees are given a 'year to accept the offer. The shares issued under the plan shall be subject to lock-in on transfer for three years from the grant date. The market price of shares of the company on the grant date is ₹60 per share. Due to post-vesting restriction on transfers, the fair value of shares issued under the plan is estimated at ₹56 per share. On 31st March 2013, 400 employees accepted the offer and paid ₹50 per share purchased. Nominal value of share is ₹10. Record the issue of shares in the books of the company under the aforesaid plan.

Ans: ₹2,40,000

Ques.11 Arihant limited has its share capital divided into equity shares of ₹10 each. On 1-10-2012, it granted 20,000 employees stock option at ₹50 per share, when the market price was ₹120 per share. The options were to be exercised between 10th December, 2012 &31st March,2013. The employee exercised their options for16,000 shares only and the remaining options lapsed. The company closes its books on 31st March every year. Show journal entries (with narration) as would appear in the books of the company upto 31st March ,2013.

Ans: ₹11,20,000

Que.12 You are provided with the following details in respect of ABC Limited:

(i) 10,000 equity shares of nominal value of ₹10 each were issued on 31st March, 2014;
(ii) Exercise price of equity shares granted under ESOP was ₹160 per share;
(iii) Market price of shares was ₹400 each on the date of the grant;

(iv) Vesting of shares was in the ratio of 30%, 60% and 100% after 1 year, 2 year and 3 year respectively from the date of grant;

(v) Vested options can be exercised up to 1 year from the date of vesting;

(iv)The number of shares expired and exercised are as under:

Particulars	Year Ended		
	31.03.2015	31.03.2016	31.03.2017
Vested Options Lapsed during the year	-	200	600
Unvested Options Lapsed during the year	400	600	1,000
Option Exercised during the year	-	2,500	2,000

From the above details you are required to calculate:

(i) Employee Compensation Expense for the year ending 31st March, 2015, 31st March, 2016, and 31st March, 2017.

(ii) Balance of Employee Stock Options Outstanding Account as on 31st March, 2015, 31st March, 2016, and 31st March, 2017.

Entries relating to ESOP lapsed and options exercised were passed at the end of the respective financial year. **8 Marks (Nov 2017)**

Ans: Expenses: ₹11,52,000, ₹5,28,000, ₹ 2,40,000, ESO O/S ₹ 11,52,000, ₹ 10,32,000, ₹ 6,48,000

Que.13 On 1st January, 2016, Tulip Ltd. offered 100 shares of ₹10 each to each of its 500 employees at ₹30 per share. The employees were given time up to 31st March, 2016 to accept the offer. The shares issued under ESOP shall be subject to lock-in-period of two years from the grant date. Other details provided are as under:

(i) The market price of shares of the company on the grant date is ₹50 per share.

(ii) Due to post vesting restriction on transfer of shares, the fair market value of shares is estimated at ₹40 per share.

(iii) On 31st March, 2016, 400 employees accepted the offer and paid ₹30 per share.

You are required to pass necessary journal entries to record the allotment of shares in the books of the company. **CS Executive (Dec 2016)**

Que 14 Suvidhi Ltd. offered 50 shares of each of its 1500 employees on 1st April, 2017 for ₹30. Option would be exercisable within a year it is vested. The share issued under the plan shall be subject to lock-in on transfer for three years from the grant date. The market price of shares of the company is ₹50 per share on grant date. Due to post-vesting restrictions on transfer, the fair value of shares issued under the plan is estimated at ₹38 per share. On 31st March,2018, 1200 employees accepted the offer and paid ₹30 per share purchased. Nominal Value of each share is ₹10. Record the issue of share in the books of the company under the aforesaid plan. **5 Marks (INTER MAY 2018)**

Ans: ₹ 4,80,000

Que.15 Lucky Ltd. grants 100 stock options to each of its 1,500 employees on 1-4-2014 for ₹40, depending upon the employees at the time of vesting of options. Options would be exercisable within a year it is vested. The market price of the share is ₹70 each. These options will vest at the end of year 1 if the earning of Lucky Ltd. is 15%, or it will vest at the end of the year 2 if the average earning of two years is 13% or lastly it will vest at the end of the third year if the average earning of 3 years will be 10% 8,000 unvested options lapsed on 31-3-2015. 6,000 unvested options lapsed on 31-3-2016 and finally 4,000 unvested options on 31-3-2017.

The earnings of Lucky Ltd. for the three financial years ended on 31st March, 2015; 2016 and 2017 are 14%, 10% and 8% respectively.

1,250 employees exercised their vested options within a year and remaining options were unexercised at the end of the contractual life.

You are required to give the necessary journal entries for the above and also prepare the statement showing compensation expense to be recognized at the end of each year.

10 Marks (INTER NOV 2018)

Ans: ₹ 21,30,000, ₹ 5,90,000 and ₹ 12,40,000

Que.16 Bee Co. Ltd. has its share capital dividend into Equity Shares of ₹10 each. On 1st April 2017, the company offered 250 shares to each of its 520 employees at ₹60 per share, when the market price was ₹150 per share. The options were to be exercised between 01-03-2018 to 31-03-2018. 410 employees accepted the offer and paid ₹60 per share purchased and the remaining options lapsed. The company closes its books on 31st March every year.
You are required to show Journal entries (with narrations) as would appear in the books of Bee Co. Ltd. for the year ended 31st March, 2018 with regard to employees stock options.

5 Marks (INTER JUNE 2019)

Ans: ₹ 92,25,000

Que.17 On 1st April, 2018, XYZ Ltd. offered 150 shares to each of its 750 employees at ₹60 per share. The employees are given a year to accept the offer. The shares issued under the plan shall be subject to lock-in period on transfer for three years from the grant date. The market price of shares of the company on the grant date is ₹72 per share. Due to post-vesting restrictions on transfer, the fair value of shares issued under the plan is estimated at ₹67 per share.
On 31st March, 2019, 600 employees accepted the offer and paid ₹60 per share purchased. Nominal value of each share is ₹10.
You are required to record the issue of shares in the books of the XYZ Ltd., under the aforesaid plan.

5 Marks (INTER NOV 2019)

Ans: ₹ 6,30,000

Que.18 P Ltd. granted option for 8,000 equity shares of nominal value of ₹10 on 1st October, 20X0 at ₹80 when the market price was ₹170. The vesting period is 4.5 years, 4,000 unvested options lapsed on 1st December, 20X2, 3,000 options were exercised on 30th September, 20X5 and 1,000 vested options lapsed at the end of the exercise period.
Pass Journal Entries for above transactions. **(Study Material)**

Que.19 A Limited grants 5,000 options to its employees on 1.04.2015 at ₹90/-, when the market price was ₹150/-. The vesting period is 3 years. The maximum exercise period is one year. 4,500 options were exercised on 31.03.2019, the remaining options lapsed. Journalise the transactions, if the fair value of equity shares is ₹10/-per share. **8 Marks (IPCC NOV 2019)**

Ans: General reserve ₹ 30,000

BUY BACK OF SHARES

When a company has substantial cash resources, it may like to buy its own shares from the market particularly when the prevailing rate of its shares in the market is much lower than the book value or what the company perceives to be its true value. Buy back of shares enables the company to go back to its shareholders and offers to purchase from them the shares they hold. Buy Back of Securities is a very important tool for Companies who wants to reduce their Share Capital.

Advantages of Buy Back:

–It is an alternative mode of reduction in capital without requiring approval of the Court/CLB(NCLT),
– to improve the earnings per share;
– to improve return on capital, return on net worth and to enhance the long-term shareholders value;
– to provide an additional exit route to shareholders when shares are undervalued or thinly traded;
– to enhance consolidation of stake in the company;
– to prevent unwelcome takeover bids;
– to return surplus cash to shareholders;
– to achieve optimum capital structure;
– to support share price during periods of sluggish market condition;
– to serve the equity more efficiently.

Sections 68, 69 and 70 of Companies Act, 2013 provides for buy back of shares.

According to section 68(1) of the Companies Act 2013, a company may purchase its own shares or other specified securities (referred to as buy-back) out of—
(a) its free reserves;
(b) the securities premium account; or
(c) the proceeds of the issue of any shares or other specified securities:
However, 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.

Conditions for buy back:

According to section 68(2), following conditions must be satisfied in order to buy-back the shares :
(a) must be authorized by its articles;
(b) a special resolution has been passed at a general meeting of the company authorizing the buy-back, but the same is not required when:
i) the buy-back is 10% or less of the total paid-up equity capital and free reserves of the company; and
ii) such buy-back has been authorized by the Board by means of a resolution passed at its meeting;
(c) the buy-back is twenty-five per cent or less of the aggregate of paid-up capital and free reserves of the company. But in case of Equity Shares, the same shall be taken as 25% of paid up equity capital only.
(d) Debt equity ratio should be 2:1, where: Debt is aggregate of secured and unsecured debts owed by the after buy-back and Equity: is aggregate of the paid-up capital and its free reserves:
(e) all the shares or other specified securities for buy-back are fully paid-up;
(f) If shares or securities are listed, buy back will be in accordance with the regulations made by the Securities and Exchange Board in this behalf; and
(g) the buy-back in respect of unlisted shares or other specified securities is in accordance with Share Capital and Debentures Rules, 2014.
(h) 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.

Explanatory Statement - Section 68(3):

The notice of the meeting at which the special resolution is proposed to be passed shall be accompanied by an explanatory statement stating –

a) a full and complete disclosure of all material facts;
b) the necessity for the buy-back;
c) the class of shares or securities intended to be purchased under the buy-back;
d) the amount to be invested under the buy-back; and
e) the time-limit for completion of buy-back.

As per the rules, following more details is to be included in the Explanatory Statement:

f) the date of the board meeting at which the proposal for buy-back was approved by the board of directors of the company;
g) the number of securities that the company proposes to buy-back;
h) the method to be adopted for the buy-back;
i) the price at which the buy-back of shares or other securities shall be made;
j) the basis of arriving at the buy-back price;
k) the maximum amount to be paid for the buy-back and the sources of funds from which the buy-back would be financed;
l) Shareholding:
i) the aggregate shareholding of the promoters and of the directors of the promoter, where the promoter is a company and of the directors and key managerial personnel as on the date of the notice convening the general meeting;
ii) the aggregate number of equity shares purchased or sold by persons mentioned in sub-clause (i) during a period of twelve months preceding the date of the board meeting at which the buy-back was approved and from that date till the date of notice convening the general meeting;
iii) the maximum and minimum price at which purchases and sales referred to in sub-clause (ii) were made along with the relevant date;
m) if the persons mentioned in l(i) intend to tender their shares for buy-back –
   i) The quantum of shares proposed to be tendered;
   ii) the details of their transactions and their holdings for the last twelve months prior to the date of the board meeting at which the buy-back was approved including information of number of shares acquired, the price and the date of acquisition;
n) a confirmation that there are no defaults subsisting in repayment of deposits, interest payment thereon, redemption of debentures or payment of interest thereon or redemption of preference shares or payment of dividend due to any shareholder, or repayment of any term loans or interest payable thereon to any financial institution or banking company;
o) a confirmation:
   i) that the Board of directors have made a full enquiry into the affairs and prospects of the company and that they have formed the opinion- general meeting is convened there shall be no grounds on which the company could be found unable to pay its debts;
   ii) as regards its prospects for the year immediately following that date, that, having regard to their intentions with respect to the management of the company's business during that year and to the amount and character of the financial resources which will in their view be available to the company during that year, the company shall be able to meet its liabilities as and when they fall due and shall not be rendered insolvent within a period of 1 year from that date; and
   iii) the directors have taken into account the liabilities(including prospective and contingent liabilities),as if the company were being wound up under the provisions of the Companies Act, 2013
p) a report addressed to the Board of directors by the company's auditors stating that
   i)they have inquired into the company's state of affairs;
   ii) the amount of the permissible capital payment for the securities in question is in their view properly determined;

iii) that the audited accounts on the basis of which calculation with reference to buy back is done is not more than six months old from the date of offer document; and

iv) the Board of directors have formed the opinion as specified in point 'o' on reasonable grounds and that the company, having regard to its state of affairs, shall not be rendered insolvent within a period of one year from that date.

Other Conditions for Buy back

– Every buy-back shall be completed within a period of one year from the date of passing of the special resolution, or as the case may be, the resolution passed by the Board. ***Section 68(4)***

– The buy-back can be from:

a) from the existing shareholders or security holders on a proportionate basis;

b) from the open market;

c) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity. **[*Section 68(5)*]**

– Before making such buy-back, file with the Registrar, a declaration of solvency signed by at least two directors of the company, one of whom shall be the managing director, if any, Form No. SH.9 may be prescribed and verified by an affidavit to the effect that the Board of Directors of the company has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year from the date of declaration adopted by the Board. **[*Section 68(6)*]**

– Company shall extinguish and physically destroy the shares or securities so bought back within seven days of the last date of completion of buy-back. **[*Section 68(7)*]**

– Where a company completes a buy-back of its shares or other specified securities, it shall not make a further issue of the same kind of shares or other securities including allotment of new shares or other specified securities within a period of six months except by way of:

a) a bonus issue or

b) 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.

– Company shall maintain a register in Form No. SH.10 of the shares or securities so bought, the consideration paid for the shares or securities bought back, the date of cancellation of shares or securities, the date of extinguishing and physically destroying the shares or securities. The register of shares or securities bought back shall be maintained at the registered office of the company and shall be kept in the custody of the secretary of the company or any other person authorized by the board in this behalf. The entries in the register shall be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose.

– A company shall, after the completion of the buy-back under this section, file with the Registrar a return in Form No. SH.11 containing such particulars relating to the buy-back within thirty days of such completion. There shall be annexed to the return, a certificate in Form No. SH.15 signed by two directors of the company including the managing director, if any, certifying that the buy-back of securities has been made in compliance with the provisions of the Act and the rules made thereunder.

– If a company makes any default in complying with the provisions of this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both.

Transfer of certain sums to capital redemption reserves account (section 69)

Where a company purchases its own shares out of free reserves or securities premium account, 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 shall be disclosed in the balance sheet. The capital redemption reserve account may be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

Prohibition on buy back in following circumstances: (section 70)

No company shall directly or indirectly purchase its own shares or other specified securities –
a) through any subsidiary company including its own subsidiary companies;
b) through any investment company or group of investment companies; or
c) if a default, is made by the company, in the repayment of deposits accepted either before or after the commencement of this Act, interest payment thereon, redemption of debentures or preference shares or payment of dividend to any shareholder, or repayment of any term loan or interest payable thereon to any financial institution or banking company. Provided that the buy-back is not prohibited, if the default is remedied and a period of three years has lapsed after such default ceased to subsist. No company shall, directly or indirectly, purchase its own shares or other specified securities in case such company has not complied with the provisions of:
a) Sections 92: Annual Return
b) Section 123: Declaration and Payment of Dividend
c) Section 127: Failure to pay Dividend
d) Section 129: Failure to give True and Fair Statement

Theory Question

Q.1 Explain the provisions of Companies Act, 2013 relating to 'buy-back'? state the conditions which are required to be satisfied by a company for the purpose of buy-back of shares. CS (Inter) — June 2003 (4 Marks)

Ans. As per Section 68 of the Companies Act, 2013 a company may buy-back its own shares or other specified securities out of:

- Free reserves
- Securities premium account or
- Proceeds of the issue of any shares or other specified securities

Other important provisions relating to buy back are as follows:

- Buy-back of any kind of shares or other specified securities shall not be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.
- Company AOA must contain authorization for buy-back is authorized by its articles.
- A special resolution has to be passed at a general meeting of the company for buy back above 10% and up to 25% of the total paid-up equity capital and free reserves.
- The buy-back of equity shares in any financial year should not exceed 25% of its total paid-up equity capital in that financial year.
- The ratio of the aggregate of secured and unsecured debts owed by the company after buy-back is not more than twice the paid-up capital and its free reserves company after buy-back is not more than twice the paid-up capital and its flee-reserves. i.e. to say
  $$\frac{\text{Secured + Unsecured Debts}}{\text{Paid-up Capital + Free Reserves}} \leq 2$$
- All the shares or other specified securities for buy-back are fully paid-up.
- The buy-back of listed securities is in accordance with the regulations made by the SEBI.
- The buy-back of unlisted securities is in accordance with prescribed rules.
- There should be gap of 1 year between two buy back.
- The notice of the meeting at which the special resolution is proposed to be passed shall be accompanied by an explanatory statement stating:
  a. A full and complete disclosure of all material facts
  b. The necessity for the buy-back
  c. The class of shares or securities intended to be purchased under the buy-back
  d. The amount to be invested under the buy-back
  e. Time limit for completion of buy-back.

- Every buy-back shall be completed within 1 year from the date of passing of the special resolution, or board resolution as the case may be.
- **Methods of** buy-back : The buy-back may be *(a)* from the existing shareholders or security holders on a proportionate basis; *(b)* from the open market; *(c)* by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.
- Company shall, before making such buy-back, file with the Registrar and the SEBI a declaration of solvency signed by at least 2 directors of the company, one of whom shall be the managing director, in prescribed form and verified by the Board of Directors.
- A company shall extinguish and physically destroy the shares or securities bought back within 7 days of the last date of completion of buy-back.
- Where a company makes a buy-back then it shall not make right issue of the same kind of shares within a period of 6 months. However, bonus issue, conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares will be allowed.
- Where a company buys back, it shall maintain a register of buy-back containing following details:
  - — Consideration paid for the shares or securities bought back
  - — Date of cancellation of shares or securities
  - — Date of extinguishing and physically destroying the shares or securities and
  - — Other prescribed particulars.
- After completion of the buy-back company shall file with the Registrar and the SEBI a return of buy- back within 30 days of completion of buy back.
- Explanation I : "Specified securities" includes employee's stock option or other securities as may be notified by the Central Government from time to time.
- Explanation II: "Free reserves" includes securities premium account.

Transfer to the capital redemption reserve account: As per Section 69 of the Companies Act, 2013, where a company purchases its own shares out of free reserves or securities premium account, a sum equal to the nominal value of the shares so purchased shall be transferred to the Capital Redemption Reserve (CRR) account and details of such transfer shall be disclosed in the balance sheet. The CRR account may be applied by the company to issue bonus shares.

Generally, free reserves include the following:

- Balance in the Profit & Loss Account
- The subsidy received under the Central Government, outright grants or subsidy scheme, 1971 subject to fulfillment of prescribed-conditions.
- General reserve
- Dividend equalization reserve
- Sinking fund
- Investment allowance (unutilized) reserve

The following adjustments should be made against free reserves to arrive at the net amount available for the purpose of buy back:

- Unamortized miscellaneous & deferred revenue expenditure
- Unamortized expenditure
- Purchase goodwill
- Contingent liabilities likely to mature and not provided for
- Any diminution of long term investments not provided for
- Any impairment in the value of tangible assets not provided for

Q.2 As a matter of prudence, whole of free reserves should not be utilized in the case of buy-back of shares. CS (Executive) – Dec 2008 (3 Marks)

Ans. As per Section 68 of the Companies Act, 2013, the sources of funds are:

- Free reserves,
- Securities premium account, or

- Proceeds of preference shares or other specified securities.

However, as a matter of prudence, whole of free reserves should not be utilized in the case of buy-back of shares and the following adjustments should be made against free reserves to arrive at the net amount available for the purpose of buy back:

- Unamortized miscellaneous expenditure
- Unamortized deferred revenue expenditure
- Purchase goodwill
- Contingent liabilities likely to mature and not provided
- Any diminution of long term investments not provided
- Any impairment in the value of tangible assets not provided

Q.3 Buy-back may be misused by the corporate entities at the cost of innocent investors. Give your comments. **CS (Executive) — June 2010 (3 Marks)**

Ans. The buy-back may be misused by the corporate entities at the cost of innocent investor because of reasons:

i. it will provide opportunity for insider trading. The promoters, before the buy-back may understate earning by manipulating accounting policies in respect of depreciation, valuation of inventories c. This would lead to a fall in the quoted prices of shares and the promoter would buy then at low quotations. In this way, the insiders would earn extra money when the company buy backs these shares at a highest price.

ii. buy back lead to artificial manipulation of stock prices.

Q.4 Write a short note on: Objectives of buy back of securities

Ans. Objectives of buy back of securities are as follows:

- To increase promoters' holding in the company.
- To increase EPS.
- To achieve or maintain a target capital structure.
- To increase the underlying share value.
- To prevent or inhibit unwelcome take-over bids.
- To pay back surplus cash not required by business.

Que 5 Conditions to be fulfilled by a Joint Stock Company to buy-back its equity shares as per Companies Act 2013.

Ans: As per section 68 to 70of the Companies Act, 2013 a joint stock company has to fulfill the following conditions to buy-back its own equity shares:

(a) A Company may purchase its own equity shares or other specified securities out of:

(i) Its Free Reserves;

(ii) The Securities Premium Account;

(iii) The proceeds of the issue of any shares or any other specified securities (not being the proceeds of an earlier issue of same kind of shares or other specified securities).

(b) The buy-back is authorised by its articles.

(c) A special resolution* has been passed in general meeting of the company authorising the buy-back (except back is off less than 10% paid up capital & free reserves of the company and the buy back is authorized by board by means of a resolution passed at a duly convened Board meeting)

(d) The buy-back does not exceed 25% of the total paid up capital and free reserves of the company. Provided the buy-back must not exceed 25% of its total paid up equity capital in that financial year.

(e) The ratio of the debt owed by the company is not more than twice the capital and its free reserves after such buy-back. All the shares for buy-back are fully paid up.

(f) The buy-back is completed within 12 months of the passing of the special resolution or a resolution passed by the Board.

(g) The buy-back of the shares listed on any recognised stock exchange is in accordance with the regulations made by the SEBI in this behalf.

(h) Before making such buy-back, a listed company has to file with the Registrar and the SEBI a declaration of solvency in the prescribed form.
The buy back may be from
(i) the existing share holders or security holders on proportionate basis;
(ii) the open market;
(iii) the shares and securities issued to the employees of the company pursuant to scheme of stock option or sweat Equity.
(j) Where a company purchase its own shares out of its free reserves or securities premium account it shall transfer an amount equal to the nominal value of such shares to Capital Redemption reserve Account & details of such transfer should be given in the balance sheet.
(k) The Capital Redemption Reserve Account may be applied by the company in paying up unissued shares of the company to be issued to the members of the company as fully paid bonus shares.

Practical Question

Ques.1 A company is contemplating buyback of its 5% share capital. Book Building process was applied as per SEBI regulations.

No. of shares to be bought back by company X 4,00,000
Share Price of Company X ₹19 per share
Quotes received from shareholders are tabulated as under:

Buy Back Price Range	Share Offered for buy back by P	Share Offered for buy back by Q	Share Offered for buy back by R	Share Offered for buy back by S	Total shares Offered for buy back
₹20	40,000	80,000	40,000	1,00,000	2,60,000
₹21	70,000	1,10,000	60,000	1,40,000	3,80,000
₹22	1,00,000	1,10,000	1,20,000	1,70,000	5,00,000
₹23	1,60,000	2,00,000	2,00,000	2,40,000	8,00,000

Journalise entries for buy back.

Ans: Buy Back Price 22 and 80% of each share holder buy back will be done.

Ques.2 Kuber ltd. Furnishes you the following Balance Sheet as at 31st March, 2000:

		(₹In Crore)
Sources of funds		
Share Capital:		
Authorized		100
Issued:		
12% redeemable preference shares of ₹100 each fully paid	75	
Equity shares of ₹10 each fully paid	25	100
Reserves & Surplus :		
Capital Reserve	15	
Share Premium	25	
Revenue Reserves	260	300
		400
Funds employed in:		
Fixed Assets : Cost	100	
Less: Provisions for depreciation	100	100
Investment at Cost (Market value ₹400 Cr.)		
Current Assets	340	

Less: Current liabilities	40	300
		400

The Company redeemed preference shares on 1st April, 2000. It also bought back 50 lakh equity shares of ₹50 per share. The payments for the above were made out of the huge bank balance, which appeared as part of current assets. You are asked to:
1) Pass Journal entries to record the above.
2) Prepare Balance Sheet.

Ans: B/S 340

Ques.3 Extra Ltd. furnishes you with the following summarized Balance Sheet as on 31st March, 2012:

Liabilities	Amount (₹ in Lakhs)	Assets	Amount (₹ in Lakhs)
Equity shares of ₹10 each fully paid	100	Fixed assets less Depreciation	50
9% Redeemable preference shares of ₹100 each fully paid	20	Investments at cost	120
Capital reserves	8	Current assets	142
Revenue reserves	50		
Securities premium	60		
10% Debentures	4		
Current liabilities	70		
	312		312

(i) The company redeemed the preference shares at a premium of 10% on 1st April, 2012.
(ii) It also bought back 3 lakhs equity shares of ₹10 each at ₹30 per share. The payment for the above, were made out of huge bank balances, which appeared as a part of the current assets.
(iii) Included in its investment were "investments in own debentures" costing ₹2 lakhs (face value ₹2.20 lakhs).
These debentures were cancelled on 1st April, 2012.
(iv) The company had 1,00,000 equity stock options outstanding on the above mentioned date, to the employees at ₹20 when the market price was ₹30.(This was included under current liabilities).On 1.04.2012 employees exercised their options for 50,000 shares.
(v) Pass the journal entries to record the above.
(vi) Prepare Balance Sheet as at 01.04.2012.

Ans: B/S 208

Ques.4 Dee Limited furnishes the following summarized Balance Sheet as at 31st March, 2012:

Liabilities	₹.'000	₹.'000
Share capital:		
Authorised capital		30,00
Issued and subscribed capital:		
2,50,000 Equity shares of ₹.10 each fully paid up	25,00	
2,000, 10% Preference shares of ₹.100 each(Issued two months back for the purpose of buy back)	2,00	27,00
Reserves and surplus:		
Capital reserve	10,00	
Revenue reserve	30,00	
Securities premium	22,00	
Profit and loss account	35,00	97,00
Current liabilities and provisions:		14,00

		1,38,00
Assets		
Fixed assets		93,00
Investments		30,00
Current assets, loans and advances (including cash and bank balance)		15,00
		1,38,00

The company passed a resolution to buy back 20% of its equity capital @ ₹50 per share.
For this purpose, it sold all of its investment for ₹.22,00,000.
You are required to pass necessary journal entries and prepare the Balance Sheet.

Ans: B/S 10,500

Ques.5 KG Limited furnishes the following summarized Balance Sheet as at 31st March, 2012.

Liabilities	Amount (₹ in Lakhs)	Assets	Amount (₹ in Lakhs)
Equity share capital(fully paid up shares of ₹10 each)	1200	Machinery	1800
Securities premium	175	Furniture	226
General reserve	265	Investment	74
Capital redemption reserve	200	Stock	600
Profit & loss A/c	170	Debtors	260
12% Debentures	750	Cash at bank	740
Sundry creditors	745		
Other current liabilities	195		
	3700		**3700**

On 1st April, 2012, 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 ₹75 lakhs.
On 5th April, 2012, the company achieved the target of buy back. On 30th April, 2012 the company issued one fully paid up equity share of ₹10 by way of bonus for every four equity shares held by the equity shareholder. 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. **(Nov 2010)**

Ans: B/S 3,251

Ques.6 M Limited furnishes the following summarized Balance Sheet as at 31st March, 2013:

Liabilities	₹.'000	₹.'000
Share capital:		
Authorised capital		5000
Issued and subscribed capital:		
3,00,000 Equity shares of ₹10 each fully paid up	3000	
20,000, 9% Preference shares of ₹100 each (Issued two months back for the purpose of buy back)	2000	5000
Reserves and surplus:		
Capital reserve	10	
Revenue reserve	4000	
Securities premium	500	
Profit and loss account	1800	6310
Non- Current liabilities		400
Current liabilities and provisions:		40

		11750
Assets		
Assets		
Fixed Assets : Cost	3000	
Less: Provision for depreciation	250	2750
Non-Current Investments at cost		5000
Current assets, loans and advances (including cash and bank balance)		4000
		11750

1) The company passed a resolution to buy back 20% of its equity capital @ ₹15 per share. For this purpose, it sold its investment for ₹30,00,000 for ₹25 lakhs.
2) The Company redeemed the preference shares at a premium of 10% on 1st April, 2013.
3) Included in Investment were: investment in own debentures' costing ₹3 lakhs (Face value ₹3.30 Lakhs).These debentures were cancelled on 1st April 2013.

You are required to pass necessary journal entries and prepare the Balance Sheet.

Ans: B/S 7,850

Ques.7 Following is the Balance Sheet of M/s Competent Ltd., as on 31st March, 2013.

Liabilities	Amount	Assets	Amount
Equity share capital(fully paid up shares of ₹10 each)	12,50,000	Fixed Assets	46,50,000
Securities premium	2,50,000	Current Assets	30,00,000
Revenue reserve	15,00,000		
Profit & loss A/c	1,25,000		
12% Debentures	18,75,000		
Unsecured Loans	10,00,000		
Current Maturities of Long Term Borrowings	16,50,000		
	76,50,000		76,50,000

The company wants to buy back 25,000 equity shares of ₹10 each, on 1st April, 2013 at ₹20 per share. Buy back of shares is duly authorised by its Articles and necessary resolution passed by the company towards this. This 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 provision of the companies Act, 2013. If yes, pass necessary journal entries towards buy back of shares and prepare the Balance Sheet after buy back of shares.

Ans: B/S 71,50,000

Ques.8 Perrotte Ltd. (a non-listed company) has the following Capital Structure as on 31.03.2011:

Particulars	(₹in crores)
Equity Share Capital (Shares of ₹10 each fully paid)	330
Reserves and Surplus	
General Reserve	240
Securities Premium Account	90
Profit & Loss Account	90
Infrastructure Development Reserve	180
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 ₹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 ₹1,200 crore or ₹1,500 crore. Assuming that the entire buy back is completed by 09.12.2011, show the accounting entries in the company's books in each situation.

Ques.9 Following is the summarized Balance Sheet of Complicated Ltd as on 31st March 2016:

Liabilities	Amount (₹)
Equity Shares of ₹10 each fully Paid Up	12,50,000
Bonus Shares	1,00,000
Share Option Outstanding Account	4,00,000
Revenue Reserve	15,00,000
Securities Premium	2,50,000
Profit & Loss Account	1,25,000
Capital Reserve	1,00,000
Revaluation Reserve	1,00,000
Unpaid Dividends	1,00,000
12% Debentures (Secured)	18,75,000
Advance from Related Parties (Unsecured)	10,00,000
Current Maturities of Long Term Borrowings	16,50,000
Application Money Received for Allotment Due for Refund	2,00,000
	86,50,000
Fixed Assets	46,50,000
Current Assets	40,00,000
	86,50,000

The Company wants to buy back 25,000 Equity Shares of ₹10 each, on 1st April 2016, at ₹20 per Share. Buy Back of Shares is duly authorized by its Articles and necessary resolution has been passed by the Company back of Shares will be made by the Company out of sufficient bank balance available shown as part of Current Assets. Comment with your calculations, whether Buy Back of Shares by the Company is within the provisions of the Companies Act, 2013. If yes, pass necessary Journal Entries towards buy back of Shares & prepare the Balance Sheet after buy back of Shares.

12 Marks (May 2016)

Ans Balance Sheet ₹81,50,000

Ques.10 The following is summarised balance sheet of M/s Vriddhi Infra ltd. as on 31st March, 2016:

Equity & Liabilities	Amount	**Assets**	Amount
1. Shareholder's fund		**1. Non-current assets**	
(a) Share Capital:		(a) Fixed (tangible)	
1,000 Equity shares of ₹10 each fully paid up	10,00,000	Assets	
(b) Reserve and Surplus:		Land & Building	21,50,000
Securities premium	3,00,000	Plant & Machinery	15,00,000
General reserve	2,50,000	(b) Non-current investments	2,00,000

Profit and loss account surplus	1,50,000	**2. Current Assets**	
2. Non-Current liabilities		(a) Trade Receivables	5,50,000
Long term borrowings:		(b) Inventories	1,80,000
10% Debentures (secured by floating charge on all assets)	20,00,000	(c) Cash & Cash Equivalents	40,000
Unsecured Loans	8,00,000		
3. Current Liability & Provisions			
Trade Payables	1,20,000		
Total	46,20,000	Total	46,20,000

On 21st April, 2016 the company announced the buy back of 25,000 of its equity shares @ ₹15 per share. For this purpose, it sold all its investment for ₹2.50 lakhs.
On 25th April, 2016 the company achieved the target of buy back. On 1st May, 2016 the company issued one fully paid up share of ₹10 each by way of bonus for every five equity shares held by the equity shareholders.
You are requested to pass necessary journal entries for the above transactions.
All necessary working should form part of your answer. **6 Marks** **(Nov 2016)**

Que.11 SMM Ltd. has the following capital structure as on 31st March, 2017:

Particulars	**Situation 1**	**Situation 2**
(i) equity share capital (shares of ₹10 each)	1,200	1,200
(ii) reserves:		
General reserves	1,080	1,080
Securities premium	400	400
Profit and loss	200	200
Infrastructure development reserve (statutory reserve)	320	320
(iii) loan funds	3,200	6,000

The company has offered a buy back price of ₹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. **8 Marks** **(May 2017)**

Que. 12 Alpha Ltd. furnishes the following summarized Balance Sheet as at 31st March, 2017:

	₹ in lakhs	**₹ in lakhs**
Equity and Liabilities		
Shareholders' Funds		
Equity Share Capital (Fully paid up shares of ₹10 each)		2,400
Reserves and Surplus		
Securities Premium	350	
General Reserve	530	
Capital Redemption Reserve	400	
Profit & Loss Account	340	1,620
Non-Current Liabilities		
12% Debentures		1,500
Current Liabilities		
Trade Payables	1,490	
Other Current Liabilities	390	1,880
Total		**7,400**
Assets		

Non-Current Assets		
Fixed Assets		4,052
Current Assets		
Current Investments	148	
Inventories	1,200	
Trade Receivables	520	
Cash and Bank	1,480	3,348
Total		**7,400**

(i) On 1st April, 2017, the company announced buy-back of 25% of its equity shares @₹15 per share. For this purpose, it sold all its investment for ₹150 lakhs.

(ii) On 10th April, 2017 the company achieved the target of buy-back.

(ii) On 30th April, 2017, the company issued one fully paid up equity share of ₹10 each by way of bonus for every four equity shares held by the equity shareholders by capitalization of Capital Redemption Reserve.

You are required to pass necessary journal entries and prepare the Balance Sheet of Alpha Ltd. after bonus issue. **10 Marks (INTER MAY 2018)**

Que.13 Pratham Ltd. (a non-listed company) has the following Capital Structure as on 31st March, 2018:

Particulars	₹	₹
Equity Share Capital (shares of ₹10 each fully paid)		30,00,000
Reserves & Surplus		
General Reserve	32,50,000	
Security Premium Account	6,00,000	
Profit & Loss Account	4,30,000	
Revaluation Reserve	6,20,000	49,00,000
Loan Funds		42,00,000

You are required to compute by Debt Equity Ratio Test, the maximum number of shares that can be bought back in the light of above information, when the offer price for buy back is ₹30 per share.

4 Marks (IPCC NOV 2018)

Que.14 Following is the summarized Balance Sheet of Competent Limited as on 31st March, 2013:

Liabilities	₹	Assets	₹
Equity Shares of 10 each fully paid up	15,00,000	Fixed Assets	61,80,000
Revenue Reserve	18,00,000	Current Assets	30,00,000
Securities Premium	3,00,000		
Profit & Loss Account	1,50,000		
Secured Loans:			
12% Debentures	22,50,000		
Unsecured Loans	12,00,000		
Current maturities of long term Borrowings	19,80,000		
	91,80,000		91,80,000

The company wants to buy back 30,000 equity shares of ₹10 each, on 1st April, 2013 at ₹20 per share. Buy Back of shares is duly authorized by its articles and necessary resolution has been 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 shown a 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 buy back of shares.

8 Marks (IPCC JUNE 2019)

Que.15 Following is the summarized Balance Sheet of Super Ltd. as on 31st March, 2018.

Liabilities	**In ₹**
Share Capital	
Equity Shares of ₹10 each fully paid up	17,00,000
Reserves and Surplus	
Revenue Reserve	23,50,000
Securities Premium	2,50,000
Profit & Loss Account	2,00,000
Infrastructure Development Reserve	1,50,000
Secured Loan	
9% Debentures	22,50,000
Unsecured Loan	8,50,000
Current Maturities of Long-term borrowings	15,50,000
	93,00,000
Assets	
Fixed Assets	
Tangible Assets	58,50,000
Current Assets	
Current Assets	34,50,000
	93,00,000

Super Limited wants to buy back 35,000 equity shares of ₹10 each fully paid up on 1st April, 2018 at ₹30 per share.

Buy Back of shares is fully authorised by its articles and necessary resolution have been 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 pet of the Current Assets.

Comment with calculations, whether the Buy Back of Shares by the company is within the provisions of the Companies Act, 2013. **10 Marks** **(INTER JUNE 2019)**

Que.16 X Ltd. furnishes the following summarized Balance Sheet as at 31-03-2018.

Liabilities	**(in ₹)**	**(in ₹)**
Share Capital		
Equity Share Capital of ₹20 each fully paid up	50,00,000	
10,000, 10% Preference Share of ₹100 each fully paid up	10,00,000	60,00,000
Reserves & Surplus	1,00,000	
Capital Reserve	12,00,000	
Securities Premium	5,00,000	
Revenue Reserve	20,00,000	
Profit and Loss	5,50,000	43,50,000
Dividend Equalization Fund		
Non-Current Liabilities		12,50,000
12% Debenture		5,50,000
Current Liabilities and Provisions		**1,21,50,000**
Total:		
Assets		
Fixed Assets		1,00,75,000
Tangible Assets		
Current Assets	3,00,000	
Investment	2,00,000	
Inventory	15,75,000	20,75,000
Cash and Bank		**1,21,50,000**
Total:		

The shareholders adopted the resolution on the date of the above mentioned Balance Sheet to:
(1) Buy back 25% of the paid up capital and it was decided to offer a price of 20% over market price. The prevailing market value of the company's share is ₹30 per share.
(2) To finance the buy back of share company;
(a) Issue 3,000, 14% debenture of ₹100 each at a premium of 20%.
(b) Issue 25,000, 10% preference share of ₹100 each.
(3) Sell investment worth ₹1,00,000 for ₹1,50,000.
(4) Maintain a balance of ₹2,00,000 in Revenue Reserve.
(5) Later the company issue three fully paid up equity share of ₹20 each by way of bonus share for every 15 equity share held by the equity shareholder.
You are required to pass the necessary journal entries to record the above transactions and prepare Balance Sheet after buy-back. **15 Marks** **(INTER NOV 2019)**

EQUITY SHARES WITH DIFFERENTIALRIGHTSEQUITY SHARES WITH DIFFERENTIAL RIGHTS

EQUITY SHARES WITH DIFFERENTIAL RIGHTS

Introduction

Section 43 Companies Amendment Act, 2013 allows companies to issue equity shares with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed. As we know that share capital is of two types – equity and preference. Preference share capital with reference to any company

limited by shares, means that part of the issued share capital of the company which carries or would carry a preferential right with respect to:

(i) Payment of dividend, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income-tax; and

(ii) Repayment, in the case of a winding up or repayment of capital, of the amount of the share capital paid-up or deemed to have been paid-up, whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company.

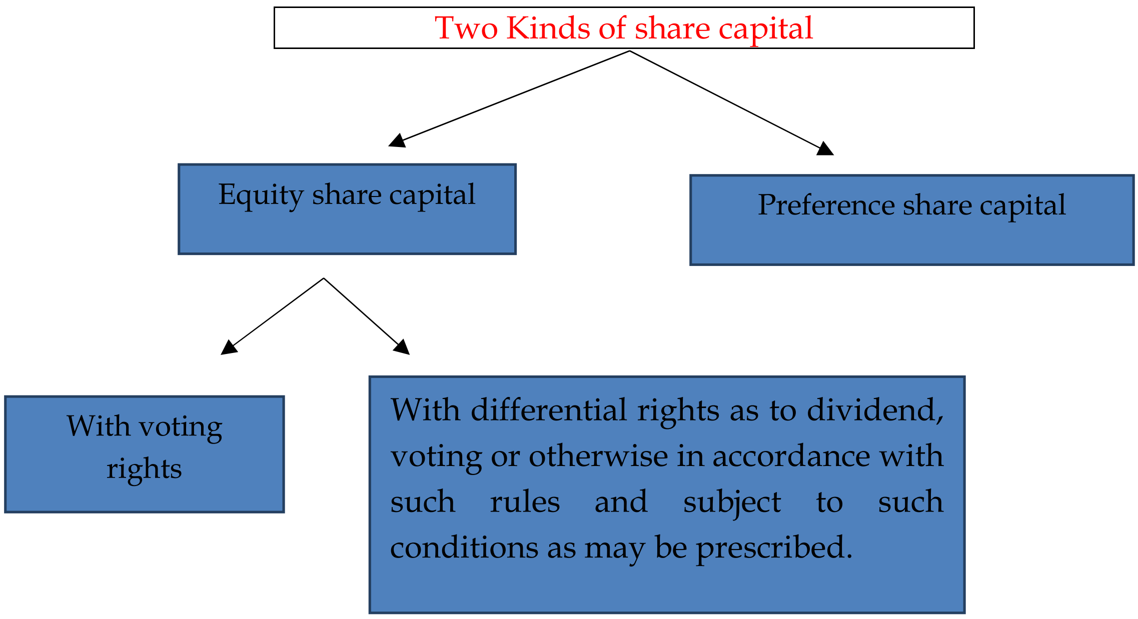
Section 43(a) of The Companies Act, 2013 defines equity share capital to include of two types viz.,

(i) With voting rights; or

(ii) With differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed

Hence, differentiation can be done by giving superior dividend / Superior voting right/ diluted voting right to a class of equity shareholder. A residual category 'otherwise' has also been created to give enough leeway to the management in structuring shareholder agreements with desired divisions of managerial control interest and financial interest. *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:–



Voting Rights

Section 2 (93) defines "voting right," as the right of a member of a company to vote in any meeting of the company or by means of postal ballot.

Equity shareholder voting rights

Of the two types of shares, equity shares have a general voting right, whereas preference shares have restrictive voting rights.

According to section 47 (1), Subject to the provisions of section 43 and sub-section (2) of section 50:

(i) 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

(ii) His voting right on a poll shall be in proportion to his share in the paid-up equity share capital of the company.

Normally, the blanket rule in Companies Act is **one share-one vote**. This gives equal voting right to every shareholder. This is a fairly democratic process and is quite robust from the corporate governance perspective.

However, sometime a segment of shareholders, normally promoters and executive management may like to have more control over decision-making process. But that may not be possible if shareholding is quite diffused. This intention of shareholders / management can be activated if they have more voting rights, even if they hold fewer shares. This can be structured by giving them shares with superior voting rights. *This is enabled by section 43(a)(ii) in the form of equity shares with differential rights.*

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. This once again points to one share – one vote doctrine of company law.

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,

Share Capital and Debentures Rules, 2014

In exercise of the power conferred under Section 43(a)(ii), the central government announced Rule 4 under Companies (**Share Capital and Debentures**) Rules, 2014, to deal with equity shares with differential rights.

The rules lay down the following conditions to be compulsorily complied with:

a) The articles of association of the company authorizes the issue of shares with differential rights;

b) The issue of shares is authorized by an ordinary resolution passed at a general meeting of the shareholders: Provided that where the equity shares of a company are listed on a recognized stock exchange, the issue of such shares shall be approved by the shareholders through postal ballot;
c) The shares with differential rights shall not exceed ***twenty-six percent*** of the total post-issue paid up equity share capital including equity shares with differential rights issued at any point of time;
d) The company having ***consistent track record of distributable profits*** for the last three years;
e) The company has ***not defaulted in filing*** financial statements and annual returns for three financial years immediately preceding the financial year in which it is decided to issue such shares;
f) The company has no ***subsisting default in the payment*** of a declared dividend to its shareholders or repayment of its matured deposits or redemption of its preference shares or debentures that have become due for redemption or payment of interest on such deposits or debentures or payment of dividend;
g) The company has not ***defaulted in payment*** of the dividend on preference shares or repayment of any term loan from a public financial institution or State level financial institution or scheduled Bank that has become repayable or interest payable thereon or dues with respect to statutory payments relating to its employees to any authority or default in crediting the amount in Investor Education and Protection Fund to the Central Government;
h) The ***company has not been penalized*** by Court or Tribunal during the last three years of any offence under the Reserve Bank of India Act, 1934, the Securities and Exchange Board of India Act, 1992, the Securities Contracts Regulation Act, 1956, the Foreign Exchange Management Act, 1999 or anyother special Act, under which such companies being regulated by sectoral regulators.
It is further clarified that the company shall not convert its existing equity share capital with voting rights into equity share capital carrying differential voting rights and *vice–versa.*
It is further clarified that the holders of the equity shares with differential rights shall enjoy all other rights such as bonus shares, rights shares etc., which the holders of equity shares are entitled to, subject to the differential rights with which such shares have been issued.
It is also specified that where a company issues equity shares with differential rights, the Register of Members maintained under section 88 shall contain all the relevant particulars of the shares so issued along with details of the shareholders.
It is further provided that for the purposes of this rule, it is hereby clarified that differential rights attached to such shares issued by any company under the provisions of Companies Act, 1956, shall continue till such rights are converted with the differential rights in accordance with the provisions of the Companies Act, 2013. To that extent rights of existing shareholders have been grandfathered.
It must be appreciated that issue of equity shares with differential rights comes with a cost. This kind of arrangement certainly dilutes the corporate governance perspective. The system clearly violates the principles of democracy. It creates classes within classes. TATA were the first in 2008 to issue equity shares with differential rights. They came out with a differential right issue under the nomenclature of class A shares, the voting rights were diluted to 1/10th and the rate of the dividend was 5% more as compared to the other category of Tata motors shares being traded on the stock exchange. Similarly, Pantaloons issued *bonus shares* with differential voting rights with an additional 5% dividend but one-tenth voting rights to ordinary equity shares. Gujarat NRE Coke and Jain Irrigation Systems issued similar bonus shares with differential voting rights.

Dilution in case of private companies

Section 43 (a) (ii) and its corresponding stringent Rules were mandatorily applicable to both private and public companies as far as issue of equity share capital with differential voting rights is concerned. However the Ministry of Corporate Affairs has *vide* its notification G.S.R 464 (E), Exemptions to private companies notification, Ministry of Corporate Affairs, June 5, 2015, has exempted private companies from the applicability of Section 43 and Rules, and private companies are now free to structure their share capital in a manner they deem best in the interests of thecompany. The rule has been essentially diluted to enable start-ups to structure their financial deals without compromising much on management control.

Variation of shareholder's rights

The rights of a shares of a particular class, once issued, can be varied or altered under section 48 if
(*a*) If provision with respect to such variation is contained in the memorandum or articles of the company; or
(*b*) In the absence of any such provision in the memorandum or articles, if such variation is not prohibited by the terms of issue of the shares of that class.
However, it would require consent in writing of the holders of not less than three-fourths of the issued shares of that class or by means of a special resolution passed at a separate meeting of the holders of the issued shares of that class.
Hence, if equity shareholders Series A require a change in their right, of a particular nature, either a special resolution of a specially convened meeting of this particular class of shareholders will suffice, or otherwise more than 75% shareholders can give their consent in writing.
However, it must be understood that a company having equity shares with voting rights cannot convert them into equity shares with differential voting rights, or vice-versa. This has been necessitated after the making of the rule 4 of the Companies (**Share Capital and Debentures**) Rules, 2014.
However, the variation in their rights should not affect the rights of any other class, say Equity shares 'B' class or Preference shares.
In such situation, if variation by one class of shareholders affects the rights of any other class of shareholders, the consent of three-fourths of such other class of shareholders shall also be obtained and the provisions of this section shall apply to such variation.

Protection of minority shareholder clause

If a particular class of shareholders wants their variation of rights, 75% shareholders can achieve the purpose. What shall be the fate of remaining 25%? If they are fragmented, not much can be done. But if the holders of **not less than ten per cent** of the issued shares of a class did not consent to such variation or vote in favor of the special resolution for the variation, they may apply to the Tribunal to have the variation cancelled, and where any such application is made, the variation shall not have effect unless and until it is confirmed by the Tribunal.

However, the application under this section shall be made within twenty-one days after the date on which the consent was given or the resolution was passed, as the case may be, and may be made on behalf of the shareholders entitled to make the application by such one or more of their number as they may appoint in writing for the purpose. The decision of the Tribunal on any application under sub-section (2) shall be binding on the shareholders. The company must comply with the order and, within thirty days of the date of the order of the Tribunal, file a copy thereof with the Registrar.

Example 1 Equity share capital is held by X,Y and Z in the proportion of 40:40:20. A, B and C hold preference share capital in proportion of 50:30:20. If the paid up Equity share capital of the company is ₹1 Crore and Preference share capital is ₹ 50 Lakh, then relative weight in the voting right of Equity shareholders and Preference shareholders will be 2/3 and 1/3. The respective Voting rights of various shareholders will be:

X = 2/3 X 40/100 = 4/15, Y = 2/3 X 40/100 = 4/15, Z = 2/3 X 20/100 = 2/15

A = 1/3 X 50/100 = 1/6, B = 1/3 X 30/100 = 1/10, C = 1/3 X 20/100 = 2/30

The Voting power is X 26.67%, Y 26.67%, Z 13.33%, A 16.67%, B 10%, C 6.67%

Notes..