

INTERNAL RECONSTRUCTION

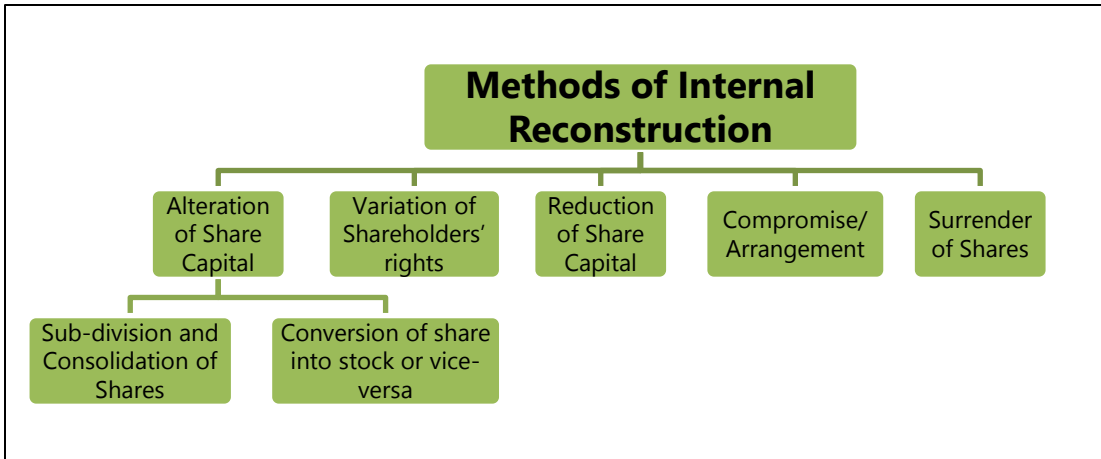


LEARNING OUTCOMES

After studying this chapter, you will be able to :

- Understand the meaning of term “reconstruction”.
- Sub-divide and consolidate shares.
- Convert shares into stock and stock into shares.
- Account for the adjustments made at the time of internal reconstruction.

CHAPTER OVERVIEW



1. MEANING OF RECONSTRUCTION

When a company has been making losses for a number of years, the financial position does not present a true and fair view of the state of the affairs of the company. In such a company the assets are overvalued, the assets side of the balance sheet consists of fictitious assets, useless intangible assets and debit balance in the profit and loss account. Such a situation does not depict a true picture of financial statements and shows a higher net worth than what the real net worth ought to be. In short the company is over capitalized. Such a situation brings the need for reconstruction.

*Reconstruction is a process by which affairs of a company are reorganized by revaluation of assets, reassessment of liabilities and by writing off the losses already suffered by reducing the paid up value of shares and/or varying the rights attached to different classes of shares. The object of reconstruction is usually to reorganize capital or to compound with creditors or to effect economies. Such a process is called **internal reconstruction** which is carried out without liquidating the company and forming a new one.*

However, there may be external reconstruction. Wherever an undertaking is being carried on by a company and is in substance transferred, not to an outsider, but to another company consisting substantially of the same shareholders with a view to its being continued by the transferee company, there is external reconstruction.

Such external reconstruction is essentially covered under the category 'amalgamation in the nature of merger' in AS-14.

Difference Between Internal and External Reconstruction

Basis	Internal Reconstruction	External Reconstruction
Liquidation	The existing company is not liquidated.	The existing company is liquidated.
Formation	No new company is formed but only the rights of shareholders and creditors are changed.	A new company is formed to take over the liquidated company.
Reduction of capital	There is certain reduction of capital and sometimes the outside liabilities like debenture holders may have to reduce their claim.	There is no reduction of capital. In fact there is a fresh share capital of the company.
Legal position	Internal reconstruction is done as per provisions of section 66 of the Companies Act, 2013.	External reconstruction is regulated by section 232 of the Companies Act, 2013.

2. METHODS OF INTERNAL RECONSTRUCTION

For properly deploying the process of internal reconstruction following methods are generally employed or used simultaneously:

2.1 Alteration of Share Capital

Sub-division and Consolidation of Shares

If authorised by its Articles, a company may, in a general meeting by passing an ordinary resolution, decide to sub-divide or consolidate the shares into those of a smaller or higher denomination than that fixed by the Memorandum of Association, so long as the proportion between the paid up and unpaid amount, if any, on the shares continues to be the same as it was in the case of the original shares.

A notice specifying alteration made must be given to the Registrar within 30 days of alteration.

For example, a company with a capital of ₹ 10,00,000 divided into 10,000 equity shares of ₹ 100 each on which ₹ 75 is paid up decides to recognise its capital by splitting one equity share of ₹ 100 each into 10 such shares of ₹ 10 each. The consequential entry to be passed in such a case would be—

	Dr.	Cr.
	₹	₹
Equity Share Capital (₹ 100) A/c Dr.	7,50,000	
To Equity Share Capital (₹ 10) A/c		7,50,000
(Being the sub-division of 10,000 shares of ₹ 100 each with ₹ 75 paid up thereon into 1,00,000 shares of ₹ 10 each with ₹ 7.50 paid up thereon as per the resolution of shareholders passed in the General Meeting held on...)		

Similar entries will be passed on consolidation of shares of a smaller amount into those of a larger amount.

Illustration 1

On 31-12-20X1, B Ltd. had 20,000, ₹ 10 Equity Shares as authorised capital and the shares were all issued on which ₹ 8 was paid up. In June, 20X2 the company in general meeting decided to *sub-divide* each share into two shares of ₹ 5 with ₹ 4 paid up. In June, 20X3 the company in general meeting resolved to *consolidate* 20 shares of ₹ 5, ₹ 4 per share paid up into one share of ₹ 100 each, ₹ 80 paid up.

Pass entries and show how share capital will appear in notes to Balance Sheet as on 31-12-20X1, 31-12-20X2 and 31-12-20X3.

Solution

Journal Entries

20X2		₹	₹
June	Equity Share Capital (₹ 10) A/c Dr.	1,60,000	
	To Equity Share Capital (₹ 5) A/c		1,60,000
	(Being the sub-division of 20,000 shares of ₹ 10 each with ₹ 8 paid up into 40,000 shares ₹ 5 each with ₹ 4 paid up by resolution in general meeting dated...)		

20X3	Equity Share Capital (₹ 5) A/c	Dr.	1,60,000	
June	To Equity Share Capital (₹ 100) A/c			1,60,000
	(Being consolidation of 40,000 shares of ₹ 5 with ₹ 4 paid up into 2,000 ₹ 100 shares with ₹ 80 paid up)			

Notes to Balance Sheet

Liabilities:	₹
As on 31-12-20X1	
1. Share Capital	
<i>Authorised:</i>	
20,000 Equity Shares of ₹ 10 each	<u>2,00,000</u>
<i>Issued and Subscribed:</i>	
20,000 Equity Shares of ₹ 10 each ₹ 8 per share called up	1,60,000
As on 31-12-20X2	
1. Share Capital	
<i>Authorised:</i>	
40,000 Equity Shares of ₹ 5 each	<u>2,00,000</u>
<i>Issued and Subscribed:</i>	
40,000 Equity Shares of ₹ 5 each ₹ 4 per share called up	1,60,000
As on 31-12-20X3	₹
1. Share Capital	
<i>Authorised:</i>	
2,000 Equity Shares of ₹ 100 each	<u>2,00,000</u>
<i>Issued and Subscribed:</i>	
20,000 Equity Shares of ₹ 100 each ₹ 80 per share called up	1,60,000

Note: Some accountants prefer not to make any entry as the amount remains same. Even when an entry is passed it applies only to the called up portion, and not to uncalled or unissued portion of share capital.

Conversion of Fully Paid Shares into Stock and Stock into Shares

According to section 61 of Companies Act, 2013, a company can convert its fully paid shares into stock and reconversion of stock into shares. If authorised by its Articles, a company may, in a general meeting by passing an ordinary resolution, can convert its fully paid shares into stock and reconversion of stock into shares. Stock is the consolidation of the share capital into one unit divisible into aliquot parts. Stock is a bundle of fully paid shares put together for convenience so that it may be divided into any amount and transferred into any fractions and subdivisions without regard to the original face value of the shares. While it is impossible for share capital to be one share, any amount of stock may be transferred. In practice, however, companies restrict the transfer of stock to multiples say, ₹ 100. A company can convert its fully paid shares into stock. Upon the company converting its shares into stock, the book-keeping entries merely record the transfer from share capital account to stock account. A separate Stock Register is started in which details of members' holdings are entered and the annual return is modified accordingly.

Illustration 2

C Ltd. had ₹5,00,000 authorised capital on 31-12-20X1 divided into shares of ₹ 100 each out of which 4,000 shares were issued and fully paid up. In June 220X2 the Company decided to convert the issued shares into stock. But in June, 20X3 the Company re-converted the stock into shares of ₹ 10 each, fully paid up.

Pass entries and show how Share Capital will appear in Notes to Balance Sheet as on 31-12-20X1, 31-12-20X2 and 31-12-20X3.

Solution

Journal Entries

20X2			₹	₹
June	Equity Share Capital A/c	Dr.	4,00,000	
	To Equity Stock A/c			4,00,000
	(Being conversion of 4,000 fully paid Equity Shares of ₹ 100 into ₹ 4,00,000 Equity Stock as per resolution in general meeting dated...)			
20X3				
June	Equity Stock A/c	Dr.	4,00,000	

To Equity Share Capital A/c (Being re-conversion of ₹ 4,00,000 Equity Stock into 40,000 shares of ₹ 10 fully paid Equity Shares as per resolution in General Meeting dated...)		4,00,000
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Notes to Balance Sheet

<i>Liabilities :</i>	
<i>As on 31-12-20X1</i>	₹
1. Share Capital	
<i>Authorised</i>	
5,000 Equity Shares of ₹ 100 each	<u>5,00,000</u>
<i>Issued and Subscribed</i>	
4,000 Equity Shares of ₹ 100 each fully called up	4,00,000
<i>As on 31-12-20X2</i>	₹
1. Share Capital	
<i>Authorised</i>	
5,000 Equity Shares of ₹ 100 each	<u>5,00,000</u>
<i>Issued and Subscribed</i>	
Equity Stock-4,000 Equity Shares of ₹ 100 converted into Stock	4,00,000
<i>As on 31-12-20X3</i>	₹
1. Share Capital	
<i>Authorised</i>	
50,000 Equity Shares of ₹ 10 each	<u>5,00,000</u>
<i>Issued and Subscribed</i>	
40,000 Equity Shares of ₹ 10 each fully called up	4,00,000

2.2 Variation of Shareholders Rights

Section 48 of the Companies Act, 2013 provides that when a company has issued different classes of shares with different rights or privileges attached to such shares e.g. rights as to dividend, voting rights etc., any of such right may be changed in any manner. It happens with the 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, (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, provided that 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.

For example, the company may change rate of (a) dividend on preference shares or (b) convert cumulative preference shares into non-cumulative preference shares without changing the amount of share capital by passing the following journal entries:

- (a) Debit (Old)% Cum. Pref. Share Capital Account
 Credit (New)% Cum. Pref. Share Capital Account
- (b) Debit ...% Cum. Pref. Share Capital Account
 Credit ...% Non-cum. Pref. Share Capital Account

2.3 Reduction of Share Capital

Section 66 of the Companies Act, 2013 lays down the procedure in respect of reduction of share capital. Subject to confirmation by the Tribunal on an application by the company, a company may, by a special resolution, reduce the share capital in the following manner-

- (a) Extinguishing or reducing the liability of the shareholders in respect of unpaid amount on the shares held by them; or
- (b) Paying off any paid-up share capital which is in excess of its requirements;
- (c) Cancelling any paid-up share capital which is lost or is unrepresented by available assets.

Generally reduction in share capital is followed when a company has been suffering losses continuously for a long time, is not truly represented by its assets. In such a case, any scheme for capital reduction should write-off that portion of capital which is already lost.

This reduction is a sacrifice by the shareholders and the amount of reduction or sacrifice is credited to a new account called Capital Reduction Account (or Reconstruction Account). The accounting treatment is as follows:

(a) When liability of the shareholders is extinguished or reduced in respect of unpaid amount on the shares held by them: Here the shareholders are not called upon to pay the unpaid amount on shares held by them in future. For example, a company decides to reduce ₹ 10 per share, into ₹ 7.5 per share fully paid up, by cancelling the unpaid amount of ₹ 2.5 per share. The entry in this case would be

Share Capital (Partly Paid-Up) Account	Dr. (₹ 7.5 X No. of Shares)
To Share Capital (Fully Paid-up) Account	(₹ 7.5 X No. of Shares)

(b) When excess paid up capital is paid off: When its not possible for the company to employ profitability its paid up capital, then in such case it may decide to refund the excess capital to its shareholders. For example, a company having fully paid-up share of ₹ 10 each, decides to pay-off ₹ 2 per share to make it of ₹ 8 fully paid-up, entries in that case would be

Share Capital Account (₹ 10)	Dr. (₹ 10 X No. of Shares)
To Share Capital Account (₹ 8)	(₹ 8 X No. of Shares)
To Sundry Shareholders Account	(₹ 2 X No. of Shares)
Sundry Shareholders Account	Dr. (₹ 2 X No. of Shares)
To Bank Account	(₹ 2 X No. of Shares)

(c) When the paid up capital which is lost or not represented is cancelled:

Reduction in paid up value only- Here the nominal value of the share remains the same and only the paid value is reduced. For example, the shareholders may agree to reduce the paid capital of ₹ 100 per share to paid value of ₹ 10 per share. The sacrifice is ₹ 90 and the entry will be

Share Capital Account	Dr. (₹ 90 X No. of Shares)
To Capital Reduction Account	(₹ 90 X No. of Shares)

Reduction in both nominal and paid up values- In this case, both the paid up capital and nominal value of the shares are reduced. Continuing the above example, the entry will be:

Share Capital Account (₹ 100 Share)	Dr. (₹ 100 X No. of Shares)
To Share Capital (₹ 10 Share)	(₹ 10 X No. of Shares)
To Capital Reduction Account	(₹ 90 X No. of Shares)

Thus in such treatment we debit the original Share Capital Account so as to close it, credit new Share Capital Account with the amount treated as paid up; and credit Capital Reduction Account with the difference. A certified copy of Court's order and Minutes approved by the Court must be filed by the Registrar.

2.4 Compromise/Arrangements

A scheme of compromise and arrangement is an agreement between a company and its members and outside liabilities when the company faces financial problems. Such an arrangement therefore also involves sacrifices by shareholders, or creditors and debenture holders or by all.

Accounting treatment for some of the cases is as follows:

- a) When equity shareholders give up their claim to reserves and accumulated profits:

Reserves Account	Dr. (With the amount of
To Reconstruction Account	reserves)

- b) Settlement of outside liabilities at lesser amount: Liabilities such as sundry creditors may agree to accept less amount in lieu of final settlement. Treatment will be as follows:

Outside Liabilities Account	Dr. (With the amount of sacrifice)
Provision Account, if any	Dr. made by creditors,
debenture	
To Reconstruction Account	holders etc.)

2.5 Surrender of Shares

In this method, shares are divided into shares of smaller denominations and then the shareholders are made to surrender their shares to the company. These shares are then allotted to debenture holders and creditors so that their liabilities are reduced. The unutilized surrendered shares are then cancelled by transferred to Reconstruction Account.

Note : The problems involving the above methods of Internal reconstruction have been given after Para 3 on "Entries in case of Internal Reconstruction".



3. ENTRIES IN CASE OF INTERNAL RECONSTRUCTION

On a scheme of reconstruction being adopted (through special resolution confirmed by the Court), the entries to be passed are:

1. An appreciation in the value of an asset or reduction in the amount of a liability should be debited to the account concerned and credited to Capital Reduction Account (or Reconstruction Account).
2. Eliminate debit balance of profit and loss account and all over-valuation of assets by crediting the accounts concerned and debiting the Capital Reduction (or Reconstruction) Account. For this purpose, any reserve appearing in the books of the company may be used. If any balance is left in the Capital Reduction (or Reconstruction) Account it should be transferred to the Capital Reserve Account.

While preparing the balance sheet of a reconstructed company, the following points are to be kept in mind:

- (a) After the name of the company, the words **“and Reduced”** should be added *only* if the Court so orders.
- (b) In case of fixed assets, the amount written off under the scheme of reconstruction must be shown for five years.

Illustration 3

The Balance Sheet of A & Co. Ltd. as on 31-12-20X1 is as follows:

Assets	₹	₹
<i>Fixed Assets:</i>		
<i>Freehold property</i>	4,25,000	
<i>Plant</i>	50,000	
<i>Patent</i>	37,500	
<i>Goodwill</i>	<u>1,30,000</u>	6,42,500
<i>Traded Investments (at cost)</i>		55,000
<i>Current Assets:</i>		
<i>Trade receivables</i>	4,85,000	

Inventory	<u>4,25,000</u>	9,10,000
Profit and Loss Account		<u>5,35,000</u>
Total		<u>21,42,500</u>
Liabilities		
Share Capital:		
4,000 6% Cumulative Preference Shares of ₹ 100 each	4,00,000	
75,000 Equity Shares of ₹ 10 each	<u>7,50,000</u>	11,50,000
6% Debentures (Secured on Freehold Property)	3,75,000	
Accrued Interest	<u>22,500</u>	3,97,500
Current Liabilities:		
Bank Overdraft	1,95,000	
Trade payables	3,00,000	
Directors' Loans	<u>1,00,000</u>	<u>5,95,000</u>
Total		<u>21,42,500</u>

The Court approved a Scheme of re-organisation to take effect on 1-1-20X1, whereby:

- (i) The Preference shares to be written down to ₹ 75 each and Equity Shares to ₹ 2 each.
- (ii) Of the Preference Share dividends which are in arrears for four years, three fourths to be waived and Equity Shares of ₹ 2 each to be allotted for the remaining quarter.
- (iii) Accrued interest on debentures to be paid in cash.
- (iv) Debenture-holders agreed to take over freehold property, book value ₹ 1,00,000 at a valuation of ₹ 1,20,000 in part repayment of their holdings and to provide additional cash of ₹ 1,30,000 secured by a floating charge on company's assets at an interest rate of 8% p.a.
- (v) Patents and Goodwill to be written off.
- (vi) Inventory to be written off by ₹ 65,000.
- (vii) Amount of ₹ 68,500 to be provided for bad debts.
- (viii) Remaining freehold property to be re-valued at ₹ 3,87,500.

- (ix) Trade Investments be sold for ₹ 1,40,000.
- (x) Directors to accept settlement of their loans as to 90% thereof by allotment of equity shares of ₹ 2 each and as to 5% in cash, and balance 5% being waived.
- (xi) There were capital commitments totalling ₹ 2,50,000. These contracts are to be cancelled on payment of 5% of the contract price as a penalty.
- (xii) Ignore taxation and cost of the scheme.

You are requested to show Journal entries reflecting the above transactions (including cash transactions) and prepare the Balance Sheet of the company after completion of the Scheme.

Solution

Journal of A & Co. Ltd.

		Dr.	Cr.						
		₹	₹						
20X1 Dec. 31	Equity Share Capital A/c (₹ 10) Dr. 7,50,000 To Capital Reduction A/c 6,00,000 To Equity Share Capital A/c (₹ 2) 1,50,000 (Reduction of equity shares of ₹ 10 each to shares of ₹ 2 each as per Reconstruction Scheme dated...)								
	<hr/> 6% Cum. Preference Share Capital A/c Dr. 4,00,000 (₹ 100) To Capital Reduction A/c 1,00,000 To Pref. Share Capital A/c (₹ 75) 3,00,000 (Reduction of preference shares of ₹ 100 each to shares of ₹ 75 each as per reconstruction scheme)								
20X1 Dec. 31	Freehold Property A/c Dr. 82,500 To Capital Reduction A/c 82,500 (Appreciation in the value of property: <table style="margin-left: 40px; border-collapse: collapse;"> <tr> <td style="border-right: 1px solid black; padding-right: 5px;">Book value</td> <td style="padding-left: 5px;">Revalued Figure</td> </tr> <tr> <td style="border-right: 1px solid black; padding-right: 5px;">₹ 1,00,000</td> <td style="padding-left: 5px;">₹ 1,20,000</td> </tr> <tr> <td style="border-right: 1px solid black; padding-right: 5px;">₹ 3,25,000</td> <td style="padding-left: 5px;">₹ 3,87,500</td> </tr> </table>	Book value	Revalued Figure	₹ 1,00,000	₹ 1,20,000	₹ 3,25,000	₹ 3,87,500		
Book value	Revalued Figure								
₹ 1,00,000	₹ 1,20,000								
₹ 3,25,000	₹ 3,87,500								

	Total	₹ 4,25,000	₹ 5,07,500		
	Profit on revaluation:	₹ 82,500)			
"	6% Debentures A/c	Dr.	1,20,000		
	To Freehold Property A/c				1,20,000
	(Claims of debenture-holders, in part, in respect of principal discharged by transfer of freehold property vide Scheme of Reconstruction)				
	Accrued Interest A/c	Dr.	22,500		
	To Bank A/c				22,500
	(Debenture interest paid)				
"	Bank A/c	Dr.	1,30,000		
	To 8% Debentures A/c				1,30,000
	(8% Debentures issued for cash)				
"	Bank A/c	Dr.	1,40,000		
	To Trade Investment A/c				55,000
	To Capital Reduction A/c				85,000
	(Sale of Trade Investment for ₹ 1,40,000 cost being ₹ 55,000; profit credited to Capital Reduction Account)				
"	Directors' Loan A/c	Dr.	1,00,000		
	To Equity Share Capital A/c				90,000
	To Bank A/c				5,000
	To Capital Reduction A/c				5,000
	(Directors' loan discharged by issue of equity shares of ₹ 90,000, cash payments of ₹ 5,000 and surrender of ₹ 5,000, vide Scheme of Reconstruction)				
Dec. 31	Capital Reduction Account	Dr.	24,000		
	To Equity Share Capital Account				24,000
	(Arrears of preference dividends satisfied by the issue of equity shares, 25% of the amount due, ₹ 96,000)				
"	Capital Reduction A/c	Dr.	8,48,500		

	To Patents	37,500
	To Goodwill	1,30,000
	To Inventory	65,000
	To Provision for Doubtful Debts	68,500
	To Bank	12,500
	To Profit & Loss Account	5,35,000
	(Writing off patents, goodwill, profit and loss account and reducing the value of stock, making the required provision for doubtful debts and payment for cancellation of capital commitments)	

Balance Sheet of A & Co. Ltd. (And Reduced) as on 1st January, 20X2

	<i>Particulars</i>	<i>Notes</i>	<i>₹</i>
	Equity and Liabilities		
1	Shareholders' funds		
a	Share capital	1	5,64,000
2	Non-current liabilities		
a	Long-term borrowings	2	3,85,000
3	Current liabilities		
a	Trade Payables		3,00,000
b	Short term provision	3	<u>68,500</u>
	Total		<u>13,17,500</u>
	Assets		
1	Non-current assets		
a	Property, Plant Equipment		
	Tangible assets	4	4,37,500
	Intangible assets	5	-
2	Current assets		
a	Inventories		3,60,000
b	Trade receivables	6	4,85,000
c	Cash and cash equivalents		<u>35,000</u>
	Total		<u>13,17,500</u>

Notes to accounts

1	Share Capital		
	Equity share capital		
	1,32,000 Equity shares of ₹ 2 each (of the above 57,000 shares have been issued for consideration other than cash)		2,64,000
	Preference share capital		
	4,000 6% Preference shares of ₹ 75 each		<u>3,00,000</u>
	Total		<u>5,64,000</u>
2	Long-term borrowings		
	Secured		
	6% Debentures		2,55,000
	8% Debentures		<u>1,30,000</u>
	Total		<u>3,85,000</u>
3	Short term provision		
	Provision for doubtful debt		68,500
4	Tangible assets		
	Fixed assets		
	Tangible assets		
	Freehold property	4,25,000	
	<i>Add:</i> Appreciation under scheme of Reconstruction	82,500	
	<i>Less:</i> Disposed of	<u>(1,20,000)</u>	3,87,500
	Plant		50,000
	Patents	37,500	
	<i>Less:</i> Written off under scheme of Reconstruction	<u>(37,500)</u>	<u>-</u>
	Net carrying value		<u>4,37,500</u>
5	Intangible assets		
	Goodwill	1,30,000	
	<i>Less:</i> Written off under scheme of		

	Reconstruction	(1,30,000)	_____
	Net carrying value	-	_____ -
6	Trade receivables		
	Trade receivables		4,85,000

Illustration 4

Given below is the summarized balance sheet of Rebuilt Ltd. as on 31.3.20X1:

Liabilities	Amount ₹	Assets	Amount ₹
<i>Authorised and issued capital:</i>		<i>Building at cost</i>	
12,000, 7% Preference shares of ₹ 50 each (Note: Preference dividend is in arrear for five years)	6,00,000	less depreciation	4,00,000
15,000 Equity shares of ₹ 50 each	<u>7,50,000</u>	Plant at cost less depreciation	2,68,000
	13,50,000	Trademarks and goodwill at cost	3,18,000
Loan	5,73,000	Inventory	4,00,000
Trade payables	2,07,000	Trade receivables	3,28,000
Other liabilities	<u>35,000</u>	Profit and loss A/c	<u>4,51,000</u>
	<u>21,65,000</u>		<u>21,65,000</u>

The Company is not earning profits short of working capital and a scheme of reconstruction has been approved by both the classes of shareholders. A summary of the scheme is as follows:

- The equity shareholders have agreed that their ₹ 50 shares should be reduced to ₹ 2.50 by cancellation of ₹ 47.50 per share. They have also agreed to subscribe for three new equity shares of ₹ 2.50 each for each equity share held.
- The preference shareholders have agreed to cancel the arrears of dividends and to accept for each ₹ 50 share, 4 new 5% preference shares of ₹ 10 each, plus 6 new equity shares of ₹ 2.50 each, all credited as fully paid.
- Lenders to the company for ₹ 1,50,000 have agreed to convert their loan into share and for this purpose they will be allotted 12,000 new preference shares of ₹ 10 each and 12,000 new equity shares of ₹ 2.50 each.

- (d) The directors have agreed to subscribe in cash for 40,000, new equity shares of ₹ 2.50 each in addition to any shares to be subscribed by them under (a) above.
- (e) Of the cash received by the issue of new shares, ₹ 2,00,000 is to be used to reduce the loan due by the company.
- (f) The equity share capital cancelled is to be applied:
- to write off the debit balance in the profit and loss A/c; and
 - to write off ₹ 35,000 from the value of plant.

Any balance remaining is to be used to write down the value of trademarks and goodwill.

Show by journal entries how the financial books are affected by the scheme and prepare the balance sheet of the company after reconstruction. The nominal capital as reduced is to be increased to ₹ 6,50,000 for preference share capital and ₹ 7,50,000 for equity share capital.

Solution

In the books of Rebuilt Ltd.

Journal Entries

	Particulars		Debit (₹)	Credit (₹)
1.	Equity share capital A/c (₹ 50) Dr. To Equity share capital A/c (₹ 2.50) To Capital reduction A/c (Being equity capital reduced to nominal value of ₹ 2.50 each)		7,50,000	37,500 7,12,500
2.	Bank A/c Dr. To Equity share capital (Being 3 right shares against each share was issued and subscribed)		1,12,500	1,12,500
3.	7% Preference share capital A/c (₹ 50) Dr. Capital reduction A/c Dr. To 5% Preference share capital (₹ 10)		6,00,000 60,000	4,80,000

	To equity share capital (₹ 50) (Being 7% preference shares of ₹ 50 each converted to 5% preference shares of ₹ 10 each and also given to them 6 equity shares for every share held)		1,80,000
4.	Loan A/c Dr. To 5% Preference share capital A/c To Equity share capital A/c (Being loan to the extent of ₹ 1,50,000 converted into share capital)	1,50,000	1,20,000 30,000
5.	Bank A/c Dr. To Equity share application money A/c (Being shares subscribed by the directors)	1,00,000	1,00,000
6.	Equity share application money A/c Dr. To Equity share capital A/c (Being application money transferred to capital A/c)	1,00,000	1,00,000
7.	Loan A/c Dr. To Bank A/c (Being loan repaid)	2,00,000	2,00,000
8.	Capital reduction A/c Dr. To Profit and loss A/c To Plant A/c To Trademarks and Goodwill A/c (Bal.fig.) (Being losses and assets written off to the extent required)	6,52,500	4,51,000 35,000 1,66,500

Balance sheet of Rebuilt Ltd. (and reduced)**as on 31.3.20X1**

	Particulars	Notes	₹
1	Equity and Liabilities Shareholders' funds		
a	Share capital	1	10,60,000

2	Non-current liabilities		
a	Long-term borrowings		2,23,000
3	Current liabilities		
a	Trade Payables		2,07,000
b	Other current liabilities		<u>35,000</u>
	Total		<u>15,25,000</u>
	Assets		
1	Non-current assets		
a	Property, Plant Equipment		
	Tangible assets	2	6,33,000
	Intangible assets	3	1,51,500
2	Current assets		
a	Inventories		4,00,000
b	Trade receivables		3,28,000
c	Cash and cash equivalents	4	<u>12,500</u>
	Total		<u>15,25,000</u>

Notes to accounts

			₹
1	Share Capital		
	Authorised capital:		
	65,000 Preference shares of ₹ 10 each	6,50,000	
	3,00,000 Equity shares of ₹ 2.50 each	7,50,000	<u>14,00,000</u>
	Issued, subscribed and paid up:		
	1,80,000 equity shares of ₹ 2.5 each	4,60,000	
	60,000, 5% Preference shares of ₹ 10 each	<u>6,00,000</u>	10,60,000
2	Tangible assets		
	Building at cost less depreciation	4,00,000	
	Plant at cost less depreciation	<u>2,33,000</u>	6,33,000

3. Intangible assets		
Trademarks and goodwill		1,51,500
4 Cash and cash equivalents		
Bank (1,12,500+1,00,000-2,00,000)		12,500

Illustration 5

Repair Ltd. is in the hands of a receiver for debenture holders who holds a charge on all assets except uncalled capital. The following statement shows the position as regards creditors as on 30th June, 20X1:

<i>Liabilities</i>	<i>₹</i>	<i>Assets</i>	<i>₹</i>
<i>6,000 shares of ₹ 60 each, ₹ 30 paid up</i>		<i>Property, machinery and plant etc. (Cost ₹ 3,90,000)</i>	
<i>First debentures</i>	<i>3,00,000</i>	<i>Estimated at</i>	<i>1,50,000</i>
<i>Second debentures</i>	<i>6,00,000</i>	<i>Cash in hand of the receiver</i>	<i><u>2,70,000</u></i>
<i>Unsecured trade payables</i>	<i>4,50,000</i>	<i>Charged under debentures</i>	<i>4,20,000</i>
		<i>Uncalled capital</i>	<i><u>1,80,000</u></i>
			<i>6,00,000</i>
		<i>Deficiency</i>	<i><u>7,50,000</u></i>
	<i><u>13,50,000</u></i>		<i><u>13,50,000</u></i>

A holds the first debentures for ₹ 3,00,000 and second debentures for ₹ 3,00,000. He is also an unsecured creditor for ₹ 90,000. B holds second debentures for ₹ 3,00,000 and is an unsecured trade payables for ₹ 60,000.

The following scheme of reconstruction is proposed:

- 1. A is to cancel ₹ 2,10,000 of the total debt owing to him, to bring ₹ 30,000 in cash and to take first debentures (in cancellation of those already issued to him) for ₹ 5,10,000 in satisfaction of all his claims.*
- 2. B is to accept ₹ 90,000 in cash in satisfaction of all claims by him.*
- 3. In full settlement of 75% of the claim, unsecured creditors (other than A and B) agreed to accept four shares of ₹ 7.50 each, fully paid against their claim for each share of ₹ 60. The balance of 25% is to be postponed and to be*

payable at the end of three years from the date of Court's approval of the scheme. The nominal share capital is to be increased accordingly.

4. Uncalled capital is to be called up in full and ₹ 52.50 per share cancelled, thus making the shares of ₹ 7.50 each.

Assuming that the scheme is duly approved by all parties interested and by the Court, give necessary journal entries.

Solution

Journal Entries

Particulars		Debit (₹)	Credit (₹)
First debentures A/c	Dr.	3,00,000	
Second debentures A/c	Dr.	3,00,000	
Unsecured creditors A/c	Dr.	90,000	
To A's A/c			6,90,000
(Being A's total liability ascertained)			
A's A/c	Dr.	2,10,000	
To Capital reduction A/c			2,10,000
(Being cancellation of debt upto ₹ 2,10,000)			
Bank A/c	Dr.	30,000	
To A's A/c			30,000
(Being cash received in course of settlement)			
A's A/c	Dr.	5,10,000	
To First debentures A/c			5,10,000
(Being liability of A, discharged against first debentures)			
Second debentures A/c	Dr.	3,00,000	
Unsecured creditors A/c	Dr.	60,000	
To B's A/c			3,60,000
(Being B's liability ascertained)			
B's A/c	Dr.	3,60,000	
To Bank A/c			90,000

To Capital reduction A/c (Being B's liability discharged)			2,70,000
Unsecured trade payables A/c	Dr.	3,00,000	
To Equity share capital A/c			1,12,500
To Loan (Unsecured) A/c			75,000
To Capital reduction A/c			1,12,500
(Being settlement of unsecured creditors)			
Share call A/c	Dr.	1,80,000	
To Share capital A/c			1,80,000
(Being final call money due)			
Bank A/c	Dr.	1,80,000	
To Share call A/c			1,80,000
(Being final call money received)			
Share capital A/c (Face value ₹ 60)	Dr.	3,60,000	
To Share capital (Face value ₹ 7.50)			45,000
To Capital reduction A/c			3,15,000
(Being share capital reduced to ₹ 7.50 each)			
Capital reduction A/c	Dr.	8,70,000	
To Profit and loss A/c			8,70,000
(Being reconstruction surplus used to write off losses)			

Working Notes:

1.	Settlement of claim of remaining unsecured creditors	₹
	75% of ₹ 3,00,000	2,25,000
	Considering their claim for share of ₹ 60 each	
	$2,25,000/60 = 3,750$ shares	
	Less: Number of shares to be issued	
	$3,750 \times 4 = 15,000$ shares of ₹ 7.5 each	
	Total value = $15,000 \times 7.50$	<u>(1,12,500)</u>
	Transferred to Capital reduction A/c	<u>1,12,500</u>

2. Ascertainment of profit and loss account's debit balance at the time of reconstruction.

	₹	₹
Asset		
Fixed assets	3,90,000	
Cash	<u>2,70,000</u>	6,60,000
Less: Capital & Liabilities:		
Share capital	1,80,000	
1 st Debenture	3,00,000	
2 nd Debenture	6,00,000	
Unsecured <i>trade payables</i>	<u>4,50,000</u>	<u>(15,30,000)</u>
Profit and loss A/c (Debit balance)		<u>(8,70,000)</u>

Illustration 6

The Balance Sheet of Vaibhav Ltd. as on 31st March 20X1 is as follows:

Liabilities	₹	Assets	₹
Equity Shares of ₹ 100 each	2,00,00,000	Fixed Assets	2,50,00,000
6%, Cumulative Preference Shares of ₹ 100 each	1,00,00,000	Investments (Market Value ₹ 19,00,000)	20,00,000
5% Debentures of ₹ 100 each	80,00,000	Current Assets	2,00,00,000
Sundry Creditors	1,00,00,000	P & L A/c	12,00,000
Provision for taxation	<u>2,00,000</u>		
TOTAL	<u>4,82,00,000</u>	TOTAL	<u>4,82,00,000</u>

The following scheme of Internal Reconstruction is sanctioned:

- (i) All the existing equity shares are reduced to ₹ 40 each.
- (ii) All preference shares are reduced to ₹ 60 each.

- (iii) The rate of Interest on Debentures increased to 6%. The Debenture holders surrender their existing debentures of ₹ 100 each and exchange the same for fresh debentures of ₹ 70 each for every debenture held by them.
- (iv) Fixed assets are to be written down by 20%.
- (v) Current assets are to be revalued at ₹90,00,000.
- (vi) Investments are to be brought to their market value.
- (vii) One of the creditors of the company to whom the company owes ₹ 40,00,000 decides to forgo 40% of his claim. The creditor is allotted with 60000 equity shares of ₹ 40 each in full and final settlement of his claim.
- (viii) The taxation liability is to be settled at ₹ 3,00,000.
- (ix) It is decided to write off the debit balance of Profit & Loss A/c.

Pass journal entries and show the Balance Sheet of the company after giving effect to the above.

Solution

Journal Entries in the books of Vaibhav Ltd.

		₹	₹
(i)	Equity share capital (₹ 100) A/c Dr. To Equity Share Capital (₹ 40) A/c To Capital Reduction A/c (Being conversion of equity share capital of ₹ 100 each into ₹40 each as per reconstruction scheme)	2,00,00,000	80,00,000 1,20,00,000
(ii)	6% Cumulative Preference Share capital (₹ 100) A/c Dr. To 6% Cumulative Preference Share Capital (₹ 60)A/c To Capital Reduction A/c (Being conversion of 6% cumulative preference shares capital of ₹ 100 each into ₹ 60 each as per reconstruction scheme)	1,00,00,000	60,00,000 40,00,000
(iii)	5% Debentures (₹ 100) A/c Dr. To 6% Debentures (₹ 70) A/c	80,00,000	56,00,000

	To Capital Reduction A/c (Being 6% debentures of ₹ 70 each issued to existing 5% debenture holders. The balance transferred to capital reduction account as per reconstruction scheme)		24,00,000
(iv)	Sundry Creditors A/c Dr. To Equity Share Capital (₹ 40) A/c To Capital Reduction A/c (Being a creditor of ₹ 40,00,000 agreed to surrender his claim by 40% and was allotted 60,000 equity shares of ₹ 40 each in full settlement of his dues as per reconstruction scheme)	40,00,000	24,00,000 16,00,000
(v)	Provision for Taxation A/c Dr. Capital Reduction A/c Dr. To Liability for Taxation A/c (Being conversion of the provision for taxation into liability for taxation for settlement of the amount due)	2,00,000 1,00,000	3,00,000
(vi)	Capital Reduction A/c Dr. To P & L A/c To Fixed Assets A/c To Current Assets A/c To Investments A/c To Capital Reserve A/c (Bal. fig.) (Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, Fixed Assets, Current Assets, Investments and the Balance transferred to Capital Reserve)	199,00,000	12,00,000 50,00,000 110,00,000 1,00,000 26,00,000
(vii)	Liability for Taxation A/c Dr. To Current Assets (Bank A/c) (Being the payment of tax liability)	3,00,000	3,00,000

Balance Sheet of Vaibhav Ltd. (After Reconstruction) as on 31st March, 20X1

<i>Particulars</i>	<i>Notes</i>	₹
Equity and Liabilities		
1 Shareholders' funds		
a Share capital	1	164,00,000
b Reserves and Surplus	2	26,00,000
2 Non-current liabilities		
Long-term borrowings	3	56,00,000
3 Current liabilities		
Trade Payables (1,00,00,000 less 40,00,000)		60,00,000
Total		3,06,00,000
Assets		
1 Non-current assets		
a Property, Plant Equipment		
Tangible assets	4	200,00,000
b Investments	5	19,00,000
2 Current assets	6	87,00,000
Total		3,06,00,000

Notes to accounts

	₹
1. Share Capital	
Equity share capital	
Issued, subscribed and paid up	
2,60,000 equity shares of ₹ 40 each (of the above 60,000 shares have been issued for consideration other than cash)	1,04,00,000
Preference share capital	
Issued, subscribed and paid up	
1,00,000 6% Cumulative Preference shares of ₹ 60 each	60,00,000
Total	1,64,00,000

2. Reserves and Surplus		
Capital Reserve		<u>26,00,000</u>
3. Long-term borrowings		
Secured		
6% Debentures		<u>56,00,000</u>
4. Tangible assets		
Fixed Assets	2,50,00,000	
Adjustment under scheme of reconstruction	(50,00,000)	<u>2,00,00,000</u>
5. Investments	20,00,000	
Adjustment under scheme of reconstruction	<u>(1,00,000)</u>	<u>19,00,000</u>
6. Current assets		
Adjustment under scheme of reconstruction	2,00,00,000	
	<u>110,00,000</u>	
Taxation liability paid	90,00,000	
	<u>(3,00,000)</u>	<u>87,00,000</u>

Working Note:**Capital Reduction Account**

To Liability for taxation A/c	1,00,000	By Equity share capital	1,20,00,000
To P & L A/c	12,00,000	By 6% Cumulative preferences	
To Fixed Assets	50,00,000	Share capital	40,00,000
To Current assets	1,10,00,000	By 5% Debentures	24,00,000
To Investment	1,00,000	By Sundry creditors	16,00,000
To Capital Reserve (Bal. fig.)	<u>26,00,000</u>		
	2,00,00,000		<u>2,00,00,000</u>

Illustration 7

Following is the Summary Balance Sheet of ABC Ltd. as at 31st March, 20X1:

Liabilities	₹	Assets	₹
Share capital:		Plant and machinery	9,00,000

2,00,000 Equity shares of ₹ 10 each fully paid up	20,00,000	Furniture and fixtures	2,50,000
6,000 8% Preference shares of ₹ 100 each	6,00,000	Patents and copyrights	70,000
9% Debentures	12,00,000	Investments (at cost) (Market value ₹ 55,000)	68,000
Bank overdraft	1,50,000	Inventory	14,00,000
Trade payables	5,92,000	Trade receivables	14,39,000
		Cash and bank balance	10,000
		Profit and Loss A/c	<u>4,05,000</u>
	<u>45,42,000</u>		<u>45,42,000</u>

The following scheme of reconstruction was finalised:

- (i) Preference shareholders would give up 30% of their capital in exchange for allotment of 11% Debentures to them.
- (ii) Debentureholders having charge on plant and machinery would accept plant and machinery in full settlement of their dues.
- (iii) Inventory equal to ₹ 5,00,000 in book value will be taken over by trade payables in full settlement of their dues.
- (iv) Investment value to be reduced to market price.
- (v) The company would issue 11% Debentures for ₹ 3,00,000 and augment its working capital requirement after settlement of bank overdraft.

Pass necessary Journal Entries in the books of the company. Prepare Capital Reduction account and Balance Sheet of the company after internal reconstruction.

Solution

In the Books of ABC Ltd.

Journal Entries

Particulars		₹	₹
8% Preference share capital A/c	Dr.	6,00,000	
To Preference shareholders A/c			4,20,000
To Capital reduction A/c			1,80,000
[Being 30% reduction in liability of preference share capital]			

Preference shareholders A/c To 11% Debentures A/c [Being the issue of debentures to preference shareholders]	Dr.	4,20,000	4,20,000
9% Debentures A/c To Debenture holders A/c [Being transfer of 9% debentures to debenture holders A/c]	Dr.	12,00,000	12,00,000
Debenture holders A/c To Plant & machinery A/c To Capital reduction A/c [Settlement of debenture holders by allotment of plant & machinery]	Dr.	12,00,000	9,00,000 3,00,000
Trade payables A/c To Inventory A/c To Capital reduction A/c [Being settlement of creditors by giving Inventories]	Dr.	5,92,000	5,00,000 92,000
Bank A/c To 11% Debentures A/c [Being fresh issue of debentures]	Dr.	3,00,000	3,00,000
Bank overdraft A/c To Bank A/c [Being settlement of bank overdraft]	Dr.	1,50,000	1,50,000
Capital reduction A/c To Investment A/c To Profit and loss A/c To Capital reserve A/c [Being decrease in investment and profit and loss account (Dr. bal.); and balance of capital reduction account transferred to capital reserve]	Dr.	5,72,000	13,000 4,05,000 1,54,000

Capital Reduction Account

	₹		₹
To Investments A/c	13,000	By Preference share capital A/c	1,80,000
To Profit and loss A/c	4,05,000	By 9% Debenture holders A/c	3,00,000
To Capital reserve A/c	<u>1,54,000</u>	By Trade payables A/c	<u>92,000</u>
	<u>5,72,000</u>		<u>5,72,000</u>

**Balance Sheet of ABC Ltd. (And Reduced)
As on 31st March 20X1**

Particulars	Note No	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	20,00,000
(b) Reserves and Surplus	2	1,54,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	7,20,000
Total		28,74,000
II. Assets		
(1) Non-current assets		
(a) <i>Property, Plant Equipment</i>		
Tangible assets	4	2,50,000
Intangible assets		70,000
(b) Non-current investments	5	55,000
(2) Current assets		
(a) Current investments		
(b) Inventories (₹ 14,00,000 – ₹ 5,00,000)		9,00,000
(c) Trade receivables		14,39,000
(d) Cash and cash equivalents		
Cash at Bank (W. N.)		1,60,000
Total		28,74,000

Notes to Accounts

	₹
1. Share Capital	
2,00,000 Equity shares of ₹ 10 each fully paid-up	20,00,000
2. Reserve and Surplus	
Capital Reserve	1,54,000
3. Long Term Borrowings	
11% Debentures (₹ 4,20,000 + ₹ 3,00,000)	7,20,000
4. Fixed Assets	
(i) Tangible assets	
Plant & machinery	9,00,000
Less: Adjustment on scheme of reconstruction dated	<u>9,00,000</u>
Furniture & fixtures	2,50,000
(ii) Intangible assets	
Patents & copyrights	<u>70,000</u>
	<u>3,20,000</u>
5. Non Current Investments	
Investments (₹ 68,000 – ₹ 13,000)	55,000

Working Note:

Cash at bank = Opening balance + 11% Debentures issued – Bank overdraft paid
= ₹ 10,000 + ₹ 3,00,000 – ₹ 1,50,000 = ₹ 1,60,000

Illustration 8

The Summarised Balance Sheet of Revise Limited as at 31st March, 20X1 was as follows :

Liabilities	₹	Assets	₹
Authorised and subscribed capital: 10,000 Equity shares of ₹ 100 each fully paid	10,00,000	Fixed Assets : Machineries	1,00,000
Unsecured Loans :		Current assets : Inventory	3,20,000

12% Debentures	2,00,000	Trade receivables	2,70,000
Accrued interest	24,000	Bank	30,000
Current liabilities		Profit and loss account	6,00,000
Trade payables-	72,000		
Provision for income tax	24,000		
	13,20,000		13,20,000

It was decided to reconstruct the company for which necessary resolution was passed and sanctions were obtained from appropriate authorities. Accordingly, it was decided that:

- Each share is sub-divided into ten fully paid up equity shares of ₹ 10 each.
- After sub-division, each shareholder shall surrender to the company 50% of his holding, for the purpose of re-issue to debenture holders and trade payables as necessary.
- Out of shares surrendered, 10,000 shares of ₹ 10 each shall be converted into 12% preference shares of ₹ 10 each, fully paid up.
- The claims of the debenture-holders shall be reduced by 75 per cent. In consideration of the reduction, the debenture holders shall receive preference shares of ₹ 1,00,000 which are converted out of shares surrendered.
- Trade payables claim shall be reduced to 50 per cent, it is to be settled by the issue of equity shares of ₹ 10 each out of shares surrendered.
- Balance of profit and loss account to be written off.
- The shares surrendered and not re-issued shall be cancelled.

You are required to show the journal entries giving effect to the above and the resultant Balance Sheet.

Solution

		Dr. ₹	Cr. ₹
Equity Share Capital (₹ 100) A/c	Dr.	10,00,000	
To Share Surrender A/c			5,00,000

To Equity Share Capital (₹ 10) A/c (Subdivision of 10,000 equity shares of ₹ 100 each into 1,00,000 equity shares of ₹ 10 each and surrender of 50,000 of such subdivided shares as per capital reduction scheme)			5,00,000
12% Debentures A/c	Dr.	1,50,000	
Accrued Interest A/c	Dr.	18,000	
To Reconstruction A/c (Transferred 75% of the claims of the debentureholders to reconstruction account in consideration of which 12% preference shares are being issued out of share surrender account as per capital reduction scheme)			1,68,000
Trade payables A/c	Dr.	72,000	
To Reconstruction A/c (Transferred claims of the trade payables to reconstruction account, 50% of which is being clear reduction and equity shares are being issued in consideration of the balance)			72,000
Share Surrender A/c	Dr.	5,00,000	
To 12% Preference Share Capital A/c			1,00,000
To Equity Share Capital A/c			36,000
To Reconstruction A/c (Issued preference and equity shares to discharge the claims of the debenture holders and the trade payables respectively as a per scheme and the balance in share surrender account is being transferred to reconstruction account)			3,64,000
Reconstruction A/c	Dr.	6,04,000	
To Profit and Loss A/c			6,00,000
To Capital Reserve A/c (Adjusted debit balance of profit and loss account against the reconstruction account and the balance in the latter is being transferred to capital reserve)			4,000

Balance Sheet of Revise Limited (and reduced) as on...

Particulars	Note No.	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	6,36,000
(b) Reserves and Surplus	2	4,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	50,000
(3) Current Liabilities		
(a) Other current liabilities	4	6,000
(b) Short-term provisions	5	24,000
Total		7,20,000
II. Assets		
(1) Non-current assets		
(a) Property, Plant Equipment		
(i) Tangible assets	6	1,00,000
(2) Current assets		
(a) Current investments		
(b) Inventories		3,20,000
(c) Trade receivables		2,70,000
(d) Cash and cash equivalents		30,000
Total		7,20,000

Notes to Accounts

		₹
1.	Share Capital	
	<i>Equity Share Capital</i>	
	Issued Capital : 53,600 Equity Shares of ₹ 10 each	5,36,000

	<i>Preference Share Capital</i>	
	Preference Shares	1,00,000
	(Of the above shares all are allotted as fully paid up pursuant to capital reduction scheme by conversion of equity shares without payment being received in cash)	
		6,36,000
2.	Reserve and Surplus	
	Capital Reserve	4,000
3.	Long-term borrowings	
	Unsecured Loans	
	12% Debentures	50,000
4.	Other current liabilities	
	Accrued interest	6,000
5.	Short-term provisions	
	Provision for Income-tax	24,000
6.	Tangible assets	
	Machineries	1,00,000

SUMMARY

1. Reconstruction is a process by which affairs of a company are reorganized by revaluation of assets, reassessment of liabilities and by writing off the losses already suffered by reducing the paid up value of shares and/or varying the rights attached to different classes of shares.
2. Reconstruction account is a new account opened to transfer the sacrifice made by the shareholders for that part of capital which is not represented by lost assets.
3. Reconstruction account is utilized for writing-off fictitious assets, writing down over-valued fixed assets, recording new liability etc.
4. If some credit balance remains in the reconstruction account, the same should be transferred to the capital reserve account.

5. Methods of Internal reconstruction :
- Alteration of share capital :
 - ✓ Sub-divide or consolidate shares into smaller or higher Denomination
 - ✓ Conversion of share into stock or vice-versa
 - Variation of shareholders' rights :
 - ✓ Only the specific rights are changed. There is no change in the amount of capital.
 - Reduction of share capital
 - Compromise, arrangements etc.
 - Surrender of Shares.

TEST YOUR KNOWLEDGE

MCQs

1. When the object of reconstruction is usually to re-organise capital or to compound with creditors or to effect economies then such type of reconstruction is called
- (a) Internal reconstruction with liquidation
 - (b) Internal reconstruction without liquidation of the company
 - (c) External reconstruction
2. The accumulated losses under scheme of internal reconstruction are written off against
- (a) Capital Reduction account
 - (b) Share Capital account
 - (c) Shareholders' account
3. A process of reconstruction, which is carried out without liquidating the company and forming a new one is called
- (a) Internal reconstruction.
 - (b) External reconstruction.

- (c) Amalgamation.
4. Reconstruction is a process by which affairs of a company are reorganized by
- (a) Revaluation of assets and Reassessment of liabilities.
- (b) Writing off the losses already suffered by reducing the paid up value of shares and/or varying the rights attached to different classes of shares.
- (c) Both (a) and (b)

Theoretical Questions

Question 1

What are the methods of internal reconstruction generally followed by companies?

Practical Questions

Question 1

Green Limited had decided to reconstruct the Balance Sheet since it has accumulated huge losses. The following is the summarized Balance Sheet of the Company on 31.3.20X1 before reconstruction:

Liabilities	₹	Assets	₹
Share Capital:		Fixed Assets:	
Authorised:		Goodwill	20,00,000
1,50,000 Equity Shares of ₹ 50 each	<u>75,00,000</u>	Building	10,00,000
Subscribed and Paid up Capital:		Plant	10,00,000
50,000 Equity Shares of ₹ 50 each	25,00,000	Computers	25,00,000
1,00,000 Equity Shares of ₹ 50 each, ₹ 40 per share paid up	40,00,000	Investments	Nil
Secured Loans:		Current Assets	Nil
12% First Debentures	5,00,000	Profit and Loss A/c-Loss	20,00,000

12% Second Debentures	10,00,000		
Current Liabilities:			
Trade payables	5,00,000		
	85,00,000		85,00,000

The following is the interest of Mr. X and Mr. Y in Green Limited:

	Mr. X ₹	Mr. Y ₹
12% First Debentures	3,00,000	2,00,000
12% Second Debentures	7,00,000	3,00,000
Trade payables	2,00,000	1,00,000
	12,00,000	6,00,000
Fully paid up ₹ 50 shares	3,00,000	2,00,000
Partly paid up shares (₹ 40 paid up)	5,00,000	5,00,000

The following Scheme of Reconstruction is approved by all parties interested and also by the Court:

- Uncalled capital is to be called up in full and such shares and the other fully paid up shares be converted into equity shares of ₹ 20 each.
- Mr. X is to cancel ₹ 7,00,000 of his total debt (other than share amount) and to pay ₹ 2 lakhs to the company and to receive new 14% First Debentures for the balance amount.
- Mr. Y is to cancel ₹ 3,00,000 of his total debt (other than equity shares) and to accept new 14% First Debentures for the balance.
- The amount thus rendered available by the scheme shall be utilised in writing off of Goodwill, Profit and Loss A/c Loss and the balance to write off the value of computers.

You are required to draw the Journal Entries to record the same and also show the Balance Sheet of the reconstructed company.

Question 2

The following is the summarised Balance Sheet of Weak Ltd. as on 31.3.20X1:

Liabilities	₹	Assets	₹
Equity shares of ₹ 100 each	1,00,00,000	Fixed assets	1,25,00,000
12% cumulative preference shares of ₹ 100 each	50,00,000	Investments (Market value ₹ 9,50,000)	10,00,000
10% debentures of ₹ 100 each	40,00,000	Current assets	1,00,00,000
Trade payables	50,00,000	P & L A/c	6,00,000
Provision for taxation	1,00,000		
	<u>2,41,00,000</u>		<u>2,41,00,000</u>

The following scheme of reorganization is sanctioned:

- (i) All the existing equity shares are reduced to ₹ 40 each.
- (ii) All preference shares are reduced to ₹ 60 each.
- (iii) The rate of interest on debentures is increased to 12%. The debenture holders surrender their existing debentures of ₹ 100 each and exchange the same for fresh debentures of ₹ 70 each for every debenture held by them.
- (iv) One of the creditors of the company to whom the company owes ₹ 20,00,000 decides to forgo 40% of his claim. He is allotted 30,000 equity shares of ₹ 40 each in full satisfaction of his claim.
- (v) Fixed assets are to be written down by 30%.
- (vi) Current assets are to be revalued at ₹ 45,00,000.
- (vii) The taxation liability of the company is settled at ₹ 1,50,000.
- (viii) Investments to be brought to their market value.
- (ix) It is decided to write off the debit balance of Profit and Loss account.

Pass Journal entries and show the Balance sheet of the company after giving effect to the above.

Question 3

The following is the summarized Balance Sheet of X Ltd. as on 31st March, 20X1:

Liabilities	₹	Assets	₹
12,000, 10% Preference shares of ₹ 100 each	12,00,000	Goodwill	90,000
24,000, Equity shares of ₹ 100 each	24,00,000	Land & building	12,00,000
10% Debentures	6,00,000	Plant & machinery	18,00,000
Bank overdraft	6,00,000	Inventories	2,60,000
Trade payables	3,00,000	Trade receivables	2,80,000
		Cash	30,000
		Profit & Loss Account	14,40,000
	51,00,000		51,00,000

On the above date, the company adopted the following scheme of reconstruction:

- (i) The equity shares are to be reduced to shares of ₹ 40 each fully paid and the preference shares to be reduced to fully paid shares of ₹ 75 each.
- (ii) The debenture holders took over Inventories and Trade receivables in full satisfaction of their claims.
- (iii) The Land and Building to be appreciated by 30% and Plant and machinery to be depreciated by 30%.
- (iv) The debit balance of profit and loss account and intangible assets are to be eliminated.
- (v) Expenses of reconstruction amounted to ₹ 5,000.

Give journal entries incorporating the above scheme of reconstruction and prepare the reconstructed Balance Sheet.

Question 4

The following scheme of reconstruction has been approved for Win Limited:

- (i) The shareholders to receive in lieu of their present holding at 1,00,000 shares of ₹ 10 each, the following:

- (a) New fully paid ₹ 10 Equity shares equal to $\frac{3}{5}$ th of their holding.
- (b) 10% Preference shares fully paid to the extent of $\frac{1}{5}$ th of the above new equity shares.
- (c) ₹ 40,000, 8% Debentures.
- (ii) An issue of ₹ 1 lakh 10% first debentures was made and allotted, payment for the same being received in cash forthwith.
- (iii) Goodwill which stood at ₹ 1,40,000 was completely written off.
- (iv) Plant and machinery which stood at ₹ 2,00,000 was written down to ₹ 1,50,000.
- (v) Freehold property which stood at ₹ 1,50,000 was written down by ₹ 50,000.

You are required to draw up the necessary Journal entries in the Books of Win Limited for the above reconstruction. Suitable narrations to Journal entries should form part of your answer.

ANSWER/HINTS

MCQs

[1. (b), 2. (a), 3. (a), 4. (c)]

Theoretical Questions

- Methods of Internal reconstruction :
 - Sub-division or consolidation of shares into smaller or higher Denomination and Conversion of share into stock or vice-versa
 - Variation of shareholders' rights :
 - Reduction of share capital
 - Compromise, arrangements etc.
 - Surrender of Shares.

Practical Questions

Answer 1

Green Limited
Journal Entries

		<i>Dr.</i>		<i>Cr.</i>
		₹		₹
Bank Account	Dr.	10,00,000		
To Equity Share Capital Account				10,00,000
(Balance of ₹ 10 per share on 1,00,000 equity shares called up as per reconstruction scheme)				
Equity Share Capital Account (₹ 50)	Dr.	75,00,000		
To Equity Share Capital Account (₹ 20)				30,00,000
To Capital Reduction Account				45,00,000
(Reduction of equity shares of ₹ 50 each to shares of ₹ 20 each as per reconstruction scheme)				
12% First Debentures Account	Dr.	3,00,000		
12% Second Debentures Account	Dr.	7,00,000		
Trade payables Account	Dr.	2,00,000		
To X				12,00,000
(The total amount due to X, transferred to his account)				
Bank Account	Dr.	2,00,000		
To X				2,00,000
(The amount paid by X under the reconstruction scheme)				
12% First Debentures Account	Dr.	2,00,000		
12% Second Debentures Account	Dr.	3,00,000		
Trade payables Account	Dr.	1,00,000		

<p>To Y</p> <p>(The total amount due to Y, transferred to his account)</p> <hr/> <p>Y</p> <p style="padding-left: 20px;">To 14% First Debentures Account</p> <p style="padding-left: 20px;">To Capital Reduction Account</p> <p>(The amount due to Y discharged by issue of 14% first debentures)</p> <hr/> <p>X</p> <p style="padding-left: 20px;">To 14% First Debentures Account</p> <p style="padding-left: 20px;">To Capital Reduction Account</p> <p>(The cancellation of ₹ 7,00,000 out of total debt of Mr. X and issue of 14% first debentures for the balance amount as per reconstruction scheme)</p> <hr/> <p>Capital Reduction Account</p> <p style="padding-left: 20px;">To Goodwill Account</p> <p style="padding-left: 20px;">To Profit and Loss Account</p> <p style="padding-left: 20px;">To Computers Account</p> <p>(The balance amount of capital reduction account utilised in writing off goodwill, profit and loss account, and computers— Working Note)</p> <hr/>	<p>6,00,000</p> <p>Dr. 6,00,000</p> <p>3,00,000</p> <p>3,00,000</p> <p>Dr. 14,00,000</p> <p>7,00,000</p> <p>7,00,000</p> <p>Dr. 55,00,000</p> <p>20,00,000</p> <p>20,00,000</p> <p>15,00,000</p>
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Balance Sheet of Green Limited (and reduced)

as on 31st March, 20X1

	Notes	₹
Equity and Liabilities		
1 Shareholders' funds		
a Share capital	1	30,00,000
2 Non-current liabilities		
a Long-term borrowings	2	10,00,000

3	Current liabilities		
a	Trade Payables		2,00,000
	Total		42,00,000
	Assets		
1	Non-current assets		
a	Property, Plant Equipment		
	Tangible assets	3	30,00,000
2	Current assets		
	Cash and cash equivalents		12,00,000
	Total		42,00,000

Notes to accounts

		₹
1. Share Capital		
Equity share capital		
Issued, subscribed and paid up		
1,50,000 equity shares of ₹ 20 each		30,00,000
	Total	30,00,000
2. Long-term borrowings		
Secured		
14% First Debentures		10,00,000
	Total	10,00,000
3. Tangible assets		
Building		10,00,000
Plant		10,00,000
Computers		10,00,000
	Total	30,00,000

Working Note:**Capital Reduction Account**

	₹		₹
To Goodwill A/c	20,00,000	By Equity Share Capital A/c	45,00,000
To P & L A/c	20,00,000	By X	7,00,000
To Computers (Bal. Fig.)	15,00,000	By Y	3,00,000
	55,00,000		55,00,000

Answer 2**Journal Entries in the books of Weak Ltd.**

		₹	₹
(i)	Equity share capital (₹ 100) A/c Dr. To Equity Share Capital (₹ 40) A/c To Capital Reduction A/c (Being conversion of equity share capital of ₹ 100 each into ₹ 40 each as per reconstruction scheme)	1,00,00,000	40,00,000 60,00,000
(ii)	12% Cumulative Preference Share capital (₹ 100) A/c Dr. To 12% Cumulative Preference Share Capital (₹ 60) A/c To Capital Reduction A/c (Being conversion of 12% cumulative preference share capital of ₹ 100 each into ₹ 60 each as per reconstruction scheme)	50,00,000	30,00,000 20,00,000
(iii)	10% Debentures A/c Dr. To 12% Debentures A/c To Capital Reduction A/c (Being 12% debentures issued to 10% debenture-holders for 70% of their claims. The balance transferred to capital reduction account as per reconstruction scheme)	40,00,000	28,00,000 12,00,000

(iv)	Trade payables A/c To Equity Share Capital A/c To Capital Reduction A/c (Being a creditor of ₹ 20,00,000 agreed to surrender his claim by 40% and was allotted 30,000 equity shares of ₹ 40 each in full settlement of his dues as per reconstruction scheme)	Dr.	20,00,000		
				12,00,000	
				8,00,000	
(v)	Provision for Taxation A/c Capital Reduction A/c To current assets(bank A/c) A/c (Being liability for taxation settled)	Dr. Dr.	1,00,000 50,000		
				1,50,000	
(vi)	Capital Reduction A/c To P & L A/c To Fixed Assets A/c To Current Assets A/c To Investments A/c (Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, Fixed Assets, Current Assets, Investments through capital reduction account)	Dr.	99,00,000		
				6,00,000	
				37,50,000	
				55,00,000	
				50,000	
(vii)	Capital Reduction A/c To capital Reserve A/c (Being balance in capital reduction account transferred to capital reserve account)	Dr	50,000		
				50,000	

Balance Sheet of Weak Ltd. (and reduced) as on 31.3.20X1

Particulars		Notes	₹
Equity and Liabilities			
1	Shareholders' funds		
a	Share capital	1	82,00,000
b	Reserves and Surplus	2	50,000

2	Non-current liabilities		
a	Long-term borrowings	3	28,00,000
3	Current liabilities		
a	Trade Payables		30,00,000
	Total		1,40,50,000
	Assets		
1	Non-current assets		
a	Property, Plant Equipment		
	Tangible assets	4	87,50,000
b	Investments	5	9,50,000
2	Current assets	6	43,50,000
	Total		1,40,50,000

Notes to accounts

		₹
1. Share Capital		
Equity share capital		
Issued, subscribed and paid up		
1,30,000 equity shares of ₹ 40 each		52,00,000
Preference share capital		
Issued, subscribed and paid up		
50,000 12% Cumulative Preference shares of ₹ 60 each		30,00,000
	Total	82,00,000
2. Reserves and Surplus		
Capital Reserve		50,000
3. Long-term borrowings		
Secured		
12% Debentures		28,00,000
4. Tangible assets		
Fixed Assets	1,25,00,000	

Adjustment under scheme of reconstruction	(37,50,000)	87,50,000
5. Investments	10,00,000	
Adjustment under scheme of reconstruction	(50,000)	9,50,000
6. Current assets	45,00,000	
Adjustment under scheme of reconstruction	(1,50,000)	43,50,000

Working Note:**Capital Reduction Account**

	₹		₹
To Current Asset	50,000	By Equity share capital	60,00,000
To P & L A/c	6,00,000	By 12% Cumulative preference share capital	20,00,000
To Fixed assets	37,50,000	By 10% Debentures	12,00,000
To Current assets	55,00,000	By Trade payables	8,00,000
To Investment	50,000		
To Capital Reserve (bal. fig.)	50,000		
	1,00,00,000		1,00,00,000

Answer 3**In the books of X Ltd.****Journal Entries**

31 st March, 20X1		₹	₹
(i)	Equity Share Capital A/c (₹ 100) Dr.	24,00,000	
	To Equity Share Capital A/c (₹ 40)		9,60,000
	To Capital Reduction A/c		14,40,000
	(Being 24,000 equity shares of ₹ 100 each reduced to ₹ 40 each fully paid up)		
(ii)	10% Preference Share Capital A/c (₹ 100) Dr.	12,00,000	
	To 10% Preference Share Capital A/c (₹ 75)		9,00,000
	To Capital Reduction A/c		3,00,000
	(Being 12,000 Preference shares of ₹ 100 each reduced to ₹ 75 each fully paid up)		

(iii)	10% Debentures A/c To Inventories A/c To Trade receivables A/c To Capital Reduction A/c (Being debenture holders given Inventories and Trade receivables in full settlement of their claims)	Dr.	6,00,000		
					2,60,000
					2,80,000
					60,000
(iv)	Land & Building A/c To Capital Reduction A/c (Being Land & Building appreciated by 30%)	Dr.	3,60,000		
					3,60,000
(v)	Capital reduction A/c To Cash A/c (Being expenses of reconstruction paid)	Dr.	5,000		
					5,000
(vi)	Capital Reduction A/c To Goodwill A/c To Profit and Loss A/c To Plant & Machinery A/c (Being various losses written off, assets written down through Capital Reserve A/c)	Dr.	20,70,000		
					90,000
					14,40,000
					5,40,000
(vii)	Capital Reduction To Capital Reserve A/c (Bal. Fig.) (Being balance in Capital Reduction A/c transferred to Capital Reserve A/c)	Dr.	85,000		
					85,000

Balance Sheet (And Reduced) of X Ltd.

as at 31st March, 20X1

Particulars		Notes No.	₹
Equity and Liabilities			
1	Shareholders' funds		
a	Share capital	1	18,60,000
b	Reserves and Surplus	2	85,000
2	Current liabilities		
a	Trade Payables		3,00,000

b	Short term borrowings		6,00,000
	Total		28,45,000
	Assets		
1	Non-current assets		
a	Property, Plant Equipment		
	Tangible assets	3	28,20,000
2	Current assets		
	Cash and cash equivalents (30,000 -5,000)		25,000
	Total		28,45,000

Notes to accounts

1.	Share Capital		
	Equity share capital		
	24,000 equity shares of ₹ 40 each fully paid up		9,60,000
	Preference share capital		
	12,000, 10% Preference shares of ₹ 75 each fully paid up		9,00,000
	Total		18,60,000
2.	Reserves and Surplus		
	Capital Reserve		85,000
3.	Tangible assets		
	Land and Building	15,60,000	
	Plant and Machinery	12,60,000	
	Total		28,20,000

Answer 4**Journal Entries**

		₹	₹
Equity Share Capital (old) A/c	Dr.	10,00,000	
To Equity Share Capital (₹ 10) A/c			6,00,000
To 10% Preference Share Capital A/c			1,20,000
To 8% Debentures A/c			40,000

To Capital Reduction A/c (Being new equity shares, 10% Preference Shares, 8% Debentures issued and the balance transferred to Reconstruction account as per the Scheme)			2,40,000
Bank A/c	Dr.	1,00,000	
To 10% First Debentures A/c (Being allotment of 10% first Debentures)			1,00,000
Capital Reduction A/c	Dr.	2,40,000	
To Goodwill Account			1,40,000
To Plant and Machinery Account			50,000
To Freehold Property Account			50,000
(Being Capital Reduction Account utilized for writing off of Goodwill, Plant and Machinery and Freehold property as per the scheme)			