

INTERNAL RECONSTRUCTION



LEARNING OUTCOMES

After studying this chapter, you will be able to:

- ◆ Understand the meaning of term “reconstruction” and the types of reconstruction.
- ◆ Understand the concept of Sub-division and consolidation of shares, conversion of shares into stock and vice versa
- ◆ Understand the meaning of Capital reduction account and rules regarding the presentation of accounts post reconstruction in accordance with the provisions of the Companies Act 2013.

CHAPTER OVERVIEW



Types of Reconstruction

Internal Reconstruction

(Sections of the Companies Act 2013)

External reconstruction

(AS14 Accounting for Amalgamations)

Methods of Internal Reconstruction

Alteration of Share Capital

Variation of Shareholders' rights

Reduction of Share Capital

Compromise/Arrangement

Surrender of Shares

Sub-division and Consolidation of Shares

Conversion of share into stock or vice-versa



1. MEANING OF RECONSTRUCTION

When a company has been making losses for several 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 generally overvalued, as the balance sheet consists of fictitious assets, unrepresented intangible assets and debit balance in the profit and loss account (showing the carry forward of losses). Such a situation always leads the company to show a higher net worth and not depicting a true picture of financial statements. In short, the company is over capitalized. Such a situation brings the need for reconstruction/reorganization of the affairs.

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 so that company can be bailed out from present situation without winding up the existing company.

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 of 'amalgamation in the nature of merger' in AS 14.

Difference Between Internal and External Reconstruction

Basis	Internal Reconstruction	External Reconstruction
Liquidation and formation of new company	The existing company is not liquidated rather the capital and debt structure is changed to bring the company back to normalcy	The existing company is liquidated to form a new company in which the existing shareholders become shareholders of new company as well
Reduction of capital and varying rights	There is certain reduction of capital and sometimes the outside liabilities like debenture holders may have to reduce their claim in this scheme.	There is no reduction of capital. In fact, there is a fresh share capital of the company. The shareholders need not vary their rights in company
Legal position	Internal reconstruction is done as per provisions of section 61 and 66 of the Companies Act, 2013.	External reconstruction is regulated by section 232 of the Companies Act, 2013.
Legal formalities	It requires court's confirmation and other legal procedures before it can be implemented	It can be affected without the court's interference and less time-consuming process.



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

According to Section 61 of the Companies Act 2013, a limited company can alter its share capital, if so authorized by its Articles, by passing an ordinary resolution in the general meeting. The provisions of the relevant sections of Companies Act will be applicable, but in this chapter, we are going to focus on the accounting treatment of the various conditions pertaining to internal reconstruction.

The following types of Alteration can be done under Section 61-

- (a) Increase of authorized share capital;
- (b) Consolidation and sub-division into shares of larger or smaller denominations;
- (c) Conversion of all or any of the shares into stock or vice versa;
- (d) Cancellation of shares which have not been taken or agreed to be taken by any person.

Sub-division and Consolidation of Shares

The existing share capital can be sub-divided or consolidated into 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.

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 reorganize 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 (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...)		7,50,000
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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 authorized 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 To Equity Share Capital (₹ 5) A/c (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....)	Dr. 1,60,000	1,60,000
20X3	Equity Share Capital (₹ 5) A/c To Equity Share Capital (₹ 100) A/c (Being consolidation of 40,000 shares of ₹ 5 with ₹ 4 paid up into 2,000 ₹ 100 shares with ₹ 80 paid up)	Dr. 1,60,000	1,60,000
June			

Notes to Balance Sheet

Liabilities:	₹
As on 31-12-20X1	
1. Share Capital	
<i>Authorized:</i>	
20,000 Equity Shares of ₹ 10 each	<u>2,00,000</u>
<i>Issued, Subscribed and Paid up:</i>	
20,000 Equity Shares of ₹ 10 each ₹ 8 per share paid up	1,60,000
As on 31-12-20X2	
1. Share Capital	
<i>Authorized:</i>	
40,000 Equity Shares of ₹ 5 each	<u>2,00,000</u>
<i>Issued, Subscribed and Paid up:</i>	
40,000 Equity Shares of ₹ 5 each ₹ 4 per share paid up	1,60,000
As on 31-12-20X3	₹
1. Share Capital	
<i>Authorized:</i>	
2,000 Equity Shares of ₹ 100 each	<u>2,00,000</u>
<i>Issued, Subscribed and Paid up:</i>	
2,000 Equity Shares of ₹ 100 each ₹ 80 per share paid 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 authorized 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 authorized 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 20X2 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 To Equity Stock A/c (Being conversion of 4,000 fully paid Equity Shares of ₹ 100 into ₹ 4,00,000 Equity Stock as per resolution in general meeting dated...)	Dr. 4,00,000	4,00,000

20X3 June	Equity Stock A/c 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...)	Dr.	4,00,000	4,00,000
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Notes to Balance Sheet

	₹
As on 31-12-20X1	
Share Capital	
<i>Authorized</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
As on 31-12-20X2	₹
Share Capital	
<i>Authorized</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
As on 31-12-20X3	₹
Share Capital	
<i>Authorized</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. The provisions will be applicable as per the Companies Act 2013 , the accounting treatment is discussed in detail here.

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 (Fv ₹10) X No. of Shares)

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

- (b) When excess paid up capital is paid off:** When it's not possible for the company to employ profitably 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.

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 or debenture holders or by all of them.

Accounting treatment for some of the cases is as follows:

- a) When equity shareholders give up their right over the reserves and accumulated profits of the company:

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

- 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 holders etc.)

To Reconstruction Account

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 transferring them to Reconstruction Account.



3. ENTRIES IN CASE OF INTERNAL RECONSTRUCTION

On a scheme of internal reconstruction being adopted (through special resolution confirmed by the Court), the accounting treatment of the different situations and the entries to be passed are as follows:

1. Under the above-mentioned methods- the alteration of share capital and the varying of the shareholders rights do not involve opening the capital reduction/reconstruction account.
2. It is only under the reduction of share capital, unrepresented reserves, compromise/ arrangements with the outsiders liabilities and surrender of shares, there shall be capital reduction/reconstruction account used to which the unrepresented assets/liabilities will be transferred as per the arrangement.
3. 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).
4. 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.

5. If there is any balance in the reconstruction account it is finally transferred to the Capital reserve under Reserves and Surplus. But if the amount for writing off the assets and accumulated losses is more than the reconstruction amount, then reserves will be adjusted against the same.

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 at 31-3-20X2 is as follows:

		Particulars	Notes	₹
1		Equity and Liabilities		
	A	Shareholders' funds		
	<i>A</i>	<i>Share capital</i>	<i>1</i>	<i>11,50,000</i>
	<i>B</i>	<i>Reserves and Surplus</i>	<i>2</i>	<i>(5,35,000)</i>
2		Non-current liabilities		
	<i>A</i>	<i>Long-term borrowings</i>	<i>3</i>	<i>3,75,000</i>
3		Current liabilities		
	<i>A</i>	<i>Trade Payables</i>		<i>3,00,000</i>
	<i>B</i>	<i>Short term borrowings - Bank Overdraft</i>		<i>1,95,000</i>
	<i>C</i>	<i>Other current liabilities</i>	<i>4</i>	<i>1,22,500</i>
			<i>Total</i>	<i>16,07,500</i>
1		Assets		
	A	Non-current assets		
	<i>A</i>	<i>Property, plant and equipment</i>	<i>5</i>	<i>4,75,000</i>
	<i>B</i>	<i>Intangible assets</i>	<i>6</i>	<i>1,67,500</i>
	<i>C</i>	<i>Non-current investments</i>	<i>7</i>	<i>55,000</i>

2	Current assets		
A	<i>Inventories</i>		4,25,000
B	<i>Trade receivables</i>		<u>4,85,000</u>
		<i>Total</i>	<u>16,07,500</u>

Notes to accounts

		₹
1	Share Capital	
	<i>Equity share capital:</i>	
	75,000 Equity Shares of ₹ 10 each	7,50,000
	<i>Preference share capital:</i>	
	4,000 6% Cumulative Preference Shares of ₹ 100 each	<u>4,00,000</u>
		<u>11,50,000</u>
2	Reserves and Surplus	
	<i>Debit balance of Profit and loss Account</i>	(5,35,000)
		<u>(5,35,000)</u>
3	Long-term borrowings	
	<i>Secured</i>	
	6% Debentures (secured on the freehold property)	<u>3,75,000</u>
		<u>3,75,000</u>
4	Other current liabilities	
	<i>Loan from directors</i>	1,00,000
	<i>Interest payable on 6% debentures</i>	<u>22,500</u>
		<u>1,22,500</u>
5	Property plant and Equipment	
	<i>Freehold property</i>	4,25,000
	<i>Plant</i>	<u>50,000</u>
		<u>4,75,000</u>

6	Intangible assets	
	Goodwill	1,30,000
	Patents	<u>37,500</u>
		<u>1,67,500</u>
7	Non-current investments	
	Investments at cost	<u>55,000</u>
		<u>55,000</u>

The Court approved a Scheme of re-organization to take effect on 1-4-20X2, 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) Interest payable 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 after giving to debenture holders, to be re-valued at ₹ 3,87,500.
- (ix) 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. ₹
20X2 April 1	Equity Share Capital A/c (₹ 10) To Capital Reduction A/c To Equity Share Capital A/c (₹ 2) (Reduction of equity shares of ₹ 10 each to shares of ₹ 2 each as per Reconstruction Scheme dated...)	Dr. 7,50,000	6,00,000 1,50,000
"	6% Cum. Preference Share Capital A/c Dr. (₹ 100) To Capital Reduction A/c To Pref. Share Capital A/c (₹ 75) (Reduction of preference shares of ₹ 100 each to shares of ₹ 75 each as per reconstruction scheme)	4,00,000	1,00,000 3,00,000
"	Capital Reduction Account To Equity Share Capital Account (Arrears of preference dividends satisfied by the issue of equity shares, 25% of the amount due, ₹ 96,000)	Dr. 24,000	24,000

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"	Freehold Property A/c To Capital Reduction A/c (Appreciation in the value of property: <table border="1"><tr><td>Book value</td><td>Revalued Figure</td></tr><tr><td>₹ 1,00,000</td><td>₹ 1,20,000</td></tr><tr><td><u>₹ 3,25,000</u></td><td><u>₹ 3,87,500</u></td></tr><tr><td>Total</td><td>₹ 4,25,000 ₹ 5,07,500</td></tr></table> Profit on revaluation: ₹ 82,500)	Book value	Revalued Figure	₹ 1,00,000	₹ 1,20,000	<u>₹ 3,25,000</u>	<u>₹ 3,87,500</u>	Total	₹ 4,25,000 ₹ 5,07,500	Dr.	82,500	82,500
Book value	Revalued Figure											
₹ 1,00,000	₹ 1,20,000											
<u>₹ 3,25,000</u>	<u>₹ 3,87,500</u>											
Total	₹ 4,25,000 ₹ 5,07,500											
"	6% Debentures A/c To Freehold Property A/c (Claims of debenture-holders, in part, in respect of principal discharged by transfer of freehold property vide Scheme of Reconstruction)	Dr.	1,20,000	1,20,000								
"	Interest payable A/c To Bank A/c (Debenture interest paid)	Dr.	22,500	22,500								
"	Bank A/c To 8% Debentures A/c (8% Debentures issued for cash)	Dr.	1,30,000	1,30,000								
"	Bank A/c To Investment A/c To Capital Reduction A/c (Sale of Investment for ₹ 1,40,000 cost being ₹ 55,000; profit credited to Capital Reduction Account)	Dr.	1,40,000	55,000 85,000								
"	Directors' Loan A/c To Equity Share Capital A/c	Dr.	1,00,000	90,000								

	To Bank A/c To Capital Reduction A/c (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)		5,000 5,000
"	Capital Reduction A/c To Patents To Goodwill To Inventory To Provision for Doubtful Debts To Bank To Profit & Loss Account (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)	Dr. 8,48,500	37,500 1,30,000 65,000 68,500 12,500 5,35,000

Note: Penalty charges for cancellation of the contract amounts to ₹ 12,500 (2,50,000X5%) being paid in cash.

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

		Particulars	Notes	₹
1	A	Equity and Liabilities Shareholders' funds Share capital	1	5,64,000
2	A	Non-current liabilities Long-term borrowings	2	3,85,000

3	A	Current liabilities			
	A	Trade Payables	Total		<u>3,00,000</u>
					<u>12,49,000</u>
1	B	Assets			
	A	Non-current assets			
	A	Property, plant and equipment	3		4,37,500
	B	Intangible assets	4		-
2	C	Current assets			
	A	Inventories			3,60,000
	B	Trade receivables	5		4,16,500
	C	Cash and cash equivalents			<u>35,000</u>
			Total		<u>12,49,000</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	Property, plant and equipment		
	Freehold property	4,25,000	
	Add: Appreciation under scheme of Reconstruction	82,500	
	Less: Disposed of	(1,20,000)	3,87,500
	Plant		<u>50,000</u>
	Net carrying value		<u>4,37,500</u>
4	Intangible assets		
	Goodwill	1,30,000	
	Less: Written off under scheme of Reconstruction	(1,30,000)	
	Net carrying value		NIL
	Patents	37,500	
	Less: Written off under scheme of Reconstruction	(37,500)	
	Net carrying value	-	<u>NIL</u>
5	Trade Receivables		
	Less: Provision for doubtful debts	<u>68,500</u>	
			4,16,500

Illustration 4

Given below is the Balance sheet of Rebuilt Ltd. as at 31.3.20X1:

		Particulars	Notes	₹
		Equity and Liabilities		
1		Shareholders' funds		
	A	<i>Share capital</i>	1	13,50,000
	B	<i>Reserves and Surplus</i>	2	(4,51,000)
2		Non-current liabilities		
	A	<i>Long-term borrowings (Loan)</i>	3	5,73,000

3	<i>Current liabilities</i>			
	A <i>Trade Payables</i>			2,07,000
	B <i>Other current liabilities</i>			<u>35,000</u>
		<i>Total</i>		<u>17,14,000</u>
1	<i>Assets</i>			
	<i>Non-current assets</i>			
	A <i>Property, plant and equipment</i>	4		6,68,000
	B <i>Intangible assets</i>	5		3,18,000
2	<i>Current assets</i>			
	A <i>Inventories</i>			4,00,000
	B <i>Trade receivables</i>			<u>3,28,000</u>
		<i>Total</i>		<u>17,14,000</u>

Notes to accounts

		₹
1	<i>Share Capital</i>	
	<i><u>Equity share capital</u></i>	7,50,000
	15,000 Equity Shares of ₹50 each	
	<i><u>Preference share capital</u></i>	
	12,000, 7% Cumulative Preference Shares of ₹50 each	
	(Preference dividend is in arrears for five years)	<u>6,00,000</u>
	<i>Total</i>	<u>13,50,000</u>
2	<i>Reserves and Surplus</i>	
	<i>Debit balance of Profit and loss Account</i>	<u>(4,51,000)</u>
		<u>(4,51,000)</u>
3	<i>Long-term borrowings</i>	
	<i>Loan</i>	<u>5,73,000</u>
		<u>5,73,000</u>

4	Property, plant and Equipment	
	<i>Building at cost less depreciation</i>	4,00,000
	<i>Plant at cost less depreciation</i>	<u>2,68,000</u>
		<u>6,68,000</u>
5	Intangible assets	
	<i>Trademarks and Goodwill at cost</i>	<u>3,18,000</u>
		<u>3,18,000</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:

- (a) 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.
- (b) 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.
- (c) 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:
 - i. to write off the debit balance in the profit and loss A/c; and
 - ii. 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) To Equity share capital A/c (₹ 2.50) To Capital reduction A/c (Being equity capital reduced to nominal value of ₹ 2.50 each)	Dr. 7,50,000	37,500 7,12,500
2.	Bank A/c To Equity share capital (Being 3 right shares against each share was issued and subscribed)	Dr. 1,12,500	1,12,500
3.	7% Preference share capital A/c (₹ 50) Capital reduction A/c To 5% Preference share capital (₹ 10) 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)	Dr. 6,00,000 Dr. 60,000	4,80,000 1,80,000
4.	Loan A/c 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)	Dr. 1,50,000	1,20,000 30,000

5.	Bank A/c To Equity share application money A/c (Being shares subscribed by the directors)	Dr.	1,00,000	1,00,000
6.	Equity share application money A/c To Equity share capital A/c (Being application money transferred to capital A/c)	Dr.	1,00,000	1,00,000
7.	Loan A/c To Bank A/c (Being loan repaid)	Dr.	2,00,000	2,00,000
8.	Capital reduction A/c 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)	Dr.	6,52,500	4,51,000 35,000 1,66,500

Balance sheet of Rebuilt Ltd. (and reduced)

as at 31.3.20X1

		Particulars	Notes	₹
1	a	Equity and Liabilities		
2	a	Shareholders' funds		
		Share capital	1	10,60,000
2	a	Non-current liabilities		
		Long-term borrowings		2,23,000
3	a	Current liabilities		
		Trade Payables		2,07,000
	b	Other current liabilities		<u>35,000</u>
			Total	<u>15,25,000</u>

		Assets		
1	a	Non-current assets		
	a	Property, plant and equipment	2	6,33,000
	b	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		
	Authorized 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:		
	1,84,000 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.	Property plant and equipment		
	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

Vaibhav Ltd. gives the following ledger balances as at 31st March 20X1:

	₹
Property, Plant and Equipment	2,50,00,000
Investments (Market-value ₹ 19,00,000)	20,00,000
Current Assets	2,00,00,000
P & L A/c (Dr. balance)	12,00,000
Share Capital: Equity Shares of ₹ 100 each	2,00,00,000
6%, Cumulative Preference Shares of ₹ 100 each	1,00,00,000
5% Debentures of ₹ 100 each	80,00,000
Creditors	1,00,00,000
Provision for taxation	2,00,000

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) Property, Plant and Equipment is 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 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)	Dr. 2,00,00,000	80,00,000 1,20,00,000
(ii)	6% Cumulative Preference Share capital (₹ 100) A/c 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)	Dr. 1,00,00,000	60,00,000 40,00,000
(iii)	5% Debentures (₹ 100) A/c To 6% Debentures (₹ 70) A/c 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)	Dr. 80,00,000	56,00,000 24,00,000
(iv)	Sundry Creditors A/c 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)	Dr. 40,00,000	24,00,000 16,00,000

(v)	Provision for Taxation A/c Capital Reduction A/c To Liability for Taxation A/c (Being conversion of the provision for taxation into liability for taxation for settlement of the amount due)	Dr.	2,00,000 1,00,000	3,00,000
(vi)	Capital Reduction A/c To P & L A/c To Property, Plant and Equipment 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, PPE, Current Assets, Investments and the Balance transferred to Capital Reserve)	Dr.	199,00,000	12,00,000 50,00,000 110,00,000 1,00,000 26,00,000
(vii)	Liability for Taxation A/c To Current Assets (Bank A/c) (Being the payment of tax liability)	Dr.	3,00,000	3,00,000

Balance Sheet of Vaibhav Ltd. (and reduced) as at 31st March, 20X1

Particulars	Notes	₹
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 and equipment	4	2,00,00,000
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	<u>1,64,00,000</u>
2. Reserves and Surplus		
Capital Reserve		<u>26,00,000</u>
3. Long-term borrowings		
Secured		
6% Debentures		<u>56,00,000</u>
4. Property, Plant and Equipment		
Carrying value	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	(1,00,000)	<u>19,00,000</u>

6. Current assets		
Adjustment under scheme of reconstruction	2,00,00,000 <u>(1,10,00,000)</u> 90,00,000	
Taxation liability paid	(3,00,000)	87,00,000

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 Property, plant and equipment	50,00,000		
To Current assets	1,10,00,000	Share capital	40,00,000
To Investment	1,00,000	By 5% Debentures	24,00,000
To Capital Reserve (Bal. fig.)	<u>26,00,000</u>	By Sundry creditors	<u>16,00,000</u>
	2,00,00,000		2,00,00,000

Illustration 6

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

		Particulars	Notes	₹
1		Equity and Liabilities		
	A	Shareholders' funds		
	B	<i>Share capital</i>	1	26,00,000
	C	<i>Reserves and Surplus</i>	2	(4,05,000)
2		Non-current liabilities		
	A	<i>Long-term borrowings</i>	3	12,00,000
3		Current liabilities		
	A	<i>Trade Payables</i>		5,92,000
	B	<i>Short term borrowings - Bank overdraft</i>		1,50,000
			Total	41,37,000

		Assets		
1		Non-current assets		
	A	<i>Property, plant and equipment</i>	4	12,20,000
	B	<i>Non-current investment</i>	6	68,000
	C			
2		Current assets		
	A	<i>Inventory</i>		14,00,000
	B	<i>Trade receivables</i>		14,39,000
	C	<i>Cash and cash equivalents</i>		<u>10,000</u>
			<i>Total</i>	41,37,000

Notes to accounts:

		₹
1	Share Capital	
	<i>Equity share capital:</i>	
	<i>2,00,000 Equity Shares of ₹ 10 each</i>	20,00,000
	<i>6,000, 8% Preference shares of ₹ 100 each</i>	<u>6,00,000</u>
		<u>26,00,000</u>
2	Reserves and Surplus	
	<i>Debit balance of Profit and loss A/c</i>	(4,05,000)
		<u>(4,05,000)</u>
3	Long-term borrowings	
	<i>9% debentures</i>	12,00,000
		<u>12,00,000</u>
4	Property, Plant and Equipment	
	<i>Plant and machinery</i>	9,00,000
	<i>Furniture and fixtures</i>	<u>3,20,000</u>
		<u>12,20,000</u>

5	Non-current investments	
	<i>Investments (market value of ₹ 55,000)</i>	<u>68,000</u>
		<u>68,000</u>

The following scheme of reconstruction was finalized:

- (i) Preference shareholders would give up 30% of their capital in exchange for allotment of 11% Debentures to them.
- (ii) Debenture holders 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 11% Debentures A/c	4,20,000
To Capital reduction A/c	1,80,000
[Being 30% reduction in liability of preference share capital and issue of 11% debentures]	

INTERNAL RECONSTRUCTION

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

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 at 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 and equipment</i>	4	3,20,000
(b) Non-current investments	5	55,000
(2) Current assets		
(a) Inventories (₹ 14,00,000 – ₹ 5,00,000)		9,00,000
(b) Trade receivables		14,39,000
(c) 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 ($\text{₹ } 4,20,000 + \text{₹ } 3,00,000$)	7,20,000
4.	Property, Plant and Equipment Plant & machinery Less: Adjustment on scheme of reconstruction <u>9,00,000</u>	9,00,000 - <u>9,00,000</u>
	Furniture & fixtures	3,20,000
5.	Non-Current Investments Investments ($\text{₹ } 68,000 - \text{₹ } 13,000$)	55,000

Working Note:

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

Illustration 7

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

		Particulars	Notes	₹
1		Equity and Liabilities		
		Shareholders' funds		
	A	Share capital	1	10,00,000
	B	Reserves and surplus	2	(6,00,000)
2		Non-current liabilities		
	A	Long-term borrowings	3	2,00,000
3		Current liabilities		
	A	Trade Payables		72,000
	B	Other current liabilities	4	24,000
	C	Short term provisions	5	<u>24,000</u>
		<i>Total</i>		<u>7,20,000</u>

	Assets		
1	Non-current assets		
	A <i>Property, Plant and Equipment</i>	6	1,00,000
2	Current assets		
	A <i>Inventory</i>		3,20,000
	B <i>Trade receivables</i>		2,70,000
	C <i>Cash and cash equivalents</i>		<u>30,000</u>
		<i>Total</i>	<u>7,20,000</u>

Notes to accounts

		₹
1	Share Capital	
	Equity share capital	
	10,000 Equity Shares of ₹ 100 each	<u>10,00,000</u>
		<u>10,00,000</u>
2	Reserves and Surplus	
	Debit balance of Profit and loss Account	(6,00,000)
		(6,00,000)
3	Long-term borrowings	
	12% debentures	<u>2,00,000</u>
		<u>2,00,000</u>
4	Other current liabilities	
	Interest payable on debentures	<u>24,000</u>
		<u>24,000</u>
5	Short term provisions	
	Provision for taxation	<u>24,000</u>
		<u>24,000</u>
6	Property, Plant and Equipment	
	Machinery	<u>1,00,000</u>
		<u>1,00,000</u>

INTERNAL RECONSTRUCTION

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:

- (a) *Each share is sub-divided into ten fully paid up equity shares of ₹ 10 each.*
- (b) *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.*
- (c) *Out of shares surrendered, 10,000 shares of ₹ 10 each shall be converted into 12% preference shares of ₹ 10 each, fully paid up.*
- (d) *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.*
- (e) *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.*
- (f) *Balance of profit and loss account to be written off.*
- (g) *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		5,00,000
(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)		

12% Debentures A/c	Dr.	1,50,000	
Interest payable A/c	Dr.	18,000	
To Reconstruction A/c			1,68,000
(Transferred 75% of the claims of the debenture holders to reconstruction account in consideration of which 12% preference shares are being issued out of share surrender account as per capital reduction scheme)			
Trade payables A/c	Dr.	72,000	
To Reconstruction A/c			72,000
(Transferred claims of the trade payables to reconstruction account, 50% of which is being cleared reduction and equity shares are being issued in consideration of the balance)			
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			3,64,000
(Issued preference and equity shares to discharge the claims of the debenture holders and the trade payables respectively as per scheme and the balance in share surrender account is being transferred to reconstruction account)			
Reconstruction A/c	Dr.	6,04,000	
To Profit and Loss A/c			6,00,000
To Capital Reserve A/c			4,000
(Adjusted debit balance of profit and loss account against the reconstruction account and the balance in the latter is being transferred to capital reserve)			

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

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 and equipment	6	1,00,000
(2) Current assets		
(a) Inventories		3,20,000
(b) Trade receivables		2,70,000
(c) Cash and cash equivalents		30,000
	Total	7,20,000

Notes to Accounts

	₹
1. Share Capital	
<u>Equity Share Capital</u>	
Issued Capital: 53,600 Equity Shares of ₹ 10 each	5,36,000
<u>Preference Share Capital</u>	
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		<u>4,000</u>
3. Long-term borrowings		
Unsecured Loans		
12% Debentures		<u>50,000</u>
4. Other current liabilities		
Interest payable on debentures		<u>6,000</u>
5. Short-term provisions		
Provision for Income-tax		<u>24,000</u>
6. Property, plant and Equipment		
Machinery		<u>1,00,000</u>

Illustration 8

Recover Ltd. decided to reorganize its capital structure owing to accumulated losses and adverse market condition. The Balance Sheet of the company as on 31st March 20X1 is as follows-

		Particulars	Notes	₹
1		Equity and Liabilities		
	A	Shareholders' funds		
	B	Share capital	1	3,50,000
		Reserves and surplus	2	(70,000)
2		Non-current liabilities		
	A	Long-term borrowings	3	50,000
3		Current liabilities		
	A	Trade Payables		80,000
		Short term Borrowings – Bank		
	B	overdraft		90,000
	C	Other Current Liabilities (Interest payable on Debentures)		<u>5,000</u>
				<u>5,05,000</u>

		Assets		
		Non-current assets		
	A	<i>Property, Plant Equipment</i>	4	3,35,000
	B	<i>Intangible assets</i>	5	50,000
	C	<i>Non-current investments</i>	6	40,000
		Current assets		
	A	<i>Inventories</i>		30,000
	B	<i>Trade receivables</i>		<u>50,000</u>
				<u>5,05,000</u>

Notes to accounts:

		₹
1	Share Capital	
	<i>Equity share capital:</i>	
	<i>20,000 Equity Shares of ₹ 10 each</i>	2,00,000
	<i>Preference share capital:</i>	
	<i>15,000 8% Cumulative Preference Shares of ₹ 10 each (preference dividend has been in arrears for 4 years)</i>	<u>1,50,000</u>
		<u>3,50,000</u>
2	Reserves and surplus	
	<i>Profit and loss account (debit balance)</i>	<u>(70,000)</u>
		<u>(70,000)</u>
3	Long-term borrowings	
	<i><u>Secured</u></i>	
	<i>10% Debentures (secured on the freehold property)</i>	<u>50,000</u>
		<u>50,000</u>
4	Property, Plant and Equipment	
	<i>Freehold property</i>	1,20,000
	<i>Leasehold property</i>	85,000
	<i>Plant and machinery</i>	<u>1,30,000</u>
		<u>3,35,000</u>

5	<i>Intangible assets</i>		
	<i>Goodwill</i>		<u>50,000</u>
6	<i>Non-current investments</i>		<u>50,000</u>
	<i>Non-Trade investments at cost</i>		<u>40,000</u>
			<u>40,000</u>

Subsequent to approval by court of a scheme for the reduction of capital, the following steps were taken:

- i. *The preference shares were reduced to ₹ 2.5 per share, and the equity shares to ₹ 1 per share.*
- ii. *One new equity share of ₹ 1 was issued for the arrears of preferred dividend for past 4 years.*
- iii. *The debenture holders took over the freehold property at an agreed figure of ₹ 75,000 and paid the balance to the company after deducting the amount due to them.*
- iv. *Plant and Machinery was written down to ₹ 1,00,000.*
- v. *Non-trade Investments were sold for ₹ 32,000.*
- vi. *Goodwill and obsolete stock (included in the value of inventories) of ₹ 10,000 were written off.*
- vii. *A contingent liability of which no provision had been made was settled at ₹ 7,000 and of this amount, ₹ 6,300 was recovered from the insurance.*

You are required (a) to show the Journal Entries, necessary to record the above transactions in the company's books and (b) to prepare the Balance Sheet, after completion of the scheme.

Solution**Journal entries in the books of Recover Ltd**

Particulars		Dr. ₹	Cr. ₹
8% Cumulative Preference share capital (₹ 10) A/c To 8% Cumulative Preference share capital (₹2.5) A/c To Reconstruction (₹ 7.5) A/c (Preference shares being reduced to shares of ₹ 2.5 per share and remaining transferred to reconstruction account as per internal reconstruction scheme)	Dr.	1,50,000	37,500 1,12,500
Equity share capital A/c (₹10) To Equity Share capital A/c (₹ 1) To Reconstruction A/c (₹ 9) (Equity shares reduced to ₹ 1 per share with the remaining amount transferred to reconstruction account as a part of the internal reconstruction scheme)	Dr.	2,00,000	20,000 1,80,000
Reconstruction A/c To Equity share capital A/c (Equity shares of ₹ 1 issued in lieu of the arrears of preference dividend for 4 years as a part of the internal reconstruction scheme)	Dr.	48,000	48,000
10% Debentures A/c Interest payable on debentures A/c Bank A/c Reconstruction A/c To Freehold property A/c (Debenture holders being paid by the sale of property, which is sold at a loss debited to the reconstruction account. Amount received in excess being refunded to company by debenture holders as a part of the internal reconstruction scheme)	Dr. Dr. Dr. Dr. Dr.	50,000 5,000 20,000 45,000 1,20,000	

Reconstruction A/c	Dr.	90,000	
To Plant and Machinery Ac		30,000	
To Goodwill A/c		50,000	
To Inventory A/c		10,000	
(The assets written off as a part of the internal reconstruction scheme)			
Bank A/c	Dr.	32,000	
Reconstruction A/c	Dr.	8,000	
To Investments A/c		40,000	
(Investments sold at a loss debited to reconstruction account as a part of the internal reconstruction scheme)			
Contingent Liability A/c	Dr.	7,000	
To Bank A/c		7,000	
(Contingent liability paid as a part of the internal reconstruction scheme)			
Bank A/c	Dr.	6,300	
Reconstruction A/c	Dr.	700	
To Contingent Liability A/c		7,000	
(The insurance company remitting part of the contingency payment amount)			
Reconstruction A/c	Dr.	70,000	
To Profit and loss A/c		70,000	
(Accumulated losses written off to reconstruction account as a part of the internal reconstruction scheme)			
Reconstruction A/c	Dr.	30,800	
To Capital reserve A/c		30,800	
(The balance in reconstruction account transferred to capital reserve as a part of the internal reconstruction scheme)			

Balance sheet of Recover Ltd. as at 31st March 20X1 (and reduced)

		Particulars	Notes	₹
1		Equity and Liabilities		
	1	Shareholders' funds		
	A	Share capital	1	1,05,500
	B	Reserves and surplus	2	30,800
2		Non-current liabilities		
	A	Long-term borrowings		-
3		Current liabilities		
	A	Trade Payables		80,000
	B	Short term borrowings - Bank Overdraft		<u>90,000</u>
			Total	<u>3,06,300</u>
		Assets		
1		Non-current assets		
	A	Property, Plant and Equipment	3	1,85,000
2		Current assets		
	A	Inventories		20,000
	B	Trade receivables		50,000
	C	Cash and cash equivalents	4	<u>51,300</u>
			Total	<u>3,06,300</u>

Notes to accounts:

1	Share Capital	₹
	Equity share capital	
	68,000 Equity Shares of ₹ 1 each	68,000
	Preference share capital	
	15,000 8% Cumulative Preference Shares of ₹ 2.5 each	<u>37,500</u>
		<u>1,05,500</u>
2	Reserves and surplus	
	Capital reserve	<u>30,800</u>
3	Property, Plant and Equipment	
	Leasehold property	85,000
	Plant and machinery	<u>1,00,000</u>
		<u>1,85,000</u>
4	Cash and cash equivalents	
	Bank A/c (20,000+32,000-7000+6,300)	<u>51,300</u>

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 and 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 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.
6. Under the Alteration and the variation of the shareholders rights, there is no capital reduction account opened, only under the reduction of share capital, compromises and surrender of shares- capital reduction account comes in the journal entries.

The balance of the reconstruction account to be transferred to the Capital reserve.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

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
 - (d) None of the above.

2. *The accumulated losses under scheme of internal reconstruction are written off against*
 - (a) *Capital Reduction account*
 - (b) *Share Capital account*
 - (c) *Shareholders' account*
 - (d) *Reserve and surplus.*
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 in the nature of merger.*
 - (d) *Amalgamation in the nature of purchase.*
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).*
 - (d) *None of the above.*
5. *For reduction of the share capital, the permission has to be sought from*
 - (a) *Court.*
 - (b) *Controller.*
 - (c) *State government.*
 - (d) *Shareholders.*
6. *In case of internal reconstruction*
 - (a) *Only one company is liquidated.*
 - (b) *Two or more companies are liquidated.*
 - (c) *No company is liquidated.*
 - (d) *Two companies amalgamated.*

Theoretical Questions

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

Scenario based Questions

8. Parth Ltd, had laid down the following terms upon the sanction of the reconstruction plan by the court-

1. Furniture and Fixtures which stood at the books at ₹ 1,50,000 to be written down to ₹ 95,000. The freehold premises which was valued at ₹ 7,00,000 showed an appreciation of ₹ 55,000.
2. Plant and machinery showed fall in value of ₹ 89,000, to be recorded in the books. Investment at ₹ 2,00,000 was brought down to the existing market value at ₹ 1,05,000.
3. Debenture holders accepted to receive the following in lieu of their present 9% debentures of ₹ 2,50,000-
 - a. 1/5th of the total to be paid in cash to them.
 - b. To take over the land and buildings of value ₹ 72,000.
 - c. To forgo the remaining unpaid portion as a policy of reconstruction.

Write off the profit and loss A/c debit balance at ₹ 70,000 which had been accumulated over the years. In case of any shortfall, the balance of the General reserve of ₹ 1,50,000 can be utilized to write off the losses under reconstruction scheme.

Show the necessary journal entries as part of the reconstruction process considering that balance in general reserve utilized to write off the losses as per reconstruction scheme.

9. 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 $3/5^{\text{th}}$ of their holding.
 - (b) 10% Preference shares fully paid to the extent of $1/5^{\text{th}}$ 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.

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

		Particulars	Notes	₹
1		Equity and Liabilities		
	A	Shareholders' funds		
	B	Share capital	1	65,00,000
		Reserves and Surplus	2	(20,00,000)
2		Non-current liabilities		
	A	Long-term borrowings	3	15,00,000
3		Current liabilities		
	A	Trade Payables		<u>5,00,000</u>
			Total	<u>65,00,000</u>
		Assets		
1		Non-current assets		
	A	Property, plant and equipment	4	45,00,000

	B	<i>Intangible assets</i>	5	20,00,000
2		<i>Current assets</i>		Nil
			<i>Total</i>	<u>65,00,000</u>

Notes to accounts

		₹
1	<i>Share Capital</i>	
	<i>Equity share capital</i>	
	<u>Authorized share capital</u>	
	1,50,000 Equity shares of ₹ 50 each	<u>75,00,000</u>
	<u>Issued, subscribed and paid up capital</u>	
	50,000 Equity Shares of ₹ 50 each	25,00,000
	1,00,000 Equity shares of ₹ 50 each, ₹ 40 paid up	<u>40,00,000</u>
		<u>65,00,000</u>
2	<i>Reserves and Surplus</i>	
	Debit balance of Profit and loss Account	<u>(20,00,000)</u>
		<u>(20,00,000)</u>
3	<i>Long-term borrowings</i>	
	Secured: 12% First debentures	5,00,000
	12% Second debentures	<u>10,00,000</u>
		<u>15,00,000</u>
4	<i>Property, Plant and Equipment</i>	
	Building	10,00,000
	Plant	10,00,000
	Computers	<u>25,00,000</u>
		<u>45,00,000</u>
5	<i>Intangible assets</i>	
	Goodwill	<u>20,00,000</u>
		<u>20,00,000</u>

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	<u>2,00,000</u>	<u>1,00,000</u>
	<u>12,00,000</u>	<u>6,00,000</u>
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:

- (a) 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.
- (b) 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.
- (c) 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.
- (d) 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.

11. The following is the Balance Sheet of Weak Ltd. as at 31.3.20X1:

		Particulars	Notes	₹
1		Equity and Liabilities		
	A	Shareholders' funds		
	B	Share capital	1	1,50,00,000
		Reserves and Surplus	2	(6,00,000)

2	<i>Non-current liabilities</i>			
A	<i>Long-term borrowings</i>	3		40,00,000
3	<i>Current liabilities</i>			
A	<i>Trade Payables</i>			50,00,000
B	<i>Short term provisions</i>	4		<u>1,00,000</u>
		<i>Total</i>		<u>2,35,00,000</u>
	<i>Assets</i>			
1	<i>Non-current assets</i>			
A	<i>Property, plant and equipment</i>	5		1,25,00,000
B	<i>Non-current investment</i>			10,00,000
2	<i>Current assets</i>			<u>1,00,00,000</u>
		<i>Total</i>		<u>2,35,00,000</u>

Notes to accounts

		₹
1	<i>Share Capital</i>	
	<i>Equity share capital</i>	
	<i>1,00,000 Equity Shares of ₹ 100 each</i>	1,00,00,000
	<i>50,000, 12% Cumulative Preference shares of ₹ 100 each</i>	<u>50,00,000</u>
		<u>1,50,00,000</u>
2	<i>Reserves and Surplus</i>	
	<i>Debit balance of Profit and loss Account</i>	(6,00,000)
		<u>(6,00,000)</u>
3	<i>Long-term borrowings</i>	
	<i>40,000, 10% debentures of ₹100 each</i>	40,00,000
		<u>40,00,000</u>
4	<i>Short term provisions</i>	
	<i>Provision for taxation</i>	1,00,000
		<u>1,00,000</u>

5	Non-current investments	
	<i>Investments (market value of ₹9,50,000)</i>	<u>10,00,000</u>
		<u>10,00,000</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) Property, plant and equipment 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.

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

		Particulars	Notes	₹
		Equity and Liabilities		
1		Shareholders' funds		
	A	Share capital	1	36,00,000
	B	Reserves and Surplus	2	(14,40,000)
2		Non-current liabilities		
	A	Long-term borrowings	3	6,00,000

3	Current liabilities			
	A <i>Trade Payables</i>			3,00,000
	B <i>Short term borrowings - Bank overdraft</i>			<u>6,00,000</u>
		<i>Total</i>		<u>36,60,000</u>
1	Assets			
	Non-current assets			
	A <i>Property, plant and equipment</i>	4		30,00,000
	B <i>Intangible assets</i>	5		90,000
2	Current assets			
	a <i>Inventories</i>			2,60,000
	b <i>Trade receivables</i>			2,80,000
	C <i>Cash and cash equivalents</i>			<u>30,000</u>
		<i>Total</i>		<u>36,60,000</u>

Notes to accounts

		₹
1	Share capital	
	<i>24,000 Equity Shares of ₹ 100 each</i>	24,00,000
	<i>12,000, 10% Preference Shares of ₹ 100 each</i>	<u>12,00,000</u>
	<i>Total</i>	<u>36,00,000</u>
2	Reserves and Surplus	
	<i>Debit balance of Profit and loss Account</i>	<u>(14,40,000)</u>
		<u>(14,40,000)</u>
3	Long-term borrowings	
	<i>10% debentures</i>	<u>6,00,000</u>
		<u>6,00,000</u>
4.	Property, plant and Equipment	

	<i>Land and Building</i>	12,00,000
	<i>Plant and Machinery</i>	18,00,000
		<u>30,00,000</u>
5	<i>Intangible assets</i>	
	<i>Goodwill</i>	90,000
		<u>90,000</u>

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.

ANSWERS/HINTS

Answer to Multiple Choice Questions

1.	(b)	2.	(a)	3.	(a)	4.	(c)	5.	(a)	6.	(c)
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Answer to Theoretical Questions

7. 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.

Answer to Scenario-based Questions

8. Journal entries in the books of Parth Ltd.

	Dr.	Cr.
	₹	₹
Reconstruction A/c	Dr. 2,39,000	
To Furniture and Fixtures A/c		55,000
To Plant and machinery A/c		89,000
To Investment A/c		95,000
(Writing off overvalued assets as per Reconstruction Scheme dated.)		
Freehold premises A/c	Dr. 55,000	
To Reconstruction A/c		55,000
(Being the increase in the premises credited to reconstruction account as per reconstruction scheme)		
9% Debentures A/c	Dr. 2,50,000	
To Bank A/c		50,000
To Land and building A/c		72,000
To Reconstruction A/c		1,28,000
(Being the debenture holders claim settled partly and foregone partly as per reconstruction scheme)		

Reconstruction A/c To Profit and loss A/c (Being the loss written off as per reconstruction scheme)	Dr.	70,000	70,000
General reserve A/c To Reconstruction A/c (Being the balance in general reserve utilized to write off the losses as per reconstruction scheme)	Dr.	1,26,000	1,26,000

9.

Journal Entries

		₹	₹
Equity Share Capital (old) A/c To Equity Share Capital (₹ 10) A/c To 10% Preference Share Capital A/c To 8% Debentures A/c 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)	Dr.	10,00,000 	6,00,000 1,20,000 40,000 2,40,000
Bank A/c To 10% First Debentures A/c (Being allotment of 10% first Debentures)	Dr.	1,00,000	1,00,000
Capital Reduction A/c To Goodwill Account To Plant and Machinery Account To Freehold Property Account (Being Capital Reduction Account utilized for writing off of Goodwill, Plant and Machinery and Freehold property as per the scheme)	Dr.	2,40,000 	1,40,000 50,000 50,000

INTERNAL RECONSTRUCTION**10.****Journal Entries in books of Green Limited**

	Dr. ₹	Cr. ₹
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	
To Y		6,00,000
(The total amount due to Y, transferred to his account)		

Y	Dr.	6,00,000
To 14% First Debentures Account		3,00,000
To Capital Reduction Account		3,00,000

(The amount due to Y discharged by issue of
14% first debentures)

X Dr. 14,00,000		
To 14% First Debentures Account	7,00,000	
To Capital Reduction Account		7,00,000

(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)

Capital Reduction Account	Dr.	55,00,000
To Goodwill Account		20,00,000
To Profit and Loss Account		20,00,000
To Computers Account		15,00,000

(The balance amount of capital reduction account utilised in
writing off goodwill, profit and loss account, and computers—
Working Note)

Balance Sheet of Green Limited (and reduced)

as at 31st March, 20X1

Particulars	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		<u>2,00,000</u>
Total		<u>42,00,000</u>

Assets			
1	Non-current assets		
a	Property, plant and equipment	3	30,00,000
2	Current assets		
	Cash and cash equivalents		<u>12,00,000</u>
	Total		<u>42,00,000</u>

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. Property, Plant and Equipment	
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	45,00,000

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

11.

Journal Entries in the books of Weak Ltd.

			₹	₹
(i)	Equity share capital (₹ 100) A/c 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)	Dr.	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)	Dr.	50,00,000	30,00,000 20,00,000
(iii)	10% Debentures A/c 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)	Dr.	40,00,000	28,00,000 12,00,000
(iv)	Trade payables A/c To Equity Share Capital A/c	Dr.	20,00,000	12,00,000

INTERNAL RECONSTRUCTION

	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)			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.	1,00,000 Dr. 50,000	1,50,000
(vi)	Capital Reduction A/c To P & L A/c To Property, plant and equipment 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, Property, plant and equipment, 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 at 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 and equipment	4	87,50,000
b Investments	5	9,50,000
2 Current assets		
	Total	43,50,000
		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. Property, plant and Equipment			
Total PPE		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 Property, plant and equipment	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

12.

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

31st March, 20X1		₹	₹
(i)	Equity Share Capital A/c (₹ 100) To Equity Share Capital A/c (₹ 40) To Capital Reduction A/c (Being 24,000 equity shares of ₹ 100 each reduced to ₹ 40 each fully paid up)	Dr. 24,00,000	9,60,000 14,40,000
(ii)	10% Preference Share Capital A/c (₹ 100) To 10% Preference Share Capital A/c (₹ 75) To Capital Reduction A/c (Being 12,000 Preference shares of ₹ 100 each reduced to ₹ 75 each fully paid up)	Dr. 12,00,000	9,00,000 3,00,000
(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 and equipment	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	Total	9,00,000
			18,60,000
2. Reserves and Surplus			
	Capital Reserve		85,000
3. Property, plant and Equipment			
	Land and Building	15,60,000	
	Plant and Machinery	12,60,000	
	Total		28,20,000