# 6. INTERNAL RECONSTRUCTION - II

## MODEL WISE ANALYSIS OF PAST EXAM PAPERS OF IPCC

| MODEL NO. | N-11 | M-12 | N-12 | M-13 | N-13 | M-14 | N-14 | M-15 | N-15 | N-15 | M-16 | N-16 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Internal Reconstruction - II | - | - | 16 | 16 | - | - | 16 | - | 16 | - | - | - |

## PROBLEMS FOR CLASSROOM DISCUSSION

**Problem 1: (PRINTED SOLUTION AVAILABLE) Basic level:** The following is the summarized Balance Sheet of Rocky Ltd. as at March 31, 2013:

| Particulars | Rs. in lacs |
|---|---|
| **LIABILITIES:** | |
| Fully paid equity shares of Rs. 10 each | 500 |
| Capital Reserve | 6 |
| 12% Debentures | 400 |
| Debenture Interest Outstanding | 48 |
| Trade payables | 165 |
| Directors' Remuneration Outstanding | 10 |
| Other Outstanding Expenses | 11 |
| Provisions | 33 |
| | **1,173** |
| **ASSETS:** | |
| Goodwill | 15 |
| Land and Building | 184 |
| Plant and Machinery | 286 |
| Furniture and Fixtures | 41 |
| Inventory | 142 |
| Trade receivables | 80 |
| Cash at Bank | 27 |
| Discount on Issue of Debentures | 8 |
| Profits and Loss Account | 390 |
| | **1,173** |



The following scheme of internal reconstruction was framed, approved by the Tribunal all the concerned parties and implemented:

1. All the equity shares are converted into the same number of fully-paid equity shares of Rs. 2.50 each.
2. Directors agree to forego their outstanding remuneration.
3. The debenture holders also agree to forego outstanding interest in return of their 12% debentures being converted into 13% debentures.
4. The existing shareholders agree to subscribe for cash, fully paid equity shares of Rs. 2.50 each for Rs. 125 lacs.

5. Trade payables are given the option of either to accept fully-paid equity shares of Rs. 2.50 each for the amount due to them or to accept 80% of the amount due in cash. Trade payables for Rs. 65 lacs accept equity shares whereas those for Rs. 100 lacs accept Rs. 80 lacs in cash in full settlement.

6. The Assets are revalued as under:

| Particulars | Rs. in lacs |
|---|---|
| Land and building | 230 |
| Plant and Machinery | 220 |
| Inventory | 120 |
| Trade receivables | 76 |

Pass Journal Entries for all the above mentioned transactions and draft the company's Balance Sheet immediately after the reconstruction. **(PM)**

*(Ans: Balance sheet Total* Rs.*759 lacs)*

**(Solve problem no 1 of assignment problems as rework)**

**Note:**______________________________________________________________________

____________________________________________________________________________

**Problem 2: Determination of value of equity shares and arrears of preference dividend:** The Balance Sheet of X Ltd. as at 31st March, 2014 was as follows:

**X Limited**

**Balance Sheet as at 31.03.2014**

| | Particulars | | Amount (Rs.) |
|---|---|---|---|
| I. | **EQUITY AND LIABILITIES:** | | |
| 1. | **Shareholders fund** | | |
| | Share Capital | | |
| | 40000 equity shares of Rs. 100 each fully paid | | 40,00,000 |
| | 20000, 10% preference shares of Rs. 100 each fully paid | | 20,00,000 |
| | **Reserve & Surplus** | | |
| | (a) Securities Premium Account | | 1,50,000 |
| | (b) Profit & Loss Account | | (23,00,000) |
| 2. | **Non-Current Liabilities** | | |
| | Long Term Borrowings 7% Debentures of Rs. 100 each | | 4,00,000 |
| 3. | **Current Liabilities** | | |
| | Other Current Liabilities | | |
| | (a) Creditors | | 10,00,000 |
| | (b) Loan from Director | | 2,00,000 |
| | **Total Liabilities** | | **54,50,000** |
| II. | **ASSETS:** | | |
| 1. | **Non-Current Assets** | | |
| | Fixed Assets | | |
| | (a) Land & Building | 20,00,000 | |
| | (b) Plant & Machinery | 12,00,000 | 32,00,000 |
| | Intangible Assets | | |
| | Goodwill | | 4,00,000 |
| 2. | **Current Assets** | | |
| | (a) Debtors | 12,00,000 | |
| | (b) Stock | 5,00,000 | |
| | (c) Cash at Bank | 1,50,000 | 18,50,000 |
| | **Total Assets** | | **54,50,000** |

No Dividend on Preference Shares has been paid for last 5 Years.

The following scheme of reorganisation was duly approved by the Court:

1. Each equity share to be reduced to Rs. 25.
2. Each existing Preference Share to be reduced to Rs. 75 and then exchanged for one new 13% Preference Share of Rs. 50 each and one Equity Share of Rs. 25 each.
3. Preference Shareholders have forgone their right for dividend for four years. One year's dividend at the old rate is however, payable to them in fully paid equity shares of Rs. 25.
4. The Debenture Holders be given the option to either accept 90% of their claims in cash or to convert their claims in full into new 13 % Preference Shares of Rs. 50 each issued at par. One-fourth (in value) of the Debenture Holders accepted Preference Shares for their claims. The rest were paid in cash.
5. Contingent Liability of Rs. 2,00,000 is payable which has been created by wrong action of one Director. He has agreed to compensate this loss out of the loan given by the Director to the Company.
6. Goodwill does not have any value in the present. Decrease the value of Plant & Machinery, Stock and Debtors by Rs. 3,00,000; Rs. 1,00,000 and Rs. 2,00,000 respectively.

   Increase the value of Land & Building to Rs. 25,00,000.
7. 50,000 new Equity Shares of Rs. 25 each are to be issued at par payable in full on application. The issue was underwritten for a commission of 4%. Shares were fully taken up.
8. Total expenses incurred by the Company in connection with the Scheme excluding underwriting Commission amounted to Rs. 20,000.

   Pass necessary Journal Entries to record the above transactions. **(PM, Nov-14)**

**(Solve problem no 2 of assignment problems as rework)**

**Note:**________________________________________



**Problem 3:** **(PRINTED SOLUTION AVAILABLE) Final settlement made to debentures holders:** The Balance Sheet of Y Limited as on 31st March, 2013 was as follows:

**Name of the Company : Y Ltd**

**Balance Sheet as at : 31-03-2013**

| | | | Particulars | Notes No. | RRs. |
|---|---|---|---|---|---|
| | | | 1 | 2 | 3 |
| 1 | | | **EQUITY AND LIABILITIES:** | | |
| | | | **Shareholder's funds** | | |
| | a | | Share capital | 1 | 70,00,000 |
| | b | | Reserves and Surplus | 2 | (15,00,000) |
| 2 | | | **Non-current liabilities** | | |
| | a | | Long term borrowings | 3 | 17,00,000 |
| 3 | | | **Current liabilities** | | |
| | a | | Trade Payable (Creditors) | | 5,00,000 |
| | b | | Other Current Liabilities | 4 | 3,00,000 |
| | c | | Short term provisions | 5 | 1,00,000 |
| | | | | | **81,00,000** |
| 1 | | | **ASSETS:** | | |
| | | | **Non current assets** | | |
| | a | | Fixed assets | | |
| | | (i) | Tangible assets | 6 | 45,00,000 |
| | | (ii) | Intangible assets | 7 | 15,00,000 |

| | | | | | |
|---|---|---|---|---|---|
| 2 | | | **Current Assets** | | |
| | a | | Current investments (At cost) | | 5,00,000 |
| | b | | Inventories (Stock) | | 10,00,000 |
| | c | | Trade receivables (Debtors) | | 5,00,000 |
| | d | | Other current assets (Discount on issue of Debentures) | | 1,00,000 |
| | | | **TOTAL** | | **81,00,000** |

**Note to Accounts:**

| Particulars | Rs. |
|---|---|
| **1. Share capital** | |
| 5, 00,000 Equity shares of Rs.10 each fully paid | 50,00,000 |
| 9% 20,000 Preference shares of Rs.100 each fully paid | 20,00,000 |
| **2. Reserves and Surplus** | |
| Profit and Loss A/c | (15,00,000) |
| **3. Long tem borrowings** | |
| 10% First debenture | 6,00,000 |
| 10% Second debentures | 10,00,000 |
| Director's loan | 1,00,000 |
| **4. Other Current Liabilities** | |
| Bank OD | 1,00,000 |
| Outstanding liabilities | 40,000 |
| Debentures interest Outstanding | 1,60,000 |
| **5 Short term provisions** | |
| Provision for income tax | 1,00,000 |
| **6. Tangible Assets** | |
| Land and Building | 30,00,000 |
| Plant and Machinery | 10,00,000 |
| Furniture and Fixtures | 2,00,000 |
| Computers | 3,00,000 |
| **7. Intangible Assets** | |
| Goodwill | 10,00,000 |
| Patent | 5,00,000 |



<u>Note</u>: Preference dividend is in arrears for last three years.

A holds 10% first debentures for Rs.4,00,000 and 10% second debentures for Rs.6,00,000. He is also creditors for Rs.1,00,000. B holds 10% first debenture for Rs.2,00,000 and 10% second debentures for Rs 4,00,000 and is also creditors for Rs.50,000.

The following scheme of reconstruction has been agreed upon and duly approved.

1. All the equity shares be converted into fully paid equity shares of Rs.5 each.
2. The preference shares be reduced to Rs.50 each and the preference share holders agree to forego their arrears of preference dividends in consideration of which 9% preference shares are to be converted into 10% preference shares.
3. Mr. ‘A’ is to cancel Rs.6,00,000 of his total debt including interest on debentures and to accept new 12% debentures for the balance a mount.
4. Mr. ’B’ is to cancel Rs.3,00,000 of his total debt including interest on debentures and to accept new 12% debentures for the balance amount.

**5.** Trade payables (Other than A and B) agreed to forego 50% of their claim.

**6.** Directors to accept settlement of their loans as to 60% thereof by allotment of equity shares and balance being waived.

**7.** There were capital commitments totaling Rs.3,00,000. These contracts are to be cancelled on payment of 5% of the contract price as a penalty.

**8.** The Directors refund Rs.1,10,000 of the fees previously received by them.

**9.** Reconstruction expenses paid Rs.10,000.

**10.** The taxation liability of the company is settled at Rs.80,000 and the same is paid immediately.

**11.** The assets are revalued as under :

| Particulars | Rs. |
|---|---|
| Land and Building | 28,00,000 |
| Plant and Machinery | 4,00,000 |
| Stock | 7,00,000 |
| Debtors | 3,00,000 |
| Computers | 1,80,000 |
| Furniture and Fixtures | 1,00,000 |
| Trade Investment | 4,00,000 |

Pass journal entries for all the above mentioned transactions including amounts to be written off of Goodwill, Patents, Loss in profit & loss Accounts and Discount on issue of debentures. Prepare Bank Accounts and working of allocation of interest on debentures between A and B.

**(Nov-2012 RTP, PM)**

*(Ans.: Balance of Bank Account: 95,000, interest on debentures – A: 1,00,000, B: 60,000)*

**Note:**____________________________________________________________



**<u>Problem 4:</u> Types of debenture holders:** The following is the Balance sheet of Star Ltd. As on 31st March, 2015:

| **A. EQUITY & LIABILITIES:** | Rs. |
|---|---|
| **1. Shareholder's Fund:** | |
| (a) Share Capital : | |
| 9,000 7% Preference Shares of Rs.100 Each fully paid | 9,00,000 |
| 10,000 Equity Shares of Rs.100 each fully paid | 10,00,000 |
| (b) Reserve & surplus: | |
| Profit & loss account | (2,00,000) |
| **2. Non-current liabilities:** | |
| "A" 6% debentures (secured on Bombay works) | 3,00,000 |
| "B" 6% debentures (secured on Chennai works) | 3,50,000 |
| **3. Current liabilities and provisions:** | |
| (a) Workmen's compensation fund: | |
| Bombay works | 10,000 |
| Chennai works | 5,000 |
| (b) Trade payables | 1,25,000 |
| **Total** | **24,90,000** |

| | |
|---|---|
| **B. ASSETS :** | |
| **1. Non-current assets:** | |
| Tangible assets: | |
| Bombay works | 9,50,000 |
| Chennai works | 7,75,000 |
| **2. Investment:** | |
| Investment for workman's compensation fund | 15,000 |
| **3. Current assets:** | |
| (a) Inventories | 4,50,000 |
| (b) Trade receivables | 2,50,000 |
| (c) Cash at bank | 50,000 |
| **Total** | **24,90,000** |

A reconstruction scheme was prepared and duly approved. The salient features of the scheme were as follows:

1. Paid up value of 7% Preference share to be reduced to Rs.80, but the rate of dividend being raised to 9%.
2. Paid up value of equity shares to be reduced to Rs.10.
3. The directors to refund Rs.50,000 of the fees previously received by them.
4. Debenture holders forego their interest of Rs.26,000 which is included among the sundry creditors.
5. The preference shareholders agreed to waive their claims for preference share dividend, which is in arrears for the last three years.
6. "B" 6% Debenture holders agreed to take over the Chennai works at Rs.4,25,000 and to accept an allotment of 1,500 equity shares of Rs.10 each at par, and upon their forming a company called Zia Ltd. (to take over the Chennai works), they allotted 9,000 equity shares of Rs.10 each fully paid at par to Star Ltd.
7. The Chennai workmen's compensation fund disclosed that there were actual liabilities of Rs.1,000 only. As a consequence, the investment of the fund were realized to the extent of the balance. Entire investments were sold at a profit of 10% on book value and the proceeds were utilized for part payment of the creditors.
8. Stock was to be written off by Rs.1,90,000 and a provision for doubtful debts is to be made to the extent of Rs.20,000.
9. Chennai works completely written off.
10. Any balance of the capital reduction account is to be applied as 2/3rd to write off the value of Bombay works and 1/3rd to capital reserve.

Pass necessary journal entries in the books of Star Ltd. After the scheme has been carried into effect. **(Nov - 2015)**

**Note:**________________________________________________

**Problem 5:** **Share surrender & re-issue:** The summarised Balance Sheet of X Limited as on 31st March 2013, was as follows:

| **Liabilities** | Rs. | **Assets** | Rs. |
|---|---|---|---|
| **Authorized & subscribed capital:** | | **Fixed Assets:** | |
| 10,000 Equity shares of Rs. 100 each fully paid | 10,00,000 | Machineries | 3,50,000 |

| | | | |
|---|---|---|---|
| **Unsecured loans:** | | **Current Assets:** | |
| 15% Debentures | 3,00,000 | Inventory | 2,53,000 |
| Accrued interest | 45,000 | Trade receivables | 2,30,000 |
| **Current Liabilities:** | | Bank | 20,000 |
| Trade payables | 52,000 | Profit & loss A/c | 5,80,000 |
| Provision for income tax | 36,000 | | |
| | **14,33,000** | | **14,33,000** |

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

1. Each share be sub-divided into 10 fully paid up equity share of Rs. 10 each.
2. After sub-division, each shareholder shall surrender to the company 50% of his holding for the purpose of reissue to debenture holders and trade payables as necessary.
3. Out of shares surrendered 10,000 shares of Rs. 10 each shall be converted into 10% Preference shares of Rs. 10 each fully paid up.
4. The claims of the debenture holders shall be reduced by 50%. In consideration of the reduction, the debenture holder shall receive Preference Shares of Rs. 1,00,000 which are converted out of shares surrendered.
5. Trade payables claim shall be reduced by 25%. Remaining trade payables are to be settled by the issue of equity shares of Rs. 10 each of out of shares surrendered.
6. Balance of Profit and Loss account to be written off.
7. The shares surrendered and not re-issued shall be cancelled.

Pass Journal Entries giving effect to the above and the resultant Balance Sheet. **(PM)**

*(Ans: Balance sheet Total Rs.8,53,000)*

**(Solve problem no 3 of assignment problems as rework)**

**Note:**________________________________________________________



**Problem 6:** **Advanced (comprehensive of amalgamation and internal reconstruction)**
Following are the summarized Balance Sheet of Companies K Ltd. and W Ltd., as at 31-12-2013:

| Liabilities | (Rs. in '000) | | Assets | (Rs. in '000) | |
|---|---|---|---|---|---|
| | K Ltd. | W Ltd. | | K Ltd. | W Ltd. |
| **Share Capital :** | | | Goodwill | 20 | - |
| Equity shares of Rs. 100 each | 2,000 | 1,500 | Other Fixed Assets | 2,400 | 1,150 |
| 10% Preference shares of Rs. 100 each | 700 | 400 | Trade receivables | 625 | 615 |
| General Reserve | 240 | 170 | Inventory | 412 | 680 |
| Profit and Loss Account | | 15 | Cash at bank | 38 | 155 |
| 12% Debentures of Rs. 100 each | 600 | 200 | Own Debenture (Nominal value of Rs. 2,00,000) | 192 | |
| Trade payables | 560 | 315 | Discount on issue of debentures | 2 | |
| | | | Profit and Loss Account | 411 | |
| | **4,100** | **2,600** | | **4,100** | **2,600** |

On 01-04-2013, K Ltd. adopted the following scheme of reconstruction:

1. Each equity share shall be sub-divided into 10 equity shares of Rs. 10 each fully paid up. 50% of the equity share capital would be surrendered to the company.

2. Preference dividends are in arrear for 3 years. Preference shareholders agreed to waive 80% of the dividend claim and accept payment for the balance.
3. Own debentures of Rs. 80,000 (nominal value) were sold at Rs. 98 cum interest and remaining own debentures were cancelled.
4. Debenture holders of Rs. 3,00,000 agreed to accept one machinery of book value of Rs. 3,20,000 in full settlement.
5. Trade payables, Trade receivables and inventory were valued at Rs. 5,00,000, Rs. 6,00,000 and Rs. 4,00,000 respectively. Goodwill, discount on issue of debentures and Profit and Loss account (Dr.) are to be written off.
6. The company paid Rs. 20,000 as penalty to avoid capital commitments of Rs. 4,00,000.

On 02.04.2013, a scheme of absorption was adopted. K Ltd. would take over W Ltd. The purchase consideration was fixed as below:

1. Equity shareholders of W Ltd. will be given 50 equity shares of Rs. 10 each fully paid up, in exchange for every 5 shares held in W Ltd.
2. Issue of 10% preference shares of Rs. 100 each in the ratio of 4 preference shares of K Ltd. for every 5 preference shares held in W Ltd.
3. Issue of 12% debentures of Rs. 100 each of K Ltd. for every 12% debenture in W Ltd.
4. Pass necessary Journal entries in the books of K Ltd. and draw the resultant Balance Sheet as at 2nd April, 2013. **(PM)** ***(Ans: Balance sheet Total Rs.57,34,400)***

**(Solve problem no 4 of assignment problems as rework)**

**Note:**____________________________________________________________

## ASSIGNMENT PROBLEMS

**Problem 1: Basic level:** S.P. Construction Co. finds itself in financial difficulty. The following is the summarized balance sheet on 31st December 2012:

| Liabilities | Rs. | Assets | Rs. |
|---|---|---|---|
| Share capital | | Land | 1,56,000 |
| 20,000 Equity Shares of Rs. 10 each fully paid | 2,00,000 | Building (net) | 27,246 |
| 5% Cum. Pref. Shares of Rs. 10 each fully paid | 70,000 | Equipment | 10,754 |
| 8% Debentures | 80,000 | Goodwill | 60,000 |
| Loan from Directors | 16,000 | Investments (Quoted) in shares | 27,000 |
| Trade payables | 96,247 | Inventory | 1,20,247 |
| Bank Overdrafts | 36,713 | Trade receivables | 70,692 |
| Interest Payable on Debentures | 12,800 | Profit & Loss Account | 39,821 |
| | **5,11,760** | | **5,11,760** |

The authorised capital of the company is 20,000 Equity Shares of Rs. 10 each and 10,000 5% Cum. Preference Shares of Rs. 10 each.

During a meeting of shareholders and directors, it was decided to carry out a scheme of internal reconstruction. The following scheme has been agreed :

1. The equity shareholders are to accept reduction of Rs. 7.50 per share. And each equity share is to be redesignated as a share of Rs. 2.50 each.
2. The equity shareholders are to subscribe for a new share on the basis of 1 for 1 at a price of Rs. 3 per share.

**3.** The existing 7,000 Preference Shares are to be exchanged for a new issue of 3,500 8% Cumulative Preference Shares of Rs. 10 each and 14,000 Equity Shares of Rs. 2.50 each.

**4.** The Debenture holders are to accept 2,000 Equity Shares of Rs. 2.50 each in lieu of interest payable.

The interest rate is to be increased to 9 ½%. Further Rs. 9,000 of this 9½% Debentures are to be issued and taken up by the existing holders at Rs. 90 for Rs. 100.

**5.** Rs . 6,000 of directors' loan is to be credited. The balance is to be settled by issue of 1,000 Equity Shares of Rs. 2.50 each.

**6.** Goodwill and the profit and loss account balance are to be written off.

**7.** The investment in shares is to be sold at current market value of Rs. 60,000.

**8.** The bank overdraft is to be repaid.

**9.** Rs. 46,000 is to be paid to trade payables now and balance at quarterly intervals.

**10.** 10% of the trade receivables are to be written off.

**11.** The remaining assets were professionally valued and should be included in the books of account as follows:

| | |
|---|---|
| Land | Rs.90,000 |
| Building | Rs.80,000 |
| Equipment | Rs.10,000 |
| Inventory | Rs.50,000 |

**12.** It is expected that due to changed condition and new management operating profit will be earned at the rate of Rs. 50,000 p.a. after depreciation but before interest and tax.

Due to losses brought forward it is unlikely that any tax liability will arise until 2014.

You are required to show the necessary journal entries to affect the reconstruction scheme; prepare the balance sheet of the company immediately after the reconstruction. **(SM)**

***(Ans: Balance sheet total Rs.3,39,010)***

**Problem 2:** The share holders of Maitri Ltd. Decided on a corporate restructuring exercise necessitated because of economic recession from the given summarized balance sheet as on 31-03-2012. And the information supplied, you are required to prepare (i) Journal entries reflecting the scheme of reconstruction, (ii) capital reduction account, (iii) cash account in the books of Maitri Ltd. **(SM)**

***Name of the Company : Maitri Ltd***

***Balance Sheet As At : 31st March, 2012***

| | | | ***Particulars*** | ***Notes No.*** | **Rs.** |
|---|---|---|---|---|---|
| | | | **1** | **2** | **3** |
| | | | **EQUITY AND LIABILITIES:** | | |
| | | | Shareholder's funds | | |
| 1 | a | | Share capital | 1 | 7,00,000 |
| | b | | Reserves and Surplus | 2 | (1,28,400) |
| | a | | **Non-current liabilities** | | |
| 2 | | (i) | **Long tem borrowings** | | |
| | | (ii) | 9% Debentures (Rs.100) | | 1,20,000 |
| | | | **Current liabilities** | | |
| 3 | a | | Trade Payable | | 1,20,000 |
| | b | | Other current liabilities | 3 | 2,78,500 |
| | | | **TOTAL** | | **10,90,100** |

| | | | | | |
|---|---|---|---|---|---|
| 1 | | | **ASSETS:** | | |
| | | | **Non current assets** | | |
| | a | | Fixed assets | | |
| | | (i) | Tangible assets | 4 | 6,84,000 |
| | | (ii) | Intangible assets | 5 | 1,46,100 |
| | | (iii) | Non current investments | 6 | 64,000 |
| 2 | | | **Current Assets** | | |
| | a | | Inventories | 7 | 76,000 |
| | b | | Trade receivables | | 1,20,000 |
| | | | **TOTAL** | | **10,90,100** |

***Note to Accounts:***

| *Particulars* | Rs. |
|---|---|
| **1. Share capital** | |
| 30,000 equity shares of Rs.10 each | 3,00,000 |
| 40,000 8% cumulative preference shares Rs.10 each | 4,00,000 |
| **2. Reserves and Surplus** | |
| Securities premium account | 10,000 |
| Profit and account | (1,38,400) |
| **3. Other current liabilities** | |
| Accrued interest on debentures | 5,400 |
| Vat payables | 50,000 |
| Temporary bank overdraft | 2,23,100 |
| **4. Tangible assets** | |
| Freehold land | 1,20,000 |
| Freehold premises | 2,44,000 |
| Plant and equipment | 3,20,000 |
| **5. Intangible assets** | |
| Goodwill at cost | 36,100 |
| **6. Non current investments** | |
| Investment (Marked to market) | 64,000 |
| **7. Inventories** | |
| Raw material and packing material | 60,000 |
| Finished goods | 16,000 |



***Note***: Preference dividends are in arrears for 4 years.

The scheme of reconstruction that received the permission of the Court was on the following lines:

- The authorized capital of the Company to be re-fixed at Rs.10 lakhs (preference capital of Rs.3 lakhs and equity capital of Rs.7 lakhs). Both classes of shares are of Rs.10 each.
- The preference shares are to be reduced to Rs.5 each and equity shares reduced by Rs.3 per share. Post reduction, both classes of shares to be re-consolidated into Rs.10 shares.
- Trade Investments are to be liquidated in open market.
- One fresh equity shares of Rs.10 to be issued for every Rs.40 of preference dividends in arrears (ignore taxation).
- Expenses for the scheme were Rs.10,000.
- The debenture holders took over freehold land at Rs.2,10,000 and settled the balance after adjusting their dues.

- Unprovided contingent liabilities were settled at Rs.54,000 and a pending insurance claim receivable settled at Rs.12,500.
- The intangible assets were all to be written off along with Rs.10,000 worth obsolete packing material and 10% of the receivables.
- Remaining cash available as a result of the above transactions is to be utilized to pay off the bank overdraft to that extent.
- The Equity shareholders agree that they will bring in necessary cash to liquidate the balance outstanding on the overdraft account by subscribing the fresh shares. The equity shares will be issued at par for this purpose. **(May - 2013 RTP)**

***(Ans.: Total of capital reduction A/c is 3,92,500)***

**Problem 3: Determination of value of equity shares and arrears of preference dividend:**
Following is the Balance Sheet of M Ltd. as at 31st March, 2013:

| Liabilities | Rs. | Assets | Rs. |
|---|---|---|---|
| 15,000, 10% Preference shares of Rs. 100 each | 15,00,000 | Goodwill | 3,50,000 |
| 35,000 Equity shares of Rs. 100 each | 35,00,000 | Land & Buildings | 15,00,000 |
| Securities Premium account | 1,00,000 | Plant & Machinery | 10,00,000 |
| 7% Debentures of Rs.100 each | 5,00,000 | Inventory | 6,00,000 |
| Trade payables | 12,50,000 | Trade receivables | 15,00,000 |
| Loan from Director | 1,50,000 | Cash at bank | 1,00,000 |
| | | Profit & Loss A/c | 19,50,000 |
| | **70,00,000** | | **70,00,000** |



No dividend on Preference shares has been paid for the last 5 years.

The following scheme of reorganization was duly approved by the Tribunal:

1. Each Equity share to be reduced to Rs. 25.
2. Each existing Preference share to be reduced to Rs. 75 and then exchanged for 1 new 13% Preference share of Rs. 50 each and 1 Equity share of Rs. 25 each.
3. Preference shareholders have forgone their right for dividend for four years. One year's dividend at the old rate is however, payable to them in fully paid equity Shares of Rs. 25.
4. The Debenture holders be given the option to either accept 90% of their claims in cash or to convert their claims in full into new 13% Preference shares of Rs. 50 each issued at par.

   One half (in value) of the debenture holders accepted Preference shares for their claims.

   The rest were paid cash.
5. Contingent liability of Rs. 1,50,000 is payable, which has been created by wrong action of one Director. He has agreed to compensate this loss out of the loan given by the Director to the company.
6. Goodwill does not have any value in the present. Decrease the value of Plant and Machinery, Inventory and Trade receivables by Rs.4,00,000, Rs.1,00,000 and Rs.1,50,000 respectively. Increase the value of Land and Buildings to Rs. 18,00,000.
7. 40,000 new Equity shares of Rs. 25 each are to be issued at par, payable in full on application. The issue was underwritten for a commission of 4%.

   Shares were fully taken up.
8. The total expenses incurred by the company in connection with the scheme excluding underwriting commission amounted to Rs. 15,000.

Pass necessary Journal Entries to record the above transactions. **(PM)**

**Problem 4: Share surrender & Re-issue:** The Balance sheet of Revise Limited as at 31st March, 2012 was as follows:

**Name of the Company : Revise Ltd**

**Balance Sheet as at : 31-03-2012**

| | | | Particulars | Notes No. | Rs. |
|---|---|---|---|---|---|
| | | | 1 | 2 | 3 |
| 1 | | | **EQUITY AND LIABILITIES:** | | |
| | | | **Shareholder's funds** | | |
| | a | | Share capital | 1 | 10,00,000 |
| | b | | Reserves and Surplus | 2 | (6,00,000) |
| 2 | | | **Non-current Liabilities** | | |
| | a | | 12% Debentures (Unsecured) | | 2,00,000 |
| 3 | | | **Current liabilities** | | |
| | a | | Trade Payable (Creditors) | | 72,000 |
| | b | | Other Current Liabilities (Accrued interest on debentures) | | 24,000 |
| | c | | Short term provisions | | 24,000 |
| | | | **TOTAL** | | **7,20,000** |
| 1 | | | **ASSETS:** | | |
| | | | **Non current assets** | | |
| | a | | Fixed assets | | |
| | | (i) | Tangible assets | 4 | 1,00,000 |
| 2 | a | | **Current Assets** | | |
| | | (i) | Inventories (stock) | | 3,20,000 |
| | | (ii) | Trade receivables (debtors) | | 2,70,000 |
| | | (iii) | Cash and cash equivalents (bank) | | 30,000 |
| | | | **TOTAL** | | **7,20,000** |

**Note to Accounts:**

| Particulars | Rs. |
|---|---|
| **1. Share capital** | |
| 10,000 Equity shares of Rs.100 | 10,00,000 |
| **2. Reserves and Surplus** | |
| Profit and Loss A/c | (6,00,000) |
| **3. Short term provisions** | |
| Provision for income tax | 24,000 |
| **4. Tangible Assets** | |
| Machineries | 1,00,000 |

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:

1. Each share will be sub-divided into ten fully paid up equity shares of Rs.10 each.
2. After sub-division, each shareholder shall surrender to the company 50% of his holding. For the purpose of re-issue to debenture holders and creditors as necessary.
3. Out of shares surrendered, 10,000 shares of Rs.10 each shall be converted into 12% preference shares of Rs.10 each fully paid up.
4. The claims of the debenture-holders shall be reduced by 75 percent. In consideration of the reduction, the debenture holders shall receive preference shares of Rs.1,00,000 which are converted out of shares surrendered.

5. Creditors claim shall be reduced to 50 percent, and for remaining balance is to be settled by the issue of equity shares of Rs.10 each out of shares surrender.
6. Balance of profit and loss account to be written off.
7. The shares surrendered and not re-issued shall be cancelled.

You are requires to show the journal entries giving effect to the above and the resultant Balance Sheet. **(SM)** ***(Ans.: Total of Balance Sheet: 7,20,000)***

**Problem 5: Advanced (comprehensive of amalgamation and internal reconstruction)**
Following is the Balance Sheet as at March 31, 2013:

**Name of the Companies: MAX Ltd, MINI Ltd**

**Balance Sheet as at : 31-03-2013** **(Rs. '000)**

| | | | Particulars | Notes No. | Max Ltd ( Rs.) | Mini Ltd ( Rs.) |
|---|---|---|---|---|---|---|
| | | | 1 | 2 | 3 | 4 |
| 1 | | | **EQUITY AND LIABILITIES:** | | | |
| | | | **Shareholder's funds** | | | |
| | a | | Share capital | 1 | 2000 | 1400 |
| | b | | Reserves and Surplus | 2 | (231) | 185 |
| 2 | | | **Non-current liabilities** | | | |
| | a | | Long term borrowings (12% Deb. of Rs.100 each) | | 600 | 200 |
| 3 | | | **Current liabilities** | | | |
| | a | | Trade Payable-(creditors) | | 415 | 225 |
| | | | TOTAL | | **2784** | **2010** |
| 1 | | | **ASSETS:** | | | |
| | | | **Non current assets** | | | |
| | a | | Fixed assets | | | |
| | | (i) | Tangible assets | 3 | 1500 | 760 |
| | | (ii) | Intangible assets (Goodwill) | | 20 | - |
| 2 | | | **Current Assets** | | | |
| | a | | Current investments | 4 | 192 | - |
| | b | | Inventories (stock) | | 393 | 680 |
| | c | | Trade receivables (debtors) | | 651 | 440 |
| | d | | Cash and cash equivalents (Cash at bank) | | 26 | 130 |
| | e | | Other current assets | 5 | 2 | - |
| | | | TOTAL | | **2784** | **2010** |

**Note to Accounts:**

| Particulars | Max Ltd (Rs.) | Mini Ltd (Rs.) |
|---|---|---|
| **1. Share capital** | | |
| E. shares of Rs.100 each | 1500 | 1000 |
| 9% P. shares of Rs.100 each | 500 | 400 |
| **2. Reserves and Surplus** | | |
| General reserve | 180 | 170 |
| Profit and loss account | (411) | 15 |

| | | |
|---|---|---|
| **3. Tangible Assets** | | |
| Other fixed assets | 1500 | 760 |
| **4. Current Investment** | | |
| Own debentures (Nominal value Rs.2 lakhs) | 192 | - |
| **5. Other Current Assets** | | |
| Discount on issue of debentures | 2 | - |

On 1.4.2013, Max Ltd. adopted the following scheme of reconstruction:

1. Each equity share shall be sub-divided into 10 equity shares of Rs.10 each fully paid up. 50% of the equity share capital would be surrendered to the company.
2. Preference dividends are in arrear for 3 years. Preference shareholders agreed to waive 90% of the dividend claim and accept payment for the balance.
3. Own debentures of Rs.80,000 were sold at Rs.98 cum-interest and remaining own debentures were cancelled.
4. Debenture holders of Rs.2,80,000 agreed to accept one machinery of book value of Rs.3, 00,000 in full settlement.
5. Creditors, debtors and stocks were valued at Rs.3,50,000, Rs.5,90,000 and Rs.3, 60,000 respectively. The goodwill, discount on issue of debentures and profit and loss (Dr.) are to be written off.
6. The Company paid Rs.15, 000 as penalty to avoid capital commitments of Rs.3, 00,000.

   On 2.4.2013 a scheme of absorption was adopted. Max Ltd. would take over Mini Ltd.

The purchase consideration was fixed as below:

1. Equity shareholders of Mini Ltd. will be given 50 equity shares of Rs.10 each fully paid up, in exchange for every 5 shares held in Mini Ltd.
2. Issue of 9% preference shares of Rs.100 each in the ratio of 4 preference shares of Max Ltd. for every 5 preference shares held in Mini Ltd.
3. Issue of one 12% debenture of Rs.100 each of Max Ltd. for every 12% debentures in Mini Ltd.

You are requested to give journal entries in the books of Max Ltd. and draw the results Balance Sheet as at 2nd April, 2013. **(PM)** ***(Ans: Balance sheet Total Rs.42,35,900)***



**Problem 6: Determination of value of equity shares held in Q ltd, and accounting treatment of arrears of preference dividend:** The Balance Sheet of R. Ltd., at March, 2008 was as follows:

***Name of the Company : R Co. Ltd***

***Balance Sheet as at : 31 – 03 – 2008***

| | | | ***Particulars*** | ***Notes No.*** | Rs. |
|---|---|---|---|---|---|
| | | | 1 | 2 | 3 |
| 1 | a<br>b | | <u>**EQUITY AND LIABILITIES:**</u><br>**Shareholder's funds**<br>Share capital<br>Reserves and Surplus | 1<br>2 | 11,20,000<br>(4,40,000) |
| 2 | a | | **Non-current liabilities**<br>Long term borrowings-<br>(Loan from directors) | | 60,000 |
| 3 | a<br>b | | **Current liabilities**<br>Trade Payable-(creditors)<br>Other Current Liabilities<br>(Bank over draft)<br>**TOTAL** | | 4,40,000<br>2,08,000<br><br>**13,88,000** |

| | | | | | |
|---|---|---|---|---|---|
| 1 | a | <br>(i)<br>(ii)<br>(iii) | **ASSETS:**<br>**Non current assets**<br>Fixed assets<br>Tangible assets<br>Intangible assets<br>Non-Current investments | 3<br><br>4 | 3,80,000<br>68,000<br>3,24,000 |
| 2 | a | (i)<br>(ii)<br>(iii) | **Current Assets**<br>Inventories (stock)<br>Trade receivables(debtors)<br>Other current assets<br><br>**TOTAL** | 5 | 2,48,000<br>3,20,000<br>48,000<br>**13,88,000** |

***Note to Accounts:***

| *Particulars* | Rs. |
|---|---|
| **1. Share capital** | |
| **Share Capital Authorized**: | |
| **Issued :** 64,000 8% Cumulative Preference Share of Rs.10 each, fully paid | 14,00,0000 |
| 64,000 Eq. shares of Rs.10 each, Rs.7.5 paid | 6,40,000 |
| **2. Reserves and Surplus** | |
| Profit and Loss Account | 4,80,000 |
| **3. Tangible Assets** | |
| Freehold premises at cost | (4,40,000) |
| Plant and Equipment at cost less | 1,40,000 |
| depreciation | 2,40,000 |
| **4. Non-Current investments** | |
| Investment in shares in Q Ltd. (at cost) | 3,24,000 |
| **5. Other current assets** | |
| Deferred Revenue Expenditure | 48,000 |



**Note:** The arrears of Preference Dividends amount to Rs.51,200.

A scheme of reconstruction was duly approved with effect from 1st April, 2008 under the conditions stated below:

1. The unpaid amount on the equity shares would be called up.
2. The preference shareholders would forego their arrears of dividends. In addition, they would accept a reduction of Rs.2.5 per share. The dividend rate would be enhanced to 10%
3. The equity shareholders would accept a reduction of Rs.7.5 per share.
4. R Ltd. holds 21,600 shares in Q Ltd. This represents 15% of the share capital of that company Q Ltd. is not a quoted company. The average net profit (after tax) of the company is Rs.2,50,000. The shares would be valued based on 12% capitalization rate.
5. A bad debt provision at 2% would be created.
6. The other assets would be valued as under:

   Intangible Rs.48,000, Plant Rs.1,40,000, Freeholds premises Rs.3,80,000, Stocks Rs.2,50,000
7. The profit and loss account debit balance and the balance standing to the debit of the deferred revenue expenditure account would be eliminated.
8. The directors would have to take equity shares at the new face value of Rs.2.5 per share in settlement of their loan.
9. The equity shareholders, including the directors, who would receive equity shares in settlement of their loans, would take up two new equity shares for every one held.
10. The preference shareholders would take up one new preference share for every four held.

**11.** The authorized share capital would be restated to Rs.14,00,000.

**12.** The new face value of the shares – preference and equity will be maintained at their reduced levels.

***You are required to prepare:***

**a)** Necessary ledger accounts to effect the above; and

**b)** The balance Sheet of the company after reconstruction **(Nov-2008)**

***(Ans.: Balance in Reconstruction account: 2,56,100; bank account: 5,12,000; total of Balance Sheet: 19,56,100)***

<u>Problem 7:</u> **Calculation of total loss borne by equity and preference share holders under the scheme of reconstruction.** The Balance Sheet of Munna Ltd. on 31st March. 2005 is as under:

**Name of the Company : Munna Ltd**

**Balance Sheet as at : 31-03-2005**

| | | | Particulars | Notes No. | Rs. |
|---|---|---|---|---|---|
| | | | 1 | 2 | 3 |
| | | | **EQUITY AND LIABILITIES:** | | |
| | | | **Shareholder's funds** | | |
| 1 | a | | Share capital | 1 | 30,00,000 |
| | b | | Reserves and Surplus | 2 | (8,00,000) |
| | | | **Current liabilities** | | |
| 2 | a | | Trade Payable-(Creditors) | | 7,00,000 |
| | b | | Other Current Liabilities (bank OD) | | 3,00,000 |
| | | | **TOTAL** | | **32,00,000** |
| | | | **ASSETS:** | | |
| | | | **Non current assets** | | |
| 1 | a | | Fixed assets | | |
| | | (i) | Tangible assets | 3 | 18,00,000 |
| | | (ii) | Intangible assets(good will) | | 2,00,000 |
| | | | **Current Assets** | | |
| 2 | a | | Inventories (stock) | | 3,00,000 |
| | b | | Trade receivables(debtors) | | 7,50,000 |
| | c | | Cash & cash equivalent(cash ) | | 1,50,000 |
| | | | **TOTAL** | | **32,00,000** |

***<u>Note to Accounts:</u>***

| ***Particulars*** | Rs. |
|---|---|
| **1. Share capital** | |
| 20,000 shares of Rs.100 each | 20,00,000 |
| 10,000 7% preference shares of Rs.100 each | 10,00,000 |
| **2. Reserves and Surplus** | |
| Profit and Loss A/c | (7,00,000) |
| Preliminary expenditure | (1,00,000) |
| **3. Tangible Assets** | |
| Plant and Machinery | 18,00,000 |

Two years preference dividend is in arrears. The company had been bad time during the last two years and hopes for better business in future, earning profit and paying dividend provided the capital base is reduced.

An internal reconstruction scheme as follows was agreed to by all concerned:

**1.** Creditors agreed to forgo 50% of the claim.

**2.** Preference shareholders withdrew arrears dividend claim. They also agreed to lower their capital claim by 20% by reducing nominal value in consideration of 9% dividend effective after reorganization in case the equity shareholders loss exceeded 50% on the application of the scheme.

**3.** Bank agreed to convert overdraft into term loan to the extent required for making current ratio equal to 2 : 1.

**4.** Revalued figure for plant and machinery was accepted as Rs.15,00,000.

**5.** Debtors to the extent of Rs.4,00,000 were considered good.

**6.** Equity shares shall be exchanged for the same number of equity shares at a revised denomination as required after the reorganization.

***Required:***

**a)** Total loss to be borne by the equity and preference shareholders for the reorganization;

**b)** Shares of loss to the individual classes of shareholders;

**c)** New structure of share capital after reorganization;

**d)** Working capital of the reorganization Company; and

**e)** A Performa balance sheet after reorganization. ***(Nov-2011, 2009 RTP Similar Problem)***

**(Ans.: Loss to be borne by equity shareholders: 11,00,000, per share Rs. 55; preference shareholders: 2,00,000, per share: Rs. 20; New structure: equity shares – 20,000, preference shares – 10,000; working capital: 4,25,000; total of Balance Sheet: 23,50,000)**

## ABC ANALYSIS

| | A Category | B Category | C Category |
|---|---|---|---|
| Class Room Problems | 2, 3, 6 | 4, 5 | 1 |
| Assignment Problems | 1, 4, 5, 6, 7 | 2 | 3 |





**Verified by:** G.S.R Sir,
Mahesh Sir,
**Executed by:** Rajasekhar

# THE END