# 9. INTERNAL RECONSTRUCTION - I

## 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 | M - 16 | N - 16 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| INTERNAL RECONSTRUCTION-1 | 16 | 16 | - | 16 | 04 | - | 12 | - | 16 | - | 16 |

**Meaning:** Reconstruction means reorganization of a company's financial structure. In reconstruction, usually the following activities are done:

1. Revaluation of Assets & Liabilities;
2. Writing off of the losses suffered by the company by reduction of the paid-up value of shares;
3. Varying of the rights attached to different classes of shares and;
4. Compounding / arrangement with the creditors.

**Reasons:** The need for reconstruction arises in the following cases:

1. When a company has accumulated losses;
2. When a company finds itself overcapitalized, i.e., value placed on assets is too much as compared to their earning capacity;
3. When the profits as a whole are insufficient to pay proper dividend;

**Types of Reconstruction:**

**External Reconstruction:** Liquidation of a company and formation of a new company with almost the same share holders and the shareholders in the liquidating company will be given shares in the new company in exchange of shares of old company held by them. The main advantage of this type of reconstruction is that the newly formed company will have a sound financial structure and good set of Assets & Liabilities recorded in the books at their fair values.

**Note:** Accounting Treatment for external reconstruction is essentially covered under the category 'amalgamation in the nature of merger in AS-14

**Internal Reconstruction:** A settlement made with members, creditors and debenture holders may result into reconstruction of a company and such reconstruction will be called as "Internal Reconstruction", if there is no liquidation of an existing company.

**Difference between Internal and External Reconstruction:**

| Basis | Internal Reconstruction | External Reconstruction |
|---|---|---|
| Liquidation | The existing company is not liquidated. | The existing company is liquidated. |
| Formation | No new company is formed but only the rights of shareholders and creditors are changed. | A new company is formed to take over the liquidated company. |
| Reduction of capital | There is certain reduction of capital and sometimes the outside liabilities like debenture holders may have to reduce their claim. | There is no reduction of capital. In fact there is a fresh share capital of the company. |
| Legal position | Internal reconstruction is done as per provisions of section 100 of the Companies Act, 1956*. | External reconstruction is regulated by section 394 of the Companies Act, 1956*. |

*The corresponding sections under Companies Act, 2013 related with these sections have been not been notified till 31st May, 2015.

**Methods of Internal Reconstruction:**

**Methods of Internal Reconstruction**

- Alteration of Share Capital (Sec.61)
- Variation of Shareholders' Rights (Sec.48)
- Reduction of Share Capital (Sec.66)
- Compromise/ Arrangement (Sec.230 to 240)
- Surrender of Shares

**1. The accounting treatment in each case of <u>Alteration of Share capital</u> will be as under:**

**a. For increase in Share Capital:**

**Ex:** X Ltd. issued 10,000 Equity Shares of Rs.10 each at par:

| | | | | |
|---|---|---|---|---|
| **i)** | Bank A/c | Dr. | 1,00,000 | |
| | To Equity Share Application and Allotment A/c | | | 1,00,000 |
| | (Being the application money received) | | | |
| **ii)** | Equity Share Application and Allotment A/c | Dr. | 1,00,000 | |
| | To Equity Share Capital A/c | | | 1,00,000 |
| | (Being 10,000 Equity Shares of Rs.10 each allotted at par) | | | |



**b. For Consolidation of Shares:**

**Ex:** X Ltd having 10,000 Equity Shares of Rs.10 each decided to convert the Share Capital into Equity Shares of Rs.100 each.

| | | | |
|---|---|---|---|
| Equity Share Capital (Rs.10) A/c | Dr. | 1,00,000 | |
| To Equity Share capital (Rs.100) A/c | | | 1,00,000 |
| (Being 10,000 Equity Shares of Rs.10 each converted into 1,000 shares of Rs.100 each) | | | |

**c. For Sub-division of Shares:**

**Ex:** X Ltd having 1,000 Equity Shares of Rs.100 each decides to convert the Share Capital into Equity Shares of Rs.10 each.

| | | | |
|---|---|---|---|
| Equity Share Capital (Rs.100) A/c | Dr. | 1,00,000 | |
| To Equity Share Capital (Rs.10) A/c | | | 1,00,000 |
| (Being 1,000 Equity Shares of Rs.100 each converted into 10,000 Shares of Rs.10 each) | | | |

**Conversion of fully paid shares into Stock and Stock into Shares:** Stock is the consolidation of the share capital into one unit divisible into aliquot parts. While it is impossible of the share capital to be one share, any amount of stock may be transferred. In practice, however, companies restrict the transfer of stock to multiples of say, Rs.100. A company can convert its fully paid shares into stock [Section 61 (c)]. Upon the company converting its shares into stock, the book-keeping entries merely record the transfer from share capital account to stock account. But a separate Stock Register is started in which details of members' holdings are entered and the annual return is modified accordingly.

**d. For Conversion of Shares into Stock:**

**Ex:** X Ltd having Equity Shares of Rs.10 each decides to convert the Share Capital into Equity Stock.

| | | | |
|---|---|---|---|
| Equity Share Capital (Rs.10) A/c | Dr. | 1,00,000 | |
| To Equity Stock A/c | | | 1,00,000 |

(Being 1,000 Equity Shares of Rs.10 each converted into equity stock)

e. **For Conversion of Stock into Shares:**

**Ex:** X Ltd having Equity Stock of Rs.1,00,000 decides to convert the Equity Stock into Equity Share Capital of Rs.10 each.

| | | | |
|---|---|---|---|
| Equity Stock A/c | Dr. | 1,00,000 | |
| To Equity Share Capital (**Rs.**10) A/c | | | 1,00,000 |

(Being Equity Stock of Rs.1,00,000 converted into 10,000 Equity Shares of Rs.10 each)

f. **For Cancellation of Un-issued Shares:**

No accounting entry is required to be passed. The Authorized Share Capital gets reduced by the amount of un-issued shares now cancelled.

2. **Variation of Shareholders rights [section 48]:**

Differential rights mean differential voting rights relating to dividend, or otherwise in accordance with rules. It may be difference related to managing control, power to appoint proxy and so on.

a. **Variation of Shareholders rights [section 48]**

**Ex:** X Ltd has 1,000, 10% Cum Pre. Shares of Rs.100 each. At a class meeting of Cum pref. Shareholders, it was decided that the rate of dividend to 9% In such a case following Journal Entry will be passed.

| | | | |
|---|---|---|---|
| 10% Cum pref. Share Capital A/c | Dr. | 1,00,000 | |
| To 9% Cum pref. share Capital A/c | | | 1,00,000 |

**Ex:** Y Ltd. has 1,000, 10% Cumulative Pref. Shares of Rs.100 each. At a meeting of Cum Pref. Shareholders, it was decided that the existing Cum-Pref.–Shares be converted into Non-Cum–Pref. Shares.

| | | | |
|---|---|---|---|
| 10% Cum pref. Shares Capital A/c | Dr. | 1,00,000 | |
| To 10% Non-cum pref. Share Capital A/c | | | 1,00,000 |

3. **The Accounting treatment in each case of <u>Reduction of Share capital</u> will be as follows:**

a. **For Reducing the liability in respect of Uncalled Amount:**

**Ex:** X Ltd having 1,000 Equity Shares of Rs.100 each Rs.60 paid up and decides to cancel the liability of member to the extent of Rs.20 per share and make shares as of Rs.80 each. Rs.60 paid up.

| | | | |
|---|---|---|---|
| Equity Share Capital (Rs.100) A/c | Dr. | 60,000 | |
| To Equity Share Capital A/c (Rs.80) | | | 60,000 |

(Being Shares of Rs.100 each converted into shares of Rs.80 each)

**Note:** The paid up Share Capital of the company will remain unchanged.

b. **For paying off the surplus paid up Capital:**

**Ex:** A Ltd. having 1,000 Equity Shares of Rs.100 fully paid decides to repay to its members Rs.20 per share and make shares as of Rs.80 each fully paid up.

| | | | |
|---|---|---|---|
| **i)** Equity Share Capital (Rs.100) A/c | Dr. | 1,00,000 | |
| To Equity Share Capital (Rs.80) A/c | | | 80,000 |
| To Sundry Members A/c | | | 20,000 |

(Being shares of Rs.100 each converted into shares of Rs.80 each and make Rs.20 per share due to members)

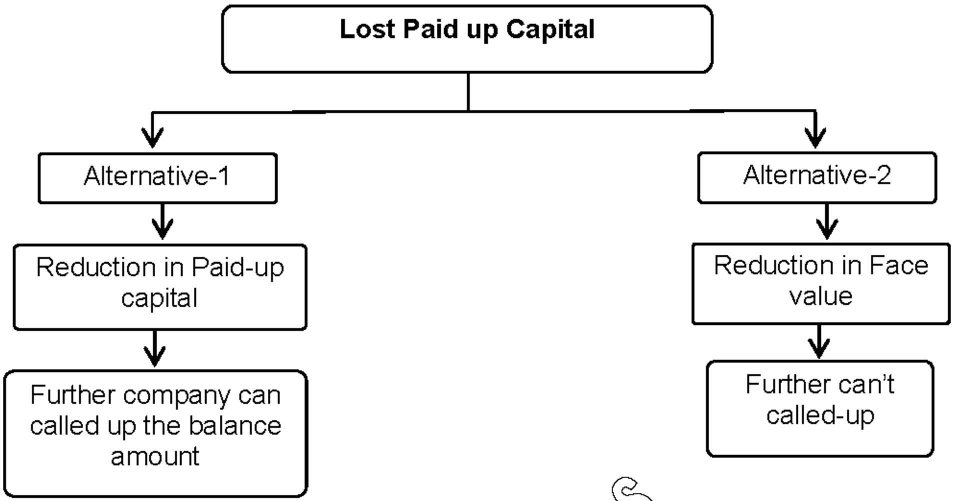
**ii)** Sundry Members A/c Dr. 20,000

To Bank A/c 20,000

(Being the payment made to members)

**c. For writing off the lost paid up Capital:**

**The reduction can be effected in any of the following two ways:**




**Alternative - 1:** Reducing the paid-up value (not Nominal Value) of existing shares from Rs.100 to Rs. 20/-

| | | | |
|---|---|---|---|
| Share Capital (Rs.100) A/c | Dr. | Rs.80 | |
| To Capital Reduction A/c | | | Rs.80 |

(Being the paid-up value of a share reduced from Rs.100 to Rs.20)

**Alternative - 2:** Reducing both Nominal Values and paid-up values of Shares from Rs.100 to Rs. 20/-

| | | | |
|---|---|---|---|
| Share Capital (Rs.100) A/c | Dr. | Rs.100 | |
| To Share Capital (Rs.20) A/c | | | Rs.20 |
| To Capital Reduction A/c | | | Rs.80 |

(Being the shares reduced to **Rs.**20 per share)

**Note:** The Shareholders will not ordinarily be willing for the first alternative since it puts additional burden on them

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

**Accounting treatment for some of the cases is as follows:**

**a.** When equity shareholders give up their claim to reserves and accumulated profits:

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

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

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

**Example** Look at the following Balance Sheet

| Liabilities | Rs. | Assets | Rs. |
|---|---|---|---|
| 10% Debentures<br>Sundry Creditors | 14,70,000<br>4,50,000 | | |

The debenture holders agree to reduce their claims up to Rs.5,00,000 in consideration of their getting 50,000 Equity Shares of Rs.10 each. Sundry Creditors agree to reduce their claims to 20% and half the balance to be satisfied by the issues of Equity Shares of Rs.10 each. The following Journal Entries shall be passed. To record the aforesaid arrangement:

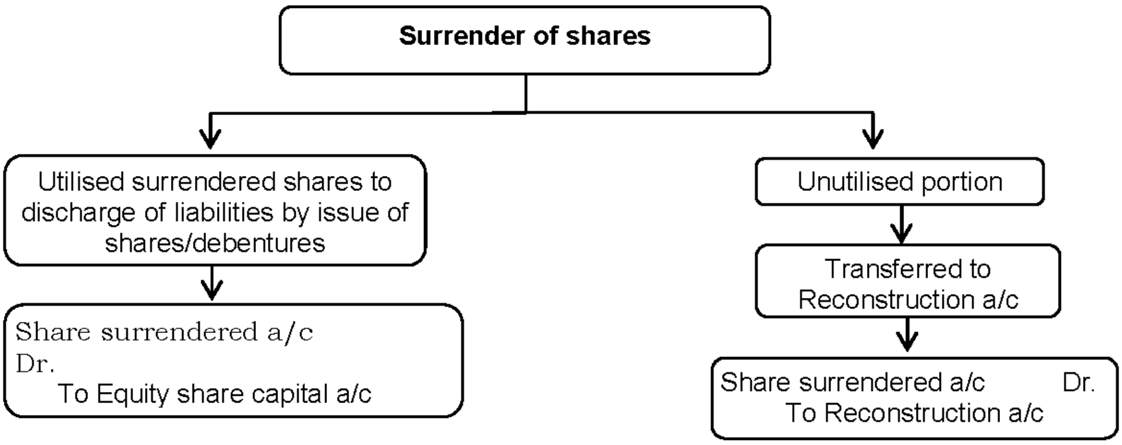
| Particulars | Debit | Credit |
|---|---|---|
| **i)** 10% debenture holders' A/c Dr.<br>To Equity Shares Capital A/c (Rs.10)<br>To Reconstruction A/c | 9,70,000 | <br>5,00,000<br>4,70,000 |
| **ii)** Sundry Creditors A/c Dr.<br>To Equity Shares Capital A/c (Rs.10)<br>To Reconstruction A/c | 4,05,000 | <br>45,000<br>3,60,000 |



**5. Surrender of Shares:** The shareholders are made to surrender their shares. These shares are then allotted to debenture holders and creditors so that their liabilities are reduced. The unutilized surrendered shares are then cancelled.

**Entry:**

| | | | |
|---|---|---|---|
| Equity share capital A/c | Dr. | XXX | |
| To shares surrendered A/c | | | XXX |



**How to deal with arrears of Preference Dividends?**

**Preference Dividend**

- **In balance sheet**
  - **Paid**
    Pro. Dividend A/c Dr
    To Bank A/c /
    Share capital A/c
  - **Waived**
    Pro. Dividend A/c Dr
    To reconstruction A/c
- **Out of balance sheet (in notes)**
  - **Paid**
    Reconstruction A/c Dr.
    To Bank A/c /
    Share capital A/c
  - **Waived**
    No entry

## SOME IMPORTANT CONCEPTS

1. **Writing off the accumulated losses, worthless intangible assets and other overvalued assets to the extent of over valuation.**

   The following Journal Entry will be passed in such regard:

   Capital Reduction A/c (Cr. Bal.) Dr.

   To Profit and loss A/c (Debit Bal.)

   To Preliminary Expenses A/c

   To Underwriting Commission A/c

   To Discount on issue of Shares / Debentures A/c

   To Goodwill A/c (To the extent of over valuation)

   To Patents A/c (To the extent of over valuation)

   To Copy Right A/c (To the extent of over valuation)

   To Other Overvalued Assets A/c (Individually)

   **Note:** Even if the question is silent as to writing off, the debit balance of Profit & Loss Account and items of Miscellaneous Expenditure (like Preliminary Expenses Underwriting Comm., Discount on issue of Shares / Debentures) should be written off to the extent of credit balance available in Reconstruction / Capital Reduction Account.

2. **Credit Balance of Capital Reduction A/c (or Reconstruction A/c):**

   The credit balance if any, left in the Capital Reduction A/c (or Reconstruction A/c) should be transferred to the Capital Reserve A/c.

   Capital Reduction A/c (or Reconstruction A/c) Dr.

   To Capital Reserve A/c

   **Note:**

   **a.** The author recommends the use of 'Reconstruction Account' particularly when the scheme of compromise / arrangement is carried out under the provisions of Sections 230 to 240. The use of Capital Reduction Account is purely justified when the capital reduction scheme is carried out without invoking the provisions of Sections 230 to 240.

   **b.** So far as Fixed Assets are concerned, the amount written off under a scheme of reconstruction must be shown in each Balance Sheet for five years.

Dr. Reconstruction A/c Cr.

| Particulars | Amount | Particulars | Amount |
|---|---|---|---|
| To Assets A/c (Downwards) | XXX | By E.s.c A/c | XXX |
| | | By P.s.c. A/c | XXX |
| To Liability (Reassessment upward) | XXX | By Asset A/c (Upward) | XXX |
| To Cash A/c (Unrecorded liability) | XXX | By Liability A/c (Downward revaluation) | XXX |
| To Profit or loss A/c | XXX | By Cash A/c (Unrecorded Asset sale) | XXX |
| To Preliminary expense A/c | XXX | | |
| To Underwriting commission A/c | XXX | | |
| To Discount on issue of shares A/c | XXX | | |
| To Goodwill A/c | XXX | | |
| To Patents A/c | XXX | | |
| To Capital reserve A/c (bal. fig) | XXX | | |
| | XXX | | XXX |

## PROBLEMS FOR CLASSROOM DISCUSSION

**Problem 1: (PRINTED SOLUTION AVAILABLE) Basic Level:** The following scheme of reconstruction has been approved for Win Limited:



1. The shareholders to receive in lieu of their present holding at 1,00,000 shares of Rs. 10 each, the following:
   a) New fully paid Rs. 10 Equity shares equal to 3/5th of their holding.
   b) 10% Preference shares fully paid to the extent of 1/5th of the above new equity shares.
   c) Rs. 40,000, 8% Debentures.
2. An issue of Rs. 1 lakh 10% first debentures was made and allotted, payment for the same being received in cash forthwith.
3. Goodwill which stood at Rs. 1,40,000 was completely written off.
4. Plant and machinery which stood at Rs. 2,00,000 was written down to Rs. 1,50,000.
5. Freehold property which stood at Rs. 1,50,000 was written down by Rs. 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. **(PM)**

**Note:**______________________________

**Problem 2: Moderate level:** The following is the summarised Balance Sheet of Weak Ltd. as on 31.3.2015:

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

The following scheme of reorganization is sanctioned:

1. All the existing equity shares are reduced to Rs. 40 each.
2. All preference shares are reduced to Rs. 60 each.
3. The rate of interest on debentures is increased to 12%. The debenture holders surrender their existing debentures of Rs. 100 each and exchange the same for fresh debentures of Rs. 70 each for every debenture held by them.
4. One of the creditors of the company to whom the company owes Rs. 20,00,000 decides to forgo 40% of his claim. He is allotted 30,000 equity shares of Rs. 40 each in full satisfaction of his claim.
5. Fixed assets are to be written down by 30%.
6. Current assets are to be revalued at Rs. 45,00,000.
7. The taxation liability of the company is settled at Rs. 1,50,000.
8. Investments to be brought to their market value.
9. 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. **(PM)***(Ans: Balance sheet total Rs.1,40,50,000)*

**(Solve problem no 1 & 4 of assignment problems as rework)**

**Note:**________________________________________________________________

**Problem 3: Debentures, Directors loan and Penalty for Contractual Commitments:** The Balance sheet of M/s Clean Ltd. as on 31st March, 2015 was summarized as follows:

| Liabilities | Rs. | Assets | Rs. |
|---|---|---|---|
| Equity shares of Rs. 50 each fully paid | 60,00,000 | Land & Buildings | 75,00,000 |
| 9% preference shares of Rs. 10 each fully paid up | 40,00,000 | Plant and machinery | 22,00,000 |
| 7% debentures(Secured by plant & machinery) | 23,00,000 | Inventories | 9,50,000 |
| 8% debentures | 17,00,000 | Trade receivable | 18,00,000 |
| Trade payables | 6,00,000 | Cash and bank balances | 3,60,000 |
| Provision for tax | 75,000 | Profit & Loss A/c | 2,15,000 |
| | **1,46,75,000** | | **1,46,75,000** |

The Board of Directors of the company decided upon the following scheme of reconstruction duly approved by all concerned parties:

1. The equity shareholders agreed to receive in lieu of their present holding of 1,20,000 shares of Rs.50 each as under:
   a. New fully paid equity shares of Rs.10 each equal to 2/3$^{rd}$ of their holding
   b. 9% preference shares of Rs..8 each to the extent of 25% of the above new equity share equal.
   c. Rs.2,80,000, 10% debentures of Rs.80 each.
2. The preference shareholders agreed that their Rs.10 shares should be reduced to Rs.8 by cancellation of Rs.2 per share. They also agreed to subscribe for two new equity shares of Rs.10 each for every five preference shares held.
3. The taxation liability of the company is settled at Rs.66,000 and the same is paid immediately.

**4.** One of the trade creditors of the company to whom the company owes Rs.1,00,000 decides to forgo 30% of his claim. He is allotted equity shares of Rs.10 each in full satisfaction of his balance claim.

**5.** Other trade creditors of Rs.5,00,000 are given option of their to accept fully paid 9% preference shares of Rs.8 each for the amount due to them or to accept 80% of the amount due to them in cash in full settlement of their claim. Trade creditors for Rs.3,50,000 accepted preference shares option and rest of them opted for cash towards full settlement of their claim.

**6.** Company's contractual commitments amounting to Rs.6,50,000 have been settled by paying 4% penalty of contract value.

**7.** Debenture holders having charge on plant and machinery accepted plant and machinery in full settlement of their dues.

**8.** The rate of interest on 8% debentures is increased to 10%. The debenture holders surrender their existing debenture of Rs.50 each and agreed to accept 10% debenture of Rs.80 each for every two debentures held by them.

**9.** The land and building to be depreciated by 5%.

**10.** The debit balance of profit and loss account is to be eliminated.

**11.** 1/4th of trade receivables and 1/5th of inventory to the written off.

Pass Journal entries and prepare Balance Sheet after completion of the reconstruction scheme in the books of M/s Clean Ltd. as per Schedule – III to the Companies Act, 2013.

**(Nov - 15)** ***(Ans.:Capital reserve - 47,73,000 Balance sheet Total - 1,26,33,000)***
**(Solve problem no 2 of assignment problems as rework)**

**Note:**



**Problem 4:** **(PRINTED SOLUTION AVAILABLE) Party wise settlement of Debentures and creditors:** Repair Ltd. is in the hands of a receiver for debenture holders who holds a charge on all assets except uncalled capital. The following statement shows the position as regards creditors as on 30th June, 2015:

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

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

The following scheme of reconstruction is proposed:

**1.** A is to cancel Rs.2,10,000 of the total debt owing to him, to bring Rs. 30,000 in cash and to take first debentures (in cancellation of those already issued to him) for Rs.5,10,000 in satisfaction of all his claims.

**2.** B is to accept Rs.90,000 in cash in satisfaction of all claims by him.

**3.** In full settlement of 75% of the claim, unsecured creditors (other than A and B) agreed to accept four shares of Rs.7.50 each, fully paid against their claim for each share of Rs.60.

The balance of 25% is to be postponed and to be payable at the end of three years from the date of Court's approval of the scheme. The nominal share capital is to be increased accordingly.

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

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

**Note:**____________________________________________________________

**Problem 5: Party wise settlement of Debentures:** M/s Platinum Limited has decided to reconstruct the Balance Sheet since it has accumulated huge losses. The following is the Balance Sheet of the company as on 31st March, 2014 before reconstruction:

| Liabilities | Amount (Rs.) | Assets | Amount (Rs.) |
|---|---|---|---|
| Share Capital<br>50,000 shares of Rs. 50 each fully paid up | 25,00,000 | Goodwill | 22,00,000 |
| 1,00,000 shares of Rs. 50 each Rs. 40 paid up | 40,00,000 | Land & Buildings | 42,70,000 |
| Capital Reserve | 5,00,000 | Machinery | 8,50,000 |
| 8% Debentures of Rs. 100 each | 4,00,000 | Computers | 5,20,000 |
| 12% Debentures of Rs. 100 each | 6,00,000 | Inventories | 3,20,000 |
| Trade Creditors | 12,40,000 | Trade receivables | 10,90,000 |
| Outstanding Expenses | 10,60,000 | Cash at Bank | 2,68,000 |
| | | Profit & Loss Account | 7,82,000 |
| | **1,03,00,000** | | **1,03,00,000** |

Following is the interest of Mr. Shiv and Mr. Ganesh in M/s Platinum Limited:

| | Mr. Shiv | Mr. Ganesh |
|---|---|---|
| 8% Debentures | 3,00,000 | 1,00,000 |
| 12% Debentures | 4,00,000 | 2,00,000 |
| **Total** | **7,00,000** | **3,00,000** |

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

**1.** Uncalled capital is to be called up in full and then all the shares to be converted into Equity Shares of Rs. 40 each.

**2.** The existing shareholders agree to subscribe in cash, fully paid up equity shares of 40 each for Rs. 12,50,000.

**3.** Trade Creditors are given option of either to accept fully paid equity shares of Rs. 40 each for the amount due to them or to accept 70% of the amount due to them in cash in full settlement of their claim. Trade Creditors for Rs. 7,50,000 accept equity shares and rest of them opted for cash towards full and final settlement of their claim.

**4.** Mr. Shiv agrees to cancel debentures amounting to Rs. 2,00,000 out of total debentures due to him and agree to accept 15% Debentures for the balance amount due. He also agree to subscribe further 15% Debentures in cash amounting to Rs. 1,00,000.

**5.** Mr. Ganesh agrees to cancel debentures amounting to Rs. 50,000 out of total debentures due to him and agree to accept 15% Debentures for the balance amount due.

6. Land & Building to be revalued at Rs. 51,84,000, Machinery at Rs. 7,20,000, Computers at Rs. 4,00,000, Inventories at Rs. 3,50,000 and Trade receivables at 10% less to as they are appearing in Balance Sheet as above.
7. Outstanding Expenses are fully paid in cash.
8. Goodwill and Profit & Loss A/c will be written off and balance, if any, of Capital Reduction A/c will be adjusted against Capital Reserve.

You are required to pass necessary Journal Entries for all the above transactions and draft the company's Balance Sheet immediately after the reconstruction. **(PM)**

*(Ans: Balance sheet Total Rs.88,50,000)*

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

**Note:**____________________________________________

## ASSIGNMENT PROBLEMS

**Problem 1: Moderate level:** The Balance Sheet of Vaibhav Ltd. as on 31st March 2014 is as follows:

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



The following scheme of Internal Reconstruction is sanctioned:

1. All the existing equity shares are reduced to Rs. 40 each.
2. All preference shares are reduced to Rs. 60 each.
3. The rate of Interest on Debentures increased to 6%. The Debenture holders surrender their existing debentures of Rs. 100 each and exchange the same for fresh debentures of Rs. 70 each for every debenture held by them.
4. Fixed assets are to be written down by 20%.
5. Current assets are to be revalued at Rs. 90,00,000.
6. Investments are to be brought to their market value.
7. One of the creditors of the company to whom the company owes Rs. 40,00,000 decides to forgo 40% of his claim. The creditor is allotted with 60000 equity shares of Rs. 40 each in full and final settlement of his claim.
8. The taxation liability is to be settled at Rs. 3,00,000.
9. 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.

**(SM, Nov - 14)** *(Ans: Balance sheet Total Rs.3,06,00,000)*

<u>Problem 2:</u> **Arrears of Preference Dividend, Directors loan and Penalty for Contractual Commitments:** The Balance Sheet of M/s. Cube Limited as on 31-03-2015 is given below:

| Particulars | Note No. | Amount |
|---|---|---|
| **EQUITY & LIABILITIES:**<br>**Shareholders' Funds** | | |
| Shares' Capital | 1 | 700 |
| Reserves & Surplus | 2 | (261) |
| **Non-Current Liabilities:** | | |
| Long term Borrowings | 3 | 350 |
| **Current Liabilities:** | | |
| Trade Payables | 4 | 51 |
| Other Liabilities | 5 | 12 |
| **Total** | | **852** |
| **ASSETS:**<br>**Non-Current Assets**<br>**Fixed Assets:** | | |
| Tangible Assets | 6 | 375 |
| **Current Assets:** | | |
| Current Investments | 7 | 100 |
| Inventories | 8 | 150 |
| Trade Receivables | 9 | 225 |
| Cash & Cash Equivalents | 10 | 2 |
| **Total** | | **852** |



**Notes to Accounts:**

| Particulars | Note No. |
|---|---|
| **(1) Share Capital:** | |
| **Authorised:** | |
| 100 lakh shares of Rs. 10 each | 1,000 |
| 4 lakh, 8% Preference Shares of Rs. 100 each | 400 |
| | **1,400** |
| **Issued, Subscribed and paid up:** | |
| 50 lakh Equity Shares of Rs. 10 each, full paid up | 500 |
| 2 lakh 8% Preference Shares of Rs.100 each, fully paid up | 200 |
| | **700** |
| **(2) Reserves and Surplus:** | |
| Debit balance of Profit & Loss A/c | (261) |
| **(3) Long Term Borrowings:** | |
| 6% Debentures (Secured by Freehold Property) | 200 |
| Directors' Loan | 150 |
| | **350** |
| **(4) Trade Payables:** | |
| Trade payables for Goods | 51 |
| **(5) Other Current Liabilities:** | |
| Interest Accrued and Due on 6% Debentures | 12 |
| **(6) Tangible Assets:** | |
| Freehold Property | 275 |
| Plant & Machinery | 100 |

| | |
|---|---|
| | **375** |
| **(7) Current Investment:** | |
| Investment in Equity Instruments | 100 |
| **(8) Inventories:** | |
| Finished Goods | 150 |
| **(9) Trade Receivables:** | |
| Trade receivables for Goods | 225 |
| **(10) Cash and Cash Equivalents:** | |
| Balance with Bank | 2 |

The Board of Directors of the company decided upon the following scheme of reconstruction with the consent of respective shareholders:

1. Preference Shares are to be written down to Rs. 80 each and Equity Shares to Rs. 2 each.
2. Preference Shares Dividend in arrears for 3 years to be waived by 2/3rd and for balance 1/3rd, Equity Shares of Rs. 2 each to be allotted.
3. Debenture holders agreed to take one Freehold Property at its book value of Rs.150 lakh in part payment of their holding. Balance Debentures to remain as liability of the company.
4. Interest accrued and due on Debentures to be paid in cash.
5. Remaining Freehold Property to be valued at Rs. 200 lakh.
6. All investments sold out for Rs. 125 lakh.
7. 70% of Directors' loan to be waived and for the balance, Equity Shares of Rs. 2 each to be allowed.
8. 40% of Trade receivables and 80% of Inventories to be written off.
9. Company's contractual commitments amounting to Rs.300 lakh have been settled by paying 5% penalty of contract value.

**You are required to:**

a) Pass Journal Entries for all the transactions related to internal reconstruction;

b) Prepare Reconstruction Account; and

c) Prepare notes on Share Capital and Tangible Assets to Balance Sheet, immediately after the implementation of scheme of internal reconstruction. **(PM, May - 13)**

***(Ans: Reconstruction a/c balance Rs.143 lakhs)***



<u>**Problem 3:**</u> **Settlement of Debentures:** Green Limited had decided to reconstruct the Balance Sheet since it has accumulated huge losses. The following is the summarized **Balance Sheet of the Company on 31.3.2015 before reconstruction:**

| Liabilities | Rs. | Assets | Rs. |
|---|---|---|---|
| **Share Capital:**<br>**Authorised:** | | **Fixed Assets:** | |
| 1,50,000 Equity Shares of Rs.50 each | 75,00,000 | Goodwill | 20,00,000 |
| **Subscribed and Paid up Capital:** | | Building | 10,00,000 |
| 50,000 Equity Shares of Rs. 50 each | 25,00,000 | Plant | 10,00,000 |
| 1,00,000 Equity Shares of Rs. 50 each, Rs. 40 per share paid up | 40,00,000 | Computers | 25,00,000 |
| **Secured Loans:** | | Investments | Nil |
| 12% First Debentures | 5,00,000 | Current Assets | Nil |
| 12% Second Debentures | 10,00,000 | Profit and Loss A/c-Loss | 20,00,000 |
| **Current Liabilities:** | | | |
| Trade payables | 5,00,000 | | |
| | **85,00,000** | | **85,00,000** |

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

| Particulars | Mr. X (Rs.) | Mr. Y (Rs.) |
|---|---|---|
| 12% First Debentures | 3,00,000 | 2,00,000 |
| 12% Second Debentures | 7,00,000 | 3,00,000 |
| Trade payables | 2,00,000 | 1,00,000 |
| | **12,00,000** | **6,00,000** |
| Fully paid up Rs. 50 shares | 3,00,000 | 2,00,000 |
| Partly paid up shares (Rs. 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 Rs. 20 each.

**b)** Mr. X is to cancel Rs. 7,00,000 of his total debt (other than share amount) and to pay Rs.2 lakhs to the company and to receive new 14% First Debentures for the balance amount.

**c)** Mr. Y is to cancel Rs. 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. **(PM)**

***(Ans: Balance sheet total Rs.42,00,000)***



**Problem 4:** Following is the Draft Balance Sheet of ABC Ltd. Co. as at 31st March, 2015:

| Liabilities | Amount (Rs.) | Assets | Amount (Rs.) |
|---|---|---|---|
| **Share capital:** | | Plant and Machinery | 9,00,000 |
| 2,00,000 Equity shares of Rs.10 each fully paid up | 20,00,000 | Furniture and fixtures | 2,50,000 |
| 6,000 8% Preference Shares of Rs.100 each | 6,00,000 | Patents and copy rights | 70,000 |
| 9 % Debentures | 12,00,000 | Investments (at cost) (Market value Rs. 55,000) | 68,000 |
| Bank overdraft | 1,50,000 | Inventory | 14,00,000 |
| Trade Payable | 5,92,000 | Trade receivables | 14,39,000 |
| | | Cash and bank balance | 10,000 |
| | | Profit & Loss A/c | 4,05,000 |
| | **45,42,000** | | **45,42,000** |

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 Rs. 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 Rs.3,00,000 to augment its working capital requirement after settlement of bank overdraft.

Give necessary journal entries reflecting the above scheme of reconstruction in the books of the ABC Ltd. Co. **(SM)**

## ABC ANALYSIS

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

**Verified by:** GSR Sir,
Hari Narayana Sir
**Executed by**: Rajasekhar

## THE END