5

INTERNAL RECONSTRUCTION

Learning Objectives

After studying this chapter, you will be able to:

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

1. Meaning of Reconstruction

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

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

However, there may be external reconstruction. Wherever an undertaking is being carried on by a company and is in substance transferred, not to an outsider, but to another company consisting substantially of the same shareholders with a view to its being continued by the transferee company, there is external reconstruction. Such external reconstruction is essentially covered under the category ‘amalgamation in the nature of merger’ in AS-14.

1.1 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 494 of the Companies Act, 1956.

2. Methods of Internal Reconstruction

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

a) Alteration of share capital as per section 94, 95 and 97 of the Companies Act.

b) Variation of Shareholders' rights as per section 106 of the Companies Act, 1956.

c) Reduction of Share Capital as per Section 100 to 105 of the Companies Act, 1956.

d) Compromise/ Arrangement as per Section 391 to 393 and Section 394A of the companies Act.

e) Surrender of Shares.

2.1 Alteration of Share Capital

Sub-division and Consolidation of Shares:

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

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

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

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

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

Illustration 1

On 31-12-2XX9 B Ltd. had 20,000, Rs. 10 Equity Shares as authorised capital and the shares were all issued on which Rs. 8 was paid up. In June, 2X10 the company in general meeting decided to *sub-divide* each share into two shares of Rs. 5 with Rs. 4 paid up. In June, 2X11 the company in general meeting resolved to *consolidate* 20 shares of Rs. 5, Rs. 4 per share paid up into one share of Rs. 100 each, Rs. 80 paid up.

Pass entries and show how share capital will appear in the Balance Sheet as on 31-12-2XX9, 31-12-2X10 and 31-12-2X11.

Solution

Journal entries

2X10			*Rs.*	*Rs.*
June	Equity Share Capital (Rs. 10) A/c	Dr.	1,60,000	
	To Equity Share Capital (Rs. 5) A/c			1,60,000
	(Being the sub-division of 20,000 Rs. 10 shares with Rs. 8 paid up into 40,000			

	shares Rs. 5 each with Rs. 4 paid up by resolution in general meeting dated....)			
2X11				
June	Equity Share Capital (Rs. 5) A/c	Dr.	1,60,000	
	To Equity Share Capital (Rs. 100) A/c			1,60,000
	(Being consolidation of 40,000 shares of Rs. 5 with Rs. 4 paid up into 2,000 Rs. 100 shares with Rs. 80 paid up as per resolution in general meeting dated....)			

Balance Sheet *(includes)**

Liabilities:	Rs.
As on 31-12-2XX9	
1. Share Capital	
Authorised:	
20,000 Equity Shares of Rs. 10 each	2,00,000
Issued and Subscribed:	
20,000 Equity Shares of Rs. 10 each Rs. 8 per share called up	1,60,000
As on 31-12-2X10	
1. Share Capital	
Authorised:	
40,000 Equity Shares of Rs. 5 each	2,00,000
Issued and Subscribed:	
40,000 Equity Shares of Rs. 5 each Rs. 4 per share called up	1,60,000
As on 31-12-2X11	*Rs.*
Shareholders' funds	
Share Capital	
Authorised:	
2,000 Equity Shares of Rs. 100 each	2,00,000
Issued and Subscribed:	
20,000 Equity Shares of Rs. 100 each Rs. 80 per share called up	1,60,000

*Balance Sheet (extract) for the year 2X11 shall be prepared as per Revised Schedule VI wherein the share capital details need to be shown in notes to accounts, however this information has been shown in the balance sheet only.

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

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 94(c)]. 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 Rs. 5,00,000 authorised capital on 31-12-2XX9 divided into shares of Rs. 100 each out of which 4,000 shares were issued and fully paid up. In June 2X10 the Company decided to *convert* the issued shares into stock. But in June, 2X11 the Company *re-converted* the stock into shares of Rs. 10 each fully paid up.

Pass entries and show how Share Capital will appear in Balance Sheet as on 31-12-2XX9, 31-12-2X10 and 31-12-2X11.

Solution

Journal Entries

2X10			*Rs.*	*Rs.*
June	Equity Share Capital A/c	Dr.	4,00,000	
	To Equity Stock A/c			4,00,000
	(Being conversion of 4,000 fully paid Equity Shares of Rs. 100 into Rs. 4,00,000 Equity Stock as per resolution in general meeting dated...)			
2X11				
June	Equity Stock A/c	Dr.	4,00,000	
	To Equity Share Capital A/c			4,00,000
	(Being re-conversion of Rs. 4,00,000 Equity Stock into 40,000 shares of Rs. 10 fully paid Equity Shares as per resolution in General Meeting dated...)			

Balance Sheet [*] (includes)

Liabilities :	
As on 31-12-2XX9	*Rs.*
1. Share Capital	
Authorised	
5,000 Equity Shares of Rs. 100 each	5,00,000
Issued and Subscribed	
4,000 Equity Shares of Rs. 100 each fully called up	4,00,000
As on 31-12-2X10	*Rs.*
1. Share Capital	
Authorised	
5,000 Equity Shares of Rs. 100 each	5,00,000
Issued and Subscribed	
Equity Stock-4,000 Equity Shares of Rs. 100 converted into Stock	4,00,000
As on 31-12-2X11	*Rs.*
Shareholders' funds	
Share Capital	
Authorised	
50,000 Equity Shares of Rs. 10 each	5,00,000
Issued and Subscribed	
40,000 Equity Shares of Rs. 10 each fully called up	4,00,000

2.2 Variation of Shareholders Rights

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.

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

---

[*] Balance Sheet (extract) for the year 2011 shall be prepared as per Revised Schedule VI wherein the share capital details need to be shown in notes to accounts, however, this information has been shown in balance sheet only.

2.3 Reduction of Share Capital

Section 100 of the Companies Act lays down the procedure in respect of reduction of share capital. One way of doing this is reducing the paid-up capital. The share capital of a company which 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.) ***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 Rs. 100 per share to paid value of Rs. 10 per share. The sacrifice is Rs. 90 and the entry will be

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

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

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

2.4 Compromise/Arrangements

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

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

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

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

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

2.5 Surrender of Shares

The shareholders are made to surrender there shares. These shares are then allotted to debenture holders and creditors so that their liabilities are reduced. The unutilized surrendered shares are then cancelled.

3. Entries in Case of Internal Reconstruction

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

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

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

(*a*) After the name of the company, the words **"and Reduced"** should be added *only* if the Court so orders.

(*b*) In case of fixed assets, the amount written off under the scheme of reconstruction must be shown for five years.

Illustration 3

The Balance Sheet of A & Co. Ltd. as on 31-12-2011 is as follows:

Assets	*Rs.*	*Rs.*
Fixed Assets:		
Freehold property	4,25,000	
Plant	50,000	
Patent	37,500	

Goodwill	1,30,000	6,42,500
Traded Investments (at cost)		55,000
Current Assets:		
Debtors	4,85,000	
Stock	4,25,000	
Deferred Advertising	1,00,000	10,10,000
Profit and Loss Account		4,35,000
Total		21,42,500
Liabilities		
Share Capital:		
4,000 6% Cumulative Preference Shares of Rs. 100 each	4,00,000	
75,000 Equity Shares of Rs. 10 each	7,50,000	11,50,000
6% Debentures (Secured on Freehold Property)	3,75,000	
Accrued Interest	22,500	3,97,500
Current Liabilities:		
Bank Overdraft	1,95,000	
Creditors	3,00,000	
Directors' Loans	1,00,000	5,95,000
Total		21,42,500

The Court approved a Scheme of re-organisation to take effect on 1-1-2012, whereby:

(*i*) The Preference Share to be written down to Rs. 75 each and Equity Shares to Rs. 2 each.

(*ii*) Of the Preference Share dividends which are in arrears for four years, three fourths to be waived and Equity Shares of Rs. 2 each to be allotted for the remaining quarter.

(*iii*) Accrued interest on debentures to be paid in cash.

(*iv*) Debenture-holders agreed to take over freehold property, book value Rs. 1,00,000 at a valuation of Rs. 1,20,000 in part repayment of their holdings and to provide additional cash of Rs. 1,30,000 secured by a floating charge on company's assets at an interest rate of 8% p.a.

(*v*) Patents, Goodwill and Deferred Advertising to be written off.

(*vi*) Stock to be written off by Rs. 65,000.

(*vii*) Amount of Rs. 68,500 to be provided for bad debts.

(*viii*) Remaining freehold property to be re-valued at Rs. 3,87,500.

(*ix*) Trade Investments be sold for Rs. 1,40,000.

(*x*) Directors to accept settlement of their loans as to 90% thereof by allotment of equity shares of Rs. 2 each and as to 5% in cash, and balance 5% being waived.

(*xi*) There were capital commitments totalling Rs. 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.
			Rs.	Rs.
2011				
Dec. 31	Equity Share Capital A/c (Rs. 10)	Dr.	7,50,000	
	To Capital Reduction A/c			6,00,000
	To Equity Share Capital A/c (Rs. 2)			1,50,000
	(Reduction of equity shares of Rs. 10 each to shares of Rs. 2 each as per Reconstruction Scheme dated...)			
	6% Cum. Preference Share CapitalA/c (Rs. 100)	Dr.	4,00,000	
	To Capital Reduction A/c			1,00,000
	To Pref. Share Capital A/c (Rs. 75)			3,00,000
	(Reduction of preference shares of Rs. 100 each to shares of Rs. 75 each as per reconstruction scheme)			
2011				
Dec. 31	Freehold Property A/c	Dr.	82,500	
	To Capital Reduction A/c			82,500
	(Appreciation in the value of property:			
	Book value — Revalued Figure			
	Rs. 1,00,000 — Rs. 1,20,000			
	Rs. 3,25,000 — Rs. 3,87,500			
	Total Rs. 4,25,000 — Rs. 5,07,500			
	Profit on revaluation: Rs. 82,500)			

”	6% Debentures A/c	Dr.	1,20,000	
	To Freehold Property A/c			1,20,000
	(Claims of debenture-holders, in part, in respect of principal discharged by transfer of freehold property vide Scheme of Reconstruction)			
	Accrued Interest A/c	Dr.	22,500	
	To Bank A/c			22,500
	(Debenture interest paid)			
”	Bank A/c	Dr.	1,30,000	
	To 8% Debentures A/c			1,30,000
	(8% Debentures issued for cash)			
”	Bank A/c	Dr.	1,40,000	
	To Trade Investment A/c			55,000
	To Capital Reduction A/c			85,000
	(Sale of Trade Investment for Rs. 1,40,000 cost being Rs. 55,000; profit credited to Capital Reduction Account)			
”	Directors' Loan A/c	Dr.	1,00,000	
	To Equity Share Capital A/c			90,000
	To Bank A/c			5,000
	To Capital Reduction A/c			5,000
	(Directors' loan discharged by issue of equity shares of Rs. 90,000, cash payments of Rs. 5,000 and surrender of Rs. 5,000, vide Scheme of Reconstruction)			
Dec. 31	Capital Reduction Account	Dr.	24,000	
	To Equity Share Capital Account			24,000
	(Arrears of preference dividends satisfied by the issue of equity shares, 25% of the amount due, Rs. 96,000)			
”	Capital Reduction A/c	Dr.	8,48,500	
	To Patents			37,500
	To Goodwill			1,30,000
	To Deferred Advertising			1,00,000

To Stock	65,000
To Provision for Doubtful Debts	68,500
To Bank	12,500
To Profit & Loss Account	4,35,000
(Writing off patents, goodwill, deferred advertising, profit and loss account and reducing the value of stock, making the required provision for doubtful debts and payment for cancellation of capital commitments)	

Balance Sheet of A & Co. Ltd. (And Reduced) as on 1st January, 2012

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	5,64,000
2		**Non-current liabilities**		
	a	Long-term borrowings	2	3,85,000
3		**Current liabilities**		
	A	Trade Payables		3,00,000
		Total		**12,49,000**
		Assets		
1		**Non-current assets**		
	A	Fixed assets		
		Tangible assets	3	4,37,500
		Intangible assets	4	-
2		**Current assets**		
	A	Inventories		3,60,000
	B	Trade receivables	5	4,16,500
	C	Cash and cash equivalents		35,000
		Total		**12,49,000**

Notes to accounts

1 Share Capital

Equity share capital	
1,32,000 Equity shares of Rs. 2 each	2,64,000
(Of the above 45,000 shares have been issued for consideration other than cash)	

	Preference share capital		
	4,000 6% Preference shares of Rs. 75 each		3,00,000
	Total		**5,64,000**
2	**Long-term borrowings**		
	Secured		
	6% Debentures		2,55,000
	8% Debentures		1,30,000
	Total		**3,85,000**
3	**Tangible assets**		
	Fixed assets		
	Tangible assets		
	Freehold property	4,25,000	
	Add: Appreciation under scheme of Reconstruction	82,500	
	Less: Disposed of	(1,20,000)	3,87,500
	Plant		50,000
	Patents	37,500	
	Less: written off under scheme of Reconstruction	(37,500)	-
	Net carrying value		**4,37,500**
4	**Intangible assets**		
	Goodwill	1,30,000	
	Less: written off under scheme of Reconstruction	(1,30,000)	
	Net carrying value	-	-
5	**Trade receivables**		
	Trade receivables	4,85,000	
	Less: Provision for Doubtful Debt	(68,500)	**4,16,500**

Illustration 4

Given below is the summarized balance sheet of Rebuilt Ltd. as on 31.3.2012:

Liabilities	Amount Rs.	Assets	Amount Rs.
Authorised and issued capital:		Building at cost less depreciation	4,00,000
12,000, 7% Preference shares of		Plant at cost less	2,68,000

Rs. 50 each(Note: Preference dividend is in arrear for five years)	6,00,000	depreciation	
15,000 Equity shares of Rs. 50 each	7,50,000	Trademarks and goodwill at cost	3,18,000
	13,50,000	Stock	4,00,000
Loan	5,73,000	Debtors	3,28,000
Sundry creditors	2,07,000	Preliminary expenses	11,000
Other liabilities	35,000	Profit and loss A/c	4,40,000
	21,65,000		21,65,000

The Company is now 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 Rs. 50 shares should be reduced to Rs. 2.50 by cancellation of Rs. 47.50 per share. They have also agreed to subscribe for three new equity shares of Rs. 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 Rs. 50 share, 4 new 5% preference shares of Rs. 10 each, plus 6 new equity shares of Rs. 2.50 each, all credited as fully paid.

(c) Lenders to the company for Rs. 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 Rs. 10 each and 12,000 new equity shares of Rs. 2.50 each.

(d) The directors have agreed to subscribe in cash for 40,000, new equity shares of Rs. 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, Rs.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 preliminary expenses;

   ii. to write off the debit balance in the profit and loss A/c; and

   iii. to write off Rs. 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 Rs.6,50,000 for preference share capital and Rs.7,50,000 for equity share capital.

Solution

In the books of Rebuilt Ltd.

Journal Entries

	Particulars		Debit (Rs.)	Credit (Rs.)
1.	Equity share capital A/c (Rs.50)	Dr.	7,50,000	
	To Equity share capital A/c (Rs. 2.50)			37,500
	To Reconstruction A/c			7,12,500
	(Being equity capital reduced to nominal value of Rs.2.50 each)			
2.	Bank A/c	Dr.	1,12,500	
	To Equity share capital			1,12,500
	(Being 3 right shares against each share was issued and subscribed)			
3.	7% Preference share capital A/c (Rs.50)	Dr.	6,00,000	
	Reconstruction A/c	Dr.	60,000	
	To 5% Preference share capital (Rs.10)			4,80,000
	To equity share capital (Rs.50)			1,80,000
	(Being 7% preference shares of Rs.50 each converted to 5% preference shares of Rs.10 each and also given to them 6 equity shares for every share held)			
4.	Loan A/c	Dr.	1,50,000	
	To 5% Preference share capital A/c			1,20,000
	To Equity share capital A/c			30,000
	(Being loan to the extent of Rs.1,50,000 converted into share capital)			
5.	Bank A/c	Dr.	1,00,000	
	To Equity share application money A/c			1,00,000
	(Being shares subscribed by the directors)			

6.	Equity share application money A/c	Dr.	1,00,000	
	To Equity share capital A/c			1,00,000
	(Being application money transferred to capital A/c)			
7.	Loan A/c	Dr.	2,00,000	
	To Bank A/c			2,00,000
	(Being loan repaid)			
8.	Reconstruction A/c	Dr.	6,52,500	
	To Preliminary expenses A/c			11,000
	To Profit and loss A/c			4,40,000
	To Plant A/c			35,000
	To Trademarks and Goodwill A/c (Bal.fig.)			1,66,500
	(Being losses and assets written off to the extent required)			

Balance sheet of Rebuilt Ltd. (and reduced)
as on 31.3.2012

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	10,60,000
2		**Non-current liabilities**		
	a	Long-term borrowings		2,23,000
3		**Current liabilities**		
	a	Trade Payables		2,07,000
	b	Other current liabilities		35,000
		Total		**15,25,000**
		Assets		
1		**Non-current assets**		
	a	Fixed assets		
		Tangible assets	2	6,33,000
		Intangible assets	3	1,51,500
2		**Current assets**		
	a	Inventories		4,00,000

b	Trade receivables		3,28,000
c	Cash and cash equivalents	4	12,500
	Total		**15,25,000**

Notes to accounts

			Rs.
1	**Share Capital**		
	Authorised capital:		
	65,000 Preference shares of Rs. 10 each	6,50,000	
	3,00,000 Equity shares of Rs. 2.50 each	7,50,000	14,00,000
	Issued, subscribed and paid up:		
	1,80,000 equity shares of Rs. 2.5 each	4,60,000	
	60,000, 5% Preference shares of Rs. 10 each	6,00,000	
	Total		**10,60,000**
2	**Tangible assets**		
	Building at cost less depreciation	4,00,000	
	Plant at cost less depreciation	2,33,000	6,33,000
3.	**Intangible assets**		
	Trademarks and goodwill		1,51,500
4	**Cash and cash equivalents**		
	Bank (1,12,500+1,00,000-2,00,000)		12,500

Illustration 5

Repair Ltd. is in the hands of a receiver for debenture holders who holds a charge on all assets except uncalled capital. The following statement shows the position as regards creditors as on 30th June, 2012:

Liabilities	Rs.	Assets	Rs.
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		
Second debentures	6,00,000	Estimated at	1,50,000
Unsecured creditors	4,50,000	Cash in hand of the receiver	2,70,000

		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 creditor 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.

Solution

Journal Entries

Particulars		Debit (Rs.)	Credit (Rs.)
First debentures A/c	Dr.	3,00,000	
Second debentures A/c	Dr.	3,00,000	
Unsecured creditors A/c	Dr.	90,000	
To A's A/c			6,90,000
(Being A's total liability ascertained)			
A's A/c	Dr.	2,10,000	
To Reconstruction A/c			2,10,000
(Being cancellation of debt upto Rs.2,10,000)			
Bank A/c	Dr.	30,000	
To A's A/c			30,000
(Being cash received in course of settlement)			

A's A/c To First debentures A/c (Being liability of A, discharged against first debentures)	Dr.	5,10,000	 5,10,000
Second debentures A/c Unsecured creditors A/c To B's A/c (Being B's liability ascertained)	Dr. Dr.	3,00,000 60,000	 3,60,000
B's A/c To Bank A/c To Reconstruction A/c (Being B's liability discharged)	Dr.	3,60,000	 90,000 2,70,000
Unsecured creditors A/c To Equity share capital A/c To Loan (Unsecured) A/c To Reconstruction A/c (Being settlement of unsecured creditors)	Dr.	3,00,000	 1,12,500 75,000 1,12,500
Share call A/c To Share capital A/c (Being final call money due)	Dr.	1,80,000	 1,80,000
Bank A/c To Share call A/c (Being final call money received)	Dr.	1,80,000	 1,80,000
Share capital A/c (Face value Rs.60) To Share capital (Face value Rs. 7.50) To Reconstruction A/c (Being share capital reduced to Rs.7.50 each)	Dr.	3,60,000	 45,000 3,15,000
Reconstruction A/c To Profit and loss A/c (Being reconstruction surplus used to write off losses)	Dr.	8,70,000	 8,70,000

Working Notes:

1. Settlement of claim of remaining unsecured creditors

	Rs.
75% of Rs.3,00,000	2,25,000
Considering their claim for share of Rs.60 each	
2,25,000/60 =3,750 shares	
Less: Number of shares to be issued	
3,750 x 4= 15,000 shares of Rs.7.5 each	
Total value= 15,000 x 7.50	1,12,500
Transferred to Reconstruction A/c	1,12,500

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

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

Summary

1. Reconstruction is a process by which affairs of a company are reorganized by revaluation of assets, reassessment of liabilities and by writing off the losses already suffered by reducing the paid up value of shares and/or varying the rights attached to different classes of shares.
2. Reconstruction account is a new account opened to transfer the sacrifice made by the shareholders for that part of capital which is not represented by lost assets.
3. Reconstruction account is utilized for writing-off fictitious and intangible 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.