4 INTERNAL RECONSTRUCTION

THEORY AND ILLUSTRATIONS

OUTLINE

No.	Topic	Page
1.	**Internal Reconstruction**	207
	1.1 Need	
	1.2 Internal Reconstruction V/s External Reconstruction	207
2.	**Reconstruction Scheme**	208
3.	**Methods**	208
4.	**Legal Procedure**	
	4.1 Alteration of Share Capital	
	4.2 Variation of Shareholders' Rights	
	4.3 Reduction of Share Capital	
	4.4 Surrender of Shares	
	4.5 Compromise & Arrangement	211
5.	**Accounting Procedure**	
	5.1 Accounting Situations	
	5.2 Entries on Internal Reconstruction	
	5.3 Pro-forma Capital Reduction/Reconstruction Account	
	5.4 Balance Sheet After Reconstruction	216
6.	**Illustrations**	
	6.1 Case Studies	
	6.2 Journal + Capital Reduction Account	
	6.3 Journal + Capital Reduction Account + Balance Sheet	
	6.4 Capital Reduction Account and / or Balance Sheet	
7.	**Rapid Revision Before Exam.**	262

1. INTERNAL RECONSTRUCTION

1.1 NEED

(1) **Final Accounts, Not True & Fair:** When an existing company has been making losses for a long time, its Final Accounts no longer show the true and fair picture of the financial position of the company. The figures of Assets, Liabilities and Capital shown in the Balance Sheet do not reflect the actual state of affairs of the company as explained below.

(2) **Assets :** The Assets side of the Balance Sheet of a loss-making or sick company shows many Intangible or Fictitious Assets. There may be a heavy debit balance in the Profit & Loss Account due to accumulated losses of past years. Preliminary Expenses, Unamortized (Deferred) Revenue Expenditure etc. may not be written off in absence of profits. Goodwill A/c in such a company represents a purely fictitious asset, because a sick company cannot boast of having any 'Goodwill'. The tangible or Real Assets are also shown at unreasonable high values. Due to losses, the company may not have provided adequate amount of depreciation resulting in inflating the book values of the Fixed Assets. The Current Assets like Inventory or Sundry Debtors may also be overstated in the Balance Sheet. Inventory may be valued at cost though the market price is lower than the cost. No provision might be made for bad and doubtful debts. In short, the Asset side of the Balance Sheet of a sick company shows the assets at much higher values than the real values.

(3) **Liabilities :** The Secured Loans of a sick company, such as Loans from Banks or Debentures may not be repaid though overdue. Interest on such Loans or on Debentures may be in arrears for a long time. Creditors may not have been paid in time. Company may have avoided recording some liabilities by showing the same as contingent liabilities. Preference dividends on Cumulative Preference Shares may be in arrears for several years.

(4) **Capital :** When a sick company shows assets at inflated values and the Liabilities are not paid in time or not provided at all, naturally Capital (which is Assets - Liabilities) is also shown at much higher figure than justified by the actual facts. The Capital of a sick company no longer reflects the real value of the net assets of the company.

(5) **Reconstruction:** Continuous losses damage the basic structure of a company. The pillars supporting the operations of the company - Assets and Capital - become weak due to the accumulated losses. If this is allowed to continue, the company may ultimately collapse. The company has to be 'reconstructed' and put on a firm foundation to ensure stability in future. Such reconstruction may be done in two ways - 'External Reconstruction' or 'Internal Reconstruction'. Internal 'Reconstruction' is a comprehensive plan designed to renovate a company and give it a new lease of life.

1.2 EXHIBIT 1 : INTERNAL RECONSTRUCTION V/S EXTERNAL RECONSTRUCTION

No.	Internal Reconstruction (IR)	External Reconstruction (ER)
(1)	Company is not liquidated.	Company is liquidated.
(2)	Rights of shareholders and creditors are altered.	A new company is formed to take over the business of the liquidated company.
(3)	IR involves reduction of capital and/or liabilities.	ER does not involve reduction in capital.
(4)	IR is governed by S. 66 of the Companies Act, 2013 w.e.f. 15-12-2016.	ER is governed by the Insolvency and Bankruptcy Code, 2016 w.e.f. 15-11-2016.

2. RECONSTRUCTION SCHEME

An Internal Reconstruction or Capital Reduction scheme covers the entire area of assets, liabilities and capital of a company. The scheme, in essence, involves writing down the assets to their true values by reducing the capital and in some cases reducing the external liabilities. The scheme expects all the participants to make some sacrifice. The shareholders may have to accept reduction in the

paid up value of the share capital. For example, ₹ 10 paid up shares may be reduced to ₹ 5 paid up shares. The Debentureholders, Preference Shareholders, Creditors etc. may have to give up their claims to some extent. If Debentures or other liabilities are required to be actually paid, shareholders may have to bring in cash by taking up more shares or by paying balance amount on partly paid up shares.

The amounts becoming available through such sacrifices are utilised to write off the accumulated losses, preliminary expenses, Goodwill etc. The Fixed Assets, Investments and the Current Assets like Inventory and Sundry Debtors are brought down to their real values. Once the Reconstruction is complete, the values of Assets, Liabilities and the Capital in the Balance Sheet of the Company will reflect the 'true and fair' financial position of the company.

Such scheme may involve (a) alteration of share capital (b) variation of shareholders rights (c) reduction of share capital (d) compromise arrangement with creditors.

3. METHODS

(1) **Alteration of Share Capital:** If the scheme involves alteration of share capital, i.e. increase, consolidation or sub-division of share capital, the company has to follow the provisions of **Section 61 and 64** of Companies Act, 2013.

(2) **Variation of Shareholders' Rights:** If the scheme involves variation of the shareholders' rights, the company has to follow the provisions of **Section 48** of Companies Act, 2013.

(3) **Reduction of Share Capital:** If the scheme involves reduction of paid-up capital, the company has to follow the procedure laid down under **Section 66** of Companies Act, 2013. The scheme has to be approved by the shareholders and in cases involving sacrifice on their part, also by the creditors. Capital Reduction can be carried out only after the scheme is approved by Tribunal.

(4) **Compromise/Arrangement:** If the scheme involves compromise/arrangement with the creditors or shareholders, the company has to follow the provisions of **Sections 230-232** of Companies Act, 2013.

4. LEGAL PROCEDURE

4.1 ALTERATION OF SHARE CAPITAL

According to **Section 61** of Companies Act, 2013 a limited company having a share capital, may, if so authorised by its articles, alter the share capital in any of the following ways :

(a) *increase* its share capital by issuing new shares;

(b) *consolidate* its share capital into shares of larger amount than its existing shares;

(c) *convert* its fully paid up shares into stock;

(d) *reconvert* that stock into fully paid up shares of any denomination;

(e) *sub-divide* its shares into shares of smaller amount than is fixed by the memorandum; [however, in such sub-division, there will be no change in the proportion between the amount paid and the amount, if any, unpaid on each reduced share as compared to the original share];

(f) *cancel* shares which till date not been taken or agreed to be taken by any person, and reduce the amount of its share capital by the amount of the un-issued shares so cancelled.

4.2 VARIATION OF SHAREHOLDERS' RIGHTS

S. 48 of the Companies Act, 2013 states that -

1. Where a share capital of the company is divided into different classes of shares, the rights attached to the shares of any class may be varied with the consent in writing of the holders of not less than three-fourths of the issued shares of that class or by means of a special resolution passed at a separate meeting of the holders of the issued shares of that class,

(a) if provision with respect to such variation is contained in the memorandum or articles of the company, or

(b) in the absence of any such provision in the memorandum or articles, if such variation is not prohibited by the terms of issue of the shares of that class.

Provided that if variation by one class of shareholders affects the rights of any other class of shareholders, the consent of three-fourths of such other class of shareholders shall also be obtained and the provisions of this section shall apply to such variation.

2. Where the holders of not less than ten percent of the issued shares of a class did not consent to such variation or vote in favour of the special resolution for the variation, they may apply to the Tribunal to have the variation cancelled, and where any such application is made, the variation shall not have effect unless and until it is confirmed by the Tribunal.

Provided that an application under this section shall be made within twenty-one days after the date on which the consent was given or the resolution was passed, as the case may be, and may be made on behalf of the shareholders entitled to make the application by such one or more of their number as they may appoint in writing for the purpose.

3. The decision of the Tribunal on any application under sub-section (2) shall be binding on the shareholders.

4. The company shall, within thirty days of the date of the order of the Tribunal, life of copy thereof with the Registrar.

5. Where any default is made in complying with the provisions of this section, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees, or with both.

4.3 REDUCTION OF SHARE CAPITAL

S. 66 of the Companies Act, 2016 states that -

1. Subject to confirmation by the Tribunal on an application by the company, a company limited by shares or limited by guarantee and having a share capital may, by a special resolution, reduce the share capital in any manner and in, particular, may

(a) *extinguish* or *reduce* the liability on any of its shares in respect of the share capital not paid-up; or

(b) either with or without extinguishing or reducing liability on any of its shares,

(i) *cancel* any paid-up share capital which is lost or is unrepresented by available assets; or

(ii) *pay off* any paid-up share capital which is in excess of the wants of the company,

alter its memorandum by reducing the amount of its share capital and of its shares accordingly.

Provided that no such reduction shall be made if the company is in arrears in the repayment of any deposits accepted by it, either before or after the commencement of this Act, or the interest payable thereon.

2. The Tribunal shall give notice of every application made to it under sub-section (1) to the Central Government, Registrar and to the Securities and Exchange Board, in the case of listed companies, and the creditors of the company and shall take into consideration the representations, if any, made to it by that Government, Registrar, the Securities and Exchange Board and the creditors within a period of three months from the date of receipt of the notice.

Provided that where no representation has been received from the Central Government, Registrar, the Securities and Exchange Board or the creditors within the said period, it shall be presumed that they have no objection to the reduction.

3. The Tribunal may, if it is satisfied that the debt or claim of every creditor of the company has been discharged or determined or has been secured on his consent is obtained, make an order confirming the reduction of share capital on such terms and conditions as it deems fit.

Provided that no application for reduction of share capital shall be sanctioned by the Tribunal unless the accounting treatment, proposed by the company for such reduction is in conformity with the accounting standards specified in **section 133** or any other provision of this Act and a certificate to that effect by the company's auditor has been filed with the Tribunal.

EXHIBIT 2 : ALTERATION V. REDUCTION OF CAPITAL

Points	Alteration of Share Capital	Reduction of Share Capital
Meaning	Alteration of share capital is governed by the provisions of **Section 64** of the Companies Act, 2013.	Reduction of share capital is governed by the provisions of **Section 66** of the Companies Act, 2013.
Resolution	Alteration of share capital is required to be done by **ordinary resolution.**	Reduction of share capital is required to be done by **special resolution.**
Confirmation	Alteration of share capital is **not** required to be **confirmed** by the **Tribunal.**	Reduction of share capital is to be **confirmed** by the **Tribunal.**
Examples	Alteration of share capital may be done in the following manner : (i) **Increasing** its nominal capital by issuing new shares. (ii) **Consolidating** and dividing all or any of its share capital into shares of large denomination. (iii) **Converting** fully paid up shares into stock or vice versa. (iv) **Sub-dividing** its shares into shares of smaller amount. (v) **Cancelling** shares which have not been taken up and diminishing the amount of share capital by the amount of the shares so cancelled.	Reduction of share capital may be done in the following manner : (i) **Extinguishing or reducing** the liability of members in respect of the capital not paid up. (ii) **Writing off or cancelling** any paid-up capital which is in excess of the needs of the company. (iii) **Paying off** any paid up share which is in excess of the needs of the company.

4.4 SURRENDER OF SHARES

Surrender of shares means giving up possession of shares to the company by the shareholders. Articles of association usually authorise the companies to accept surrender of shares. Surrender of fully paid shares amounts to a reduction of capital. The surrendered shares can, however, be reissued to new shareholders/debentureholders/creditors (as a part of scheme of reconstruction).

4.5 COMPROMISE & ARRANGEMENT

Section 230 of Companies Act, 2013 contains provisions on ' Compromises, Arrangements and Reconstructions.' A "scheme of compromise and arrangement" is an agreement between a company and its creditors or members when the company is in financial difficulties. It may involve-

(a) *equity shareholders* giving up their claim to the reserves and accumulated profits, if any;

(b) *debenture-holders* giving an extension of time for payment; accepting a cash payment less than the face value of their debentures; giving up their security in whole or in part, exchanging their debentures for shares in the company; agreeing to variation of their rights;

(c) *creditors* accepting part payment of their claims and the balance in shares or debentures in the company;

(d) *preference shareholders* giving up their rights to arrears of dividends; agreeing to accept a reduced rate of dividend in the future or variation of their rights.

5. ACCOUNTING PROCEDURE

5.1 ACCOUNTING SITUATIONS

(1) **Alteration of Capital:** Internal Reconstruction may involve Alteration of Capital, i.e., increase, consolidation or sub-division of share capital. Alteration involves only change in the face value and number of shares. Alteration does not involve any Capital reduction. [see para 5.2(1), below].

(2) **Variation of Rights:** Variation of shareholders rights may involve change in the rate of preference dividend payable in future or conversion of cumulative preference shares into non-cumulative preference shares (without any change in the amount of capital). [see para 5.2(2), below].

(3) **Capital Reduction:** Capital Reduction involves the reduction in the paid-up value of share capital. The reduction is a sacrifice by the shareholders and the amount of reduction is credited to a new Account called Capital Reduction Account. [see para 5.2(3), below].

(4) **Compromise:** Compromise involves sacrifices made by the shareholders or the creditors or the debentureholders etc. as a part of the scheme for reconstruction. These sacrifices are also credited to the Capital Reduction A/c. (Some authorities use the Capital Reduction A/c only to record the sacrifices made by the shareholders and open another A/c called Reconstruction A/c to record the sacrifices made by the outsiders like debentureholders, creditors, etc.). In case some liabilities are to be actually paid in cash, some assets may be sold. The profit on sale of assets is also credited to the Capital Reduction A/c. If the terms of the scheme so provide, Reserves, if any, are also transferred to the Capital Reduction A/c. [see para 5.2(4), below].

(5) **Use of Capital Reduction A/c:** The Capital Reduction/Reconstruction A/c at this stage will show credits gathered from above sacrifices. The credit balance so accumulated in the Capital Reduction/Reconstruction A/c is utilised in writing off the intangible assets or in writing down the values of the assets and for providing the liabilities which were not recorded earlier. In case some credit balance still remains in the Capital Reduction/Reconstruction A/c, it is transferred to 'Capital Reserve' A/c. [see para 5.2(5), below].

The actual Accounting entries are explained in detail below.

5.2 WORKSHEET 1 : ENTRIES ON INTERNAL RECONSTRUCTION

No.	*Transaction/Entry*		*Amount*
(1)	**ALTERATION OF SHARE CAPITAL**		
1.1	*Increase by Issue of Shares*		
	Bank A/c	Dr.	[No. of shares x Issue price]
	To Share Capital (Equity or Preference)		
1.2	*Consolidation*		
	Share Capital (₹ 1) A/c	Dr.	[Old No. of shares x Old NV]
	To Share Capital (₹ 10) A/c		[New No. of shares x New NV]
Note: The existing shares of smaller amounts (say 1,000 shares of ₹ 1 each) may be consolidated into larger amounts (say 100 shares of ₹ 10 each). The amount of share capital remains the same; only the number of shares and the nominal value [NV] per share change.			
1.3	*Sub-division*		
	Share Capital (₹ 100) A/c	Dr.	[Old No. of shares x Old NV]
	To Share Capital (₹ 10) A/c		[New No. of shares x New NV]
Note: Sub-division is the reverse of consolidation. Here the existing shares of larger amounts (say 1,000 shares of ₹ 100 each) are sub-divided into smaller amounts (say 10,000 shares of ₹ 10 each). The amount of share capital remains the same, only the number of shares and the nominal value [NV] of shares change.			

1.4	*Converting shares into stock*		
	Equity Share Capital (₹ 100) A/c To Equity Stock A/c	Dr.	[No. of shares x NV] [Total]

Note: In conversion of shares into stock, the existing shares (say 1,000 shares of ₹ 100 each) are converted into a single stock (say equity capital stock of ₹ 1,00,000). Capital Stock can be purchased or sold even in fractions (as in demat accounts). The amount of share capital remains the same.

1.5	*Converting stock into shares*		
	Equity Stock A/c To Equity Share Capital A/c	Dr.	[Total] [No. of shares x NV]

Note: In conversion of stock into shares, the existing capital stock (say ₹ 1,00,000) is converted into, say 1,000 equity shares of ₹ 100 each). This is similar to sub-division. The amount of share capital remains the same.

1.6	*Cancelling un-issued Shares*		

Note: No entry is required to be passed for cancelling un-issued shares. Only the authorised capital is to be shown at a lower amount as it gets reduced to the extent of such cancellation.

(2)	**VARIATION OF SHAREHOLDERS' RIGHTS**		
2.1	*Reduction in rate of dividend*		
	10% Cum. Pref. Share Capital To 8% Cum. Pref. Share Capital	Dr.	[Old shares] [New shares]

Note: Here, the rights of preference shareholders have been changed in respect of rate of dividend. There is no change in the amount of share capital.

2.2	*Change from Cumulative to Non-cumulative*		
	10% Cum. Pref. Share Capital To 10% Non-Cum. Pref. Share Capital	Dr.	[Old shares] [New shares]

Note: Here, the rights of preference shareholders have been changed in respect of right to accumulate arrears of dividends. There is no change in rate of dividend or the amount of share capital.

(3)	**CAPITAL REDUCTION**		
3.1	*Reduction in nominal value only*		
	Share Capital A/c (₹ 100) To Share Capital (₹ 90) A/c	Dr.	[No. of Shares x NV ₹ 100] [No. of Shares x NV ₹ 90]

Note: Suppose, shares of ₹ 100 each (paid-up value ₹ 90 each) are reduced to shares of nominal value of ₹ 90 each. Here, there is reduction in nominal value [Shares with nominal value of ₹ 100 reduced to Shares with nominal value of ₹ 90 each]. There is no reduction in the paid-up value [₹ 90].

3.2	*Reduction in paid-up value only*		
	Share Capital A/c (₹ 100) To Capital Reduction A/c	Dr.	[₹ 90 x No. of Shares] [₹ 90 x No. of Shares]

Note: ₹ 100 paid-up shares are reduced to ₹ 10 paid-up shares resulting in a sacrifice of ₹ 90 per share by the shareholders. The Share Capital may be Equity or Preference.

3.3	*Reduction in both nominal and paid-up value*		
	Share Capital A/c (₹ 100) To Capital Reduction A/c To Share Capital A/c (₹ 10)	Dr.	[₹ 100 x No. of Shares] [₹ 90 x No. of Shares] [₹ 10 x No. of Shares]

Note: Here, there is reduction in nominal value [₹ 100 shares reduced to ₹ 10 shares] as well as reduction in the paid-up value [from ₹ 100 to ₹10] resulting in a sacrifice of ₹ 90 per share by the shareholders.

3.4	*Surrender of Shares*		
a.	***On Surrender of shares***		
	Share Capital A/c	Dr.	
	To Shares Surrendered A/c		
b.	***On Re-issue of surrendered shares***		
	Shares Surrendered A/c	Dr.	
	To Share Capital A/c		
c.	***On Cancellation of surrendered shares***		
	Shares Surrendered A/c	Dr.	
	To Capital Reduction A/c		
(4)	**COMPROMISE/ARRANGEMENT**		
4.1	*Transfer of Reserves*		
	Reserve A/c	Dr.	
	To Capital Reduction/Reconstruction A/c		

Note: The Equity Shareholders may agree to further sacrifice by allowing the Reserves to which they alone are entitled, to be used for making available larger amounts for write-offs.

4.2	*Appreciation / Profit on Sale of Assets*		
(a)	***Revaluation***		
	Fixed Assets A/c	Dr.	Increase in value of asset
	To Capital Reduction/Reconstruction A/c		

Note: The market value of some Fixed Assets of the Company, like Land or buildings etc., may be higher than the written down value shown in the Balance Sheet. Such Fixed Assets may be revalued and the increase in the value may be credited to the Capital Reduction/Reconstruction A/c. (Revaluation of Fixed Assets reflects the 'true and correct' values of the assets, which is in fact the aim of the whole exercise of Internal Reconstruction).

(b)	***Sale at Profit***		
	Bank A/c	Dr.	Sale price realised
	To Fixed Assets A/c		Cost of assets sold
	To Capital Reduction/Reconstruction A/c		Profit on the sale transferred

Note: Some Fixed Assets may be actually sold at a profit to provide funds for paying off the external liabilities. The profit realised on such sale of Fixed Assets is also credited to the Capital Reduction/Reconstruction A/c.

4.3	*Settlement of External Liabilities*		
(a)	***Sacrifice***		
	External Liability A/c	Dr.	Sacrifice by Creditors etc.
	Provision A/c	Dr.	Prov. not required
	To Capital Reduction/Reconstruction A/c		

Note: The external creditors like debentureholders, sundry creditors, banks, etc., may agree to accept less amount in full and final settlement of their dues. The sacrifice - profit on settlement of external liabilities - is credited to the Capital Reduction / Reconstruction A/c. Further, some provisions may no longer be payable and can be credited to the Capital Reduction/Reconstruction A/c.

(b)	***Payment***		
	External Liability A/c	Dr.	
	To Bank A/c		Liability paid
	To Share Capital A/c		Shares issued in settlement
	To Assets A/c		Assets taken over in settlement

Note: In some cases, certain Liabilities may have actually to be paid. The Debentureholders or Creditors may be paid in cash or may agree to take over an asset of the company or shares may be issued to them, in settlement of the amount due to them.

4.4	*Arrears of Preference Dividend*		
(a)	***Waived***		
Note: No entry is passed if dividend on Cumulative Preference Shares in Arrears are waived by the Preference Shareholders. Such arrears is a contingent liability.			
(b)	***Paid now***		
	(i) Capital Reduction/Reconstruction A/c To Preference Shareholders A/c	Dr.	[record dividend payable]
	(ii) Preference Shareholders A/c To Bank A/c	Dr.	[dividend paid]
All the above entries record the sacrifices made by the participants of the Internal Reconstruction Scheme (Shareholders and external creditors). The amounts sacrificed are accumulated on the Credit side of the Capital Reduction/Reconstruction A/c to be utilised subsequently, as shown below.			
(5)	**UTILISATION OF CAPITAL REDUCTION/RECONSTRUCTION ACCOUNT**		
5.1	*Writing off Intangible Assets*		
	Capital Reduction/Reconstruction A/c To Profit & Loss A/c [Dr. bal.] To Misc. Expenditure not w/o To Goodwill	Dr.	
Note: The primary aim of the Capital Reduction exercise is to write off the fictitious or intangible assets viz. the Profit & Loss Account (Dr.) balance which represents the accumulated losses, the accounts falling under the head Misc. Expenditure not written off - such as Preliminary Expenses, and intangible assets like Goodwill. These amounts are to be written off even if not specifically stated.			
5.2	*Writing Down Fixed and Current Assets*		
	Capital Reduction/Reconstruction A/c To (Fixed Assets) A/c To (Current Assets) A/c	Dr.	Name of Assets
Note: Other Assets, i.e., Fixed Assets and Current Assets are to be brought down to their real values by debiting the Capital Reduction/Reconstruction A/c and crediting the relevant assets A/c, as shown above.			
5.3	*Recording New Liability or Provision*		
	Capital Reduction/Reconstruction A/c To (Liability or Provision) A/c	Dr.	Name of Liability or Provision
Note: As explained earlier, the company may have avoided recording a liability in the past or, a contingent liability may materialise and become payable. Such liabilities are now to be brought in the books by debiting the Capital Reduction/Reconstruction A/c and crediting the Liability A/c. If such liability is paid in cash the Liability A/c is debited and the Cash A/c is credited as shown above, in 4.3(b), above. A fresh provision may also be required to be created as a part of the scheme of Internal Reconstruction, for example, Provision for Doubtful Debts or Provision for Taxation etc. This is done by debiting the Capital Reduction/Reconstruction A/c and crediting the relevant Provision A/c.			
5.4	*Expenses of Reconstruction*		
	Capital Reduction/Reconstruction A/c To Cash/Bank	Dr.	
5.5	*Balance Transferred to Capital Reserve A/c*		
	Capital Reduction/Reconstruction A/c To Capital Reserve A/c	Dr.	

Note : If, at this stage the Capital Reduction /Reconstruction A/c still shows some credit balance (indicating that the sacrifices are more than the write-offs), the balance is transferred to the Capital Reserve Account as above.

With this, the whole exercise of Capital Reduction and Internal Reconstruction is complete and the new Balance Sheet of the company would now reflect the true values of the Assets, Liabilities, and Capital of the company. The Balance Sheet after Capital Reduction/Reconstruction would show the 'true and fair' view of the financial position of the company.

5.3 WORKSHEET 2 : PRO-FORMA CAPITAL REDUCTION ACCOUNT

Capital Reduction/Reconstruction Account

Dr. Utilisation	₹	Sacrifices	₹ Cr.
To Profit & Loss A/c (Dr.)	xxx	By Share Capital	xxx
To Preliminary Expenses etc.	xxx	(reduction in paid-up value)	
To Goodwill (fictitious assets w/o)	xxx	By Reserves (transfer)	xxx
To Fixed Assets	xxx	By Fixed Assets	xxx
To Current Assets	xxx	(appreciation on revaluation)	
(assets written down)		By Bank/Fixed Assets	xxx
To Liability/Provisions	xxx	(profit on sale of assets)	
(new liab/prov. booked)		By External Liability	xxx
To Expenses of Reconstruction	xxx	(sacrifice by creditors etc.)	
To Capital Reserve	xxx	By Provision (prov. not required)	xxx
(balance transferred)			
	xxx		xxx

Note : It is advisable to prepare the Capital Reduction A/c, by way of a Working Note in an examination answer, even if not specifically asked for.

5.4 BALANCE SHEET AFTER RECONSTRUCTION

The following point should be kept in mind while preparing the Balance Sheet of the company after reconstruction.

(1) **Name of Company (..... and reduced):** While granting approval to any scheme of Capital Reduction, the court may direct the company to add the words "and Reduced" to its name for such period as it thinks fit. Thus, when preparing the Balance Sheet of the Company after Capital reduction, the words - "and reduced" - should be added to its name.

(2) **Appreciation in value of Fixed Assets on Revaluation:** The fixed assets may be revalued as part of the scheme of reconstruction. The Balance Sheet after Reconstruction should show the revised (higher) figures in place of the original cost shown before. Further, the Balance Sheet after Reconstruction, should also show the amount of appreciation or increase due to revaluation in notes for 5 years. The above rules are prescribed by the **Schedule III** of the Companies Act, 2013 and should be kept in mind while preparing the Balance Sheet of the Company after Reconstruction.

(3) **Amounts Written off:** The primary aim of reconstruction is to write off intangible assets (Goodwill etc.) and to bring down the values of other fixed assets to their realistic level. The Balance Sheet after reconstruction should show the revised (lower) figures in place of the original cost. Further, the Balance Sheet after Reconstruction should show the amount written off under the scheme of reconstruction in notes for 5 years. The above rules are prescribed by the **Schedule III** of the Companies Act, 2013 and should be kept in mind while preparing the Balance Sheet of the Company after reconstruction.

6. ILLUSTRATIONS

6.1 CASE STUDIES

Illustration 1 :

Pass Journal Entries for the following transactions :

1. Conversion of 2 lakh fully paid Equity shares of ₹ 10 each into Stock of ₹ 1,00,000 and balance as 12% fully Convertible Debenture.
2. Consolidation of 40 lakh fully paid Equity shares of ₹ 2.50 each into 10 lakh fully paid Equity share of ₹ 10 each.
3. Sub-division of 10 lakh fully paid 11% Preference shares of ₹ 50 each into 50 lakh fully paid 11% Preference shares of ₹ 10 each.
4. Conversion of 12% Preference shares of ₹ 5,00,000 into 14% Preference shares ₹ 3,00,000 and remaining balance as 12% Non-cumulative Preference shares. ***(CA-Inter, Nov. 2013, adapted)***

Solution :

Journal Entries

No.	Particulars		Dr. ₹	Cr. ₹
1.	Equity Share Capital A/c	Dr.	20,00,000	
	To Equity Stock A/c			1,00,000
	To 12% Fully Convertible Debentures A/c			19,00,000
	[Being conversion of 2 lakh Equity shares of ₹ 10 each into stock of ₹ 1,00,000 and balance as 12% fully Convertible Debentures as per resolution dated .....]			
2.	Equity Share Capital A/c (₹ 2.50)	Dr.	1,00,00,000	
	To Equity Share Capital A/c (₹ 10)			1,00,00,000
	[Being consolidation of 40 lakh shares of ₹ 2.50 each into 10 lakh shares of ₹ 10 each as per resolution dated .....]			
3.	11% Preference Shares Capital A/c (₹ 50)	Dr.	5,00,00,000	
	To 11% Preference Share Capital A/c (₹ 10)			5,00,00,000
	[Being subdivision of 10 lakh Preference shares of ₹ 50 each into 50 lakh shares of ₹ 10 each as per resolution dated .....]			
4.	12% Preference Share Capital A/c	Dr.	5,00,000	
	To 14% Preference Share Capital A/c			3,00,000
	To 12% Non-Cumulative Preference Share Capital A/c			2,00,000
	[Being conversion of 12% Preference shares of ₹ 5,00,000 into 14% Preference shares of ₹ 3,00,000 and 12% Non-cumulative Preference shares of ₹ 2,00,000 as per resolution dated .....]			

Illustration 2 : (Cancellation of uncalled capital and writing off paid up capital)

B Ltd. has 40,000 shares of ₹ 10 each, ₹ 8 per share paid up. The company has an accumulated loss of ₹ 1,20,000 in the Profit & Loss A/c. The company now decides to reduce the share capital to fully paid shares of ₹ 5 each and to write off the accumulated loss.

Show Journal entries.

Solution :

Journal of B Ltd.

No.	Particulars		Dr. ₹	Cr. ₹
1.	Equity Share Capital (₹ 10) A/c (40,000 x 8)	Dr.	3,20,000	
	To Equity Share Capital (₹ 5) A/c (40,000 x 5)			2,00,000
	To Capital Reduction A/c (40,000 x 3)			1,20,000
	[Reduction of 40,000 shares of ₹ 10 each, ₹ 8 per share paid up, to 40,000 shares of ₹ 5 each fully paid up, as per special resolution dated.... as confirmed by the Court]			
2.	Capital Reduction A/c	Dr.	1,20,000	
	To Profit & Loss A/c			1,20,000
	[Accumulated loss written off as per scheme of capital reduction]			

6.2 JOURNAL + CAPITAL REDUCTION ACCOUNT

Illustration 3 :
M/s Unwell Ltd. has incurred heavy losses since past few years. The company adopted a scheme of reconstruction on the basis of following summarised Balance Sheet.

Summarised Balance Sheet of Unwell Ltd. as on 31st March 2014

Particulars		₹
Liabilities :		
Equity Share Capital :		
1,60,000 Shares of ₹ 10 each fully paid	... ...	16,00,000
Preference Share Capital :		
4,000, 10% Shares of ₹ 100 each fully paid	... ...	4,00,000
10% Debentures	... ...	20,00,000
Interest accrued and due on debentures	... ...	2,00,000
Creditors	... ...	8,00,000
Bills Payable	... ...	1,00,000
Outstanding Audit Fees	... ...	1,00,000
Total	... ...	52,00,000
Assets :		
Land and Building	... ...	12,20,000
Furniture	... ...	4,00,000
Computer	... ...	6,00,000
Debtors	... ...	6,00,000
Stock	... ...	80,000
Bills Receivable	... ...	5,00,000
Cash at Bank	... ...	3,60,000
Share Issue Expenses	... ...	40,000
Profit and Loss Account (Dr. Balance)	... ...	14,00,000
Total	... ...	52,00,000

The following scheme of reconstruction was approved by the court :

1. 10% Preference Shares to be reduced by ₹ 20 per share.
2. Equity Shares to be reduced by ₹ 5 per share.
3. Debentureholders agreed to settle their claim fully by issue of New 11% Debentures of ₹ 14,00,000. They also agree to forgo 50% of their interest. The payment of remaining 50% of interest to be made immediately.
4. Computer was to be written down by ₹ 40,000.
5. Land and Building and Furniture to be appreciated by 10%.
6. Stock to be appreciated by ₹ 60,000.
7. Fictitious Assets and debit balance of Profit and Loss Account to be written off.
8. Cost of Reconstruction was ₹ 50,000.
9. 75% of the Creditors agreed to forgo their claims by 10%.
10. Reduce Debtors by ₹ 70,000.

You are required to pass journal entries to record the above transactions and prepare the Capital Reduction Account in the books of M/s Unwell Ltd. ***(T.Y.B.Com., Oct. 2014, adapted)***

Solution :

In the Books of Unwell Ltd.

Journal Entries

No.	Particulars		Dr. ₹	Cr. ₹
1.	Equity Share Capital A/c (₹ 10)	Dr.	16,00,000	
	To Equity Share Capital A/c (₹ 5)			8,00,000
	To Capital Reduction A/c			8,00,000
	[Being 1,60,000 Equity shares of ₹ 10 each fully paid reduced by ₹ 5 per share]			

2.	10% Preference Share Capital A/c (₹ 100) Dr.		4,00,000	
	To 10% Preference Share Capital A/c (₹ 80)			3,20,000
	To Capital Reduction A/c			80,000
	[Being 4,000, 10% Preference Shares of 100 shares each reduced by ₹ 20 per share]			
3.	10% Debentures A/c Dr.		20,00,000	
	To 11% Debentures A/c			14,00,000
	To Capital Reduction A/c			6,00,000
	[Being 10% Debentures settled and profit transferred to Capital Reduction Account]			
4.	Land & Building A/c Dr.		1,22,000	
	Furniture A/c Dr.		40,000	
	Stock A/c Dr.		60,000	
	To Capital Reduction A/c			2,22,000
	[Being the assets appreciated and the difference transferred to Capital Reserve A/c]			
5.	Creditors A/c Dr.		60,000	
	To Capital Reduction A/c			60,000
	[Being 75% creditors' foregoing 10% of their claim]			
6.	Capital Reduction A/c Dr.		50,000	
	To Cash / Bank A/c			50,000
	[Being cost of reconstruction paid]			
7.	Interest Accrued and Due on Debentures A/c Dr.		2,00,000	
	To Capital Reduction A/c			1,00,000
	To Cash / Bank A/c			1,00,000
	[Being 50% of Interest accrued on debenture foregone and the balance settled immediately]			
8.	Capital Reduction A/c Dr.		15,50,000	
	To Computer A/c			40,000
	To Debtors A/c			70,000
	To Share Issue Expenses A/c			40,000
	To Profit and Loss A/c			14,00,000
	[Being various assets and Profit and Loss balance written off through Capital Reduction A/c]			
9.	Capital Reduction A/c Dr.		2,62,000	
	To Capital Reserve A/c			2,62,000
	[Being the balance amount in Capital Reduction A/c transferred to Capital Reserve A/c]			

Dr. Capital Reduction Account Cr.

Particulars	*JV*	*₹*	*Particulars*	*JV*	*₹*
To Write-offs	(8)	15,50,000	By Equity Share Capital	(1)	8,00,000
To Cash (Cost)	(6)	50,000	By Preference Share Capital	(2)	80,000
To CRR (Bal. Fig.)	(9)	2,62,000	By 10% Debentures	(3)	6,00,000
			By Assets	(4)	2,22,000
			By Creditors	(5)	60,000
			By Interest on Debentures	(7)	1,00,000
		18,62,000			18,62,000

Illustration 4 :

Following is the summarised Balance Sheet of Risky Ltd. as on 31st March, 2015 :

Liabilities	*₹*	*Assets*	*₹*
10% Preference Shares of ₹ 10 each	4,80,000	Premises	6,40,000
Equity Shares of ₹ 10 each	8,00,000	Plant and Machinery	10,40,000
5% Debentures of ₹ 100 each	9,60,000	Investments	2,40,000
Sundry Creditors	4,00,000	Stock	2,88,000
		Debtors	1,92,000

Bank Overdrafts	2,40,000	Deposits & Advances	80,000
Other Liabilities	3,20,000	Preliminary Expenses	3,20,000
		Profit and Loss Account (Dr. Balance)	4,00,000
	32,00,000		32,00,000

Note : Preference Dividend is in arrears for 3 years.

A scheme of reconstruction is prepared and approved by all the authorities.

The salient features of the scheme are :

1. Plant and Machinery having book value of ₹ 1,60,000 is obsolete. This is sold as scrap for ₹ 32,000.
2. The depreciation on plant and machinery is to be provided to the extent of ₹ 80,000.
3. Stock includes items valued at ₹ 96,000 which are sold at a loss of 50%.
4. The present realizable value of investments is ₹ 1,12,000.
5. Arrears of Preference Dividend is not payable.
6. Reconstruction expenses were ₹ 16,000.
7. The paid up value of equity shares is to be reduced to ₹ 2 per share and preference shares to ₹ 5 per share. However, the face value of both equity and preference shares remain unchanged.
8. The creditors dues are settled as :
   (a) 20% immediate payment in cash
   (b) 40% amount is cancelled
   (c) 40% paid by issue of 6% debentures.
9. Other liabilities of ₹ 80,000 is to be cancelled.
10. A call of ₹ 3 per share on equity shares is made and received.

You are required to pass Journal Entries in the books of Risky Ltd. to record the above transactions.

Solution : ***(T.Y.B.Com., Oct. 2015, adapted)***

In the Books of Risky Ltd.

Journal Entries

No.	Particulars		Dr. ₹	Cr. ₹
1.	Equity Share Capital A/c	Dr.	6,40,000	
	10% Preference Share Capital A/c	Dr.	2,40,000	
	To Capital Reduction A/c			8,80,000
	[Being reduction of Equity and Preference capital]			
2.	Creditors A/c	Dr.	4,00,000	
	To Cash / Bank A/c (20%)			80,000
	To Capital Reduction A/c (40%)			1,60,000
	To 6% Debentures (40%)			1,60,000
	[Being creditors dues settled as per scheme of reconstruction]			
3.	Other Liabilities A/c	Dr.	80,000	
	To Capital Reduction A/c			80,000
	[Being dues to directors cancelled]			
4.	Cash / Bank A/c	Dr.	32,000	
	Capital Reduction A/c	Dr.	1,28,000	
	To Plant and Equipment A/c			1,60,000
	[Being sale of plant having book value of ₹ 1,60,000 for ₹ 32,000]			
5.	Capital Reduction A/c	Dr.	80,000	
	To Plant and Equipment A/c			80,000
	[Being depreciation provided]			
6.	Cash / Bank A/c	Dr.	48,000	
	Capital Reduction A/c	Dr.	48,000	
	To Stock A/c			96,000
	[Being sale of stock having book value of ₹ 96,000 at a loss of 50%]			
7.	Capital Reduction A/c	Dr.	1,28,000	
	To Investment A/c			1,28,000
	[Being reduction in value by ₹ 1,28,000]			

8.	Capital Reduction A/c	Dr.	7,20,000	
	To Profit and Loss A/c			4,00,000
	To Preliminary Expenses A/c			3,20,000
	[Being bought forward losses and fictitious assets written off as per scheme of reconstruction]			
9.	Capital Reduction A/c	Dr.	16,000	
	To Cash / Bank A/c			16,000
	[Being paid expenses on reconstruction]			
10.	Cash / Bank A/c (80,000 x 3)	Dr.	2,40,000	
	To Equity Share Capital A/c			2,40,000
	[Being receipt of call money on 80,000 shares @ ₹ 3 each]			

Illustration 5 : (Share Consolidation)

The following is the summarised Balance Sheet of Safemoving Ltd. as on 31st March, 2018 :

Liabilities		₹	Assets	₹
Authorised & Issued Capital :			Goodwill	2,40,000
60,000 - 6% Pref. Shares of ₹ 10 each		6,00,000	Land & Buildings	5,34,000
12,00,000 Equity Shares of ₹ 1 each		12,00,000	Plant	5,10,000
6% Debentures	2,40,000		Investment in Subsidiary Ltd. (at cost)	1,50,000
Add : Interest	12,000	2,52,000	Stock	4,50,000
Bank Overdraft		3,30,000	Debtors	5,40,000
Director's Loan		1,50,000	Profit & Loss Account	5,28,000
Creditors		5,40,000	Advertisement Expenses	1,20,000
		30,72,000		30,72,000

Note : (i) There is a contingent liability for damages ₹ 60,000.

(ii) Preference shares are cumulative and dividends are in arrears for three years.

A capital reduction scheme setting the following terms was duly approved :

(a) The preference shares to be reduced to ₹ 8 per share and Equity Share to 25 paisa each and to be consolidated as shares of ₹ 10 each and ₹ 1 each fully paid respectively. The preference shareholders waive two third of the dividend in arrears and receive equity share for the balance. The authorised capital to be restored to 60,000 preference shares of ₹ 10 each and 12,00,000 equity shares of ₹ 1 each.

(b) The share in Subsidiary Ltd. are sold to an outsider for ₹ 3,00,000.

(c) All intangible and fictitious assets are to be eliminated and bad debts of ₹ 42,000 and obsolete stock of ₹ 60,000 is to be written-off.

(d) The debentureholders to take over one of the company's properties (Book Value ₹ 1,08,000) at a price of ₹ 1,20,000 in part satisfaction of the debentures and to provide further cash ₹ 90,000 on a floating charge. The arrears of interest are paid.

(e) Director's refund ₹ 20,000 of the fees previously received by them.

(f) The contingent liability materialised in the sum stated but the company recovered ₹ 30,000 of these damages in action against one of its directors which was debited to his loan account of ₹ 48,000 and the balance of loan was paid in cash on his resignation.

(g) The remaining directors agreed to take equity shares in satisfaction of their loans.

Pass Journal Entries and prepare Capital Reduction Account in the books of the Company.

Solution : ***(T.Y.B.Com., Oct. 2003, adapted)***

Safemoving Ltd.
Journal

No.	Particulars		Dr. ₹	Cr. ₹
1.	**Reduction in Equity Capital :**			
	Equity Share Capital A/c (₹ 1)	Dr.	12,00,000	
	To Equity Share Capital A/c (₹ 0.25)			3,00,000
	To Capital Reduction A/c			9,00,000
	[Reduction of 12,00,000 Equity Share Capital of ₹ 1 each of equal no. of shares of ₹ 0.25 each vide Scheme of Reconstruction dated .....]			

2.	**Reduction in Preference Share Capital :**			
	Preference Share Capital (₹ 10) A/c	Dr.	6,00,000	
	To Preference Share Capital (₹ 8) A/c			4,80,000
	To Capital Reduction A/c			1,20,000
	[Reduction of 60,000 Preference Shares of ₹ 10 each to equal no. of shares of ₹ 8 each]			
3.	**Arrears of Preference Dividends :**			
	Capital Reduction A/c	Dr.	36,000	
	To Equity Share Capital A/c			36,000
	[Discharge of 1/3 arrears of Preference Dividends ₹ 1,08,000 by issue of Equity Shares]			
4.	**Sale of Investments :**			
	Bank A/c	Dr.	3,00,000	
	To Investment in Subsidiary			1,50,000
	To Capital Reduction A/c			1,50,000
	[Investments sold, profit on sale tfd. to Capital Reduction A/c]			
5.	**Settlement of Debentures :**			
	6% Debentures A/c	Dr.	1,20,000	
	To Land and Building A/c			1,08,000
	To Capital Reduction A/c			12,000
	[Debentures partly settled by way of Property; appreciation in value, credited to Capital Reduction A/c; see Note]			
6.	Bank A/c	Dr.	90,000	
	To 6% Debentures			90,000
	[Further issue of Debentures against of floating charge]			
7.	Debenture Interest Accrued A/c	Dr.	12,000	
	To Bank			12,000
	[Payment of accrued interest]			
8.	**Contingent Liabilities for Damages :**			
	Capital Reduction A/c	Dr.	60,000	
	To Bank A/c			60,000
	[Contingent Liability paid]			
9.	Bank A/c	Dr.	20,000	
	To Capital Reduction A/c			20,000
	[Fees refunded by Directors]			
10.	**Director's Loans :**			
	Directors Loan A/c	Dr.	48,000	
	To Capital Reduction A/c			30,000
	To Bank A/c			18,000
	[Damages recovered ₹ 18,000 from a Director adjusted in his Loan A/c and Credited to Capital Reduction A/c; balance loan paid in cash]			
11.	Director's Loan A/c	Dr.	1,02,000	
	To Equity Share Capital A/c			1,02,000
	[Directors Loans balance settled by issue of Equity Shares; see Note]			
12.	**Utilisation of Capital Reduction A/c :**			
	Capital Reduction A/c	Dr.	9,90,000	
	To Profit & Loss A/c			5,28,000
	To Advertisement A/c			1,20,000
	To Goodwill A/c			2,40,000
	To Debtors (Bad Debts) A/c			42,000
	To Stock			60,000
	[Value of assets and P & L A/c adjusted against Capital Reduction A/c vide Scheme of Reconstruction dated.....]			
13.	**Balance of Capital Reduction A/c :**			
	Capital Reduction A/c	Dr.	1,46,000	
	To Capital Reserve A/c			1,46,000
	[Balance transferred]			

8.	Capital Reduction A/c	Dr.	7,20,000	
	To Profit and Loss A/c			4,00,000
	To Preliminary Expenses A/c			3,20,000
	[Being bought forward losses and fictitious assets written off as per scheme of reconstruction]			
9.	Capital Reduction A/c	Dr.	16,000	
	To Cash / Bank A/c			16,000
	[Being paid expenses on reconstruction]			
10.	Cash / Bank A/c (80,000 x 3)	Dr.	2,40,000	
	To Equity Share Capital A/c			2,40,000
	[Being receipt of call money on 80,000 shares @ ₹ 3 each]			

Illustration 5 : (Share Consolidation)

The following is the summarised Balance Sheet of Safemoving Ltd. as on 31st March, 2018 :

Liabilities		₹	*Assets*	₹
Authorised & Issued Capital :			Goodwill	2,40,000
60,000 - 6% Pref. Shares of ₹ 10 each		6,00,000	Land & Buildings	5,34,000
12,00,000 Equity Shares of ₹ 1 each		12,00,000	Plant	5,10,000
6% Debentures	2,40,000		Investment in Subsidiary Ltd. (at cost)	1,50,000
Add : Interest	12,000	2,52,000	Stock	4,50,000
Bank Overdraft		3,30,000	Debtors	5,40,000
Director's Loan		1,50,000	Profit & Loss Account	5,28,000
Creditors		5,40,000	Advertisement Expenses	1,20,000
		30,72,000		30,72,000

Note : (i) There is a contingent liability for damages ₹ 60,000.

(ii) Preference shares are cumulative and dividends are in arrears for three years.

A capital reduction scheme setting the following terms was duly approved :

(a) The preference shares to be reduced to ₹ 8 per share and Equity Share to 25 paisa each and to be consolidated as shares of ₹ 10 each and ₹ 1 each fully paid respectively. The preference shareholders waive two third of the dividend in arrears and receive equity share for the balance. The authorised capital to be restored to 60,000 preference shares of ₹ 10 each and 12,00,000 equity shares of ₹ 1 each.

(b) The share in Subsidiary Ltd. are sold to an outsider for ₹ 3,00,000.

(c) All intangible and fictitious assets are to be eliminated and bad debts of ₹ 42,000 and obsolete stock of ₹ 60,000 is to be written-off.

(d) The debentureholders to take over one of the company's properties (Book Value ₹ 1,08,000) at a price of ₹ 1,20,000 in part satisfaction of the debentures and to provide further cash ₹ 90,000 on a floating charge. The arrears of interest are paid.

(e) Director's refund ₹ 20,000 of the fees previously received by them.

(f) The contingent liability materialised in the sum stated but the company recovered ₹ 30,000 of these damages in action against one of its directors which was debited to his loan account of ₹ 48,000 and the balance of loan was paid in cash on his resignation.

(g) The remaining directors agreed to take equity shares in satisfaction of their loans.

Pass Journal Entries and prepare Capital Reduction Account in the books of the Company.

Solution : ***(T.Y.B.Com., Oct. 2003, adapted)***

Safemoving Ltd.
Journal

No.	*Particulars*		*Dr. ₹*	*Cr. ₹*
1.	**Reduction in Equity Capital :**			
	Equity Share Capital A/c (₹ 1)	Dr.	12,00,000	
	To Equity Share Capital A/c (₹ 0.25)			3,00,000
	To Capital Reduction A/c			9,00,000
	[Reduction of 12,00,000 Equity Share Capital of ₹ 1 each of equal no. of shares of ₹ 0.25 each vide Scheme of Reconstruction dated .....]			

2.	**Reduction in Preference Share Capital :**			
	Preference Share Capital (₹ 10) A/c	Dr.	6,00,000	
	To Preference Share Capital (₹ 8) A/c			4,80,000
	To Capital Reduction A/c			1,20,000
	[Reduction of 60,000 Preference Shares of ₹ 10 each to equal no. of shares of ₹ 8 each]			
3.	**Arrears of Preference Dividends :**			
	Capital Reduction A/c	Dr.	36,000	
	To Equity Share Capital A/c			36,000
	[Discharge of 1/3 arrears of Preference Dividends ₹ 1,08,000 by issue of Equity Shares]			
4.	**Sale of Investments :**			
	Bank A/c	Dr.	3,00,000	
	To Investment in Subsidiary			1,50,000
	To Capital Reduction A/c			1,50,000
	[Investments sold, profit on sale tfd. to Capital Reduction A/c]			
5.	**Settlement of Debentures :**			
	6% Debentures A/c	Dr.	1,20,000	
	To Land and Building A/c			1,08,000
	To Capital Reduction A/c			12,000
	[Debentures partly settled by way of Property; appreciation in value, credited to Capital Reduction A/c; see Note]			
6.	Bank A/c	Dr.	90,000	
	To 6% Debentures			90,000
	[Further issue of Debentures against of floating charge]			
7.	Debenture Interest Accrued A/c	Dr.	12,000	
	To Bank			12,000
	[Payment of accrued interest]			
8.	**Contingent Liabilities for Damages :**			
	Capital Reduction A/c	Dr.	60,000	
	To Bank A/c			60,000
	[Contingent Liability paid]			
9.	Bank A/c	Dr.	20,000	
	To Capital Reduction A/c			20,000
	[Fees refunded by Directors]			
10.	**Director's Loans :**			
	Directors Loan A/c	Dr.	48,000	
	To Capital Reduction A/c			30,000
	To Bank A/c			18,000
	[Damages recovered ₹ 18,000 from a Director adjusted in his Loan A/c and Credited to Capital Reduction A/c; balance loan paid in cash]			
11.	Director's Loan A/c	Dr.	1,02,000	
	To Equity Share Capital A/c			1,02,000
	[Directors Loans balance settled by issue of Equity Shares; see Note]			
12.	**Utilisation of Capital Reduction A/c :**			
	Capital Reduction A/c	Dr.	9,90,000	
	To Profit & Loss A/c			5,28,000
	To Advertisement A/c			1,20,000
	To Goodwill A/c			2,40,000
	To Debtors (Bad Debts) A/c			42,000
	To Stock			60,000
	[Value of assets and P & L A/c adjusted against Capital Reduction A/c vide Scheme of Reconstruction dated.....]			
13.	**Balance of Capital Reduction A/c :**			
	Capital Reduction A/c	Dr.	1,46,000	
	To Capital Reserve A/c			1,46,000
	[Balance transferred]			

14.	**Consolidation on Equity Capital :** Equity Share Capital (₹ 0.25) A/c To Equity Share Capital (₹ 1) A/c [Consolidation of Equity Shares into 4,38,000 Equity Shares of ₹ 1 each]	Dr.	4,38,000	4,38,000
15.	**Consolidation of Preference Capital :** Preference Share Capital (₹ 8) A/c To Preference Share Capital (₹ 10) A/c [Consolidation of 60,000 Preference Share of ₹ 8 each into 48,000 Pref. Shares of ₹ 10 each]	Dr.	4,80,000	4,80,000

Working Notes :

(1) Land and Buildings

	Cost	Revalued	Profit
Taken over by Debentureholders	1,08,000	1,20,000	12,000
Balance c/d to Balance Sheet	4,26,000		
Total	5,34,000		

(2) Director's Loans

	Total	Defaulting	Other
Total Loans	1,50,000	48,000	1,02,000
Less : Recovered (damages)		30,000	
Balance Paid in Cash		18,000	
Less : Equity Shares		--	1,02,000
		NIL	NIL
		(3,30,000)	

(3) Bank Overdraft

Received			
- Sale of Investments	3,00,000		
- Debentures	90,000		
- Fees Refunded	20,000	4,10,000	80,000
Less Paid			
- Debenture Interest	12,000		
- Contingent Liability	60,000		
- Directors Loans	18,000		(90,000)
- Balance (Overdraft) c/d			(10,000)

(4) Dr. Capital Reduction Account Cr.

Utilisation	JV	₹	Sacrifice	JV	₹
To Equity Share Capital (Pref. Div.)	3	36,000	By Equity Share Capital	1	9,00,000
To Bank (Damages)	8	60,000	By Pref. Share Capital	2	1,20,000
To Profit & Loss A/c (Dr.)	12	5,28,000	By Investment in subsidiary	4	1,50,000
To Advertisement	12	1,20,000	By Debentures	5	12,000
To Goodwill	12	2,40,000	By Bank (Refund of fees)	9	20,000
To Debtors	12	42,000	By Director's Loans	10	30,000
To Stock	12	60,000			
Total Use		10,86,000			
To Capital Reserve (Bal. Fig.)	13	1,46,000			
		12,32,000			12,32,000

Illustration 6 :

The Ledger Balances of Feel Bad Ltd. Include :

Building ₹ 6,10,000, Furniture ₹ 2,00,000, Computer ₹ 3,00,000, Debtors ₹ 3,00,000, Share issue Expenses ₹ 20,000, Cash at Bank ₹ 80,000, Bills Receivable ₹ 2,50,000, Stock ₹ 40,000; 8% Preference Share Capital - 2,000 shares of ₹ 100 each; Equity Share Capital - 80,000 shares of ₹ 10 each, 'A' 10% Debentures ₹ 4,00,000, 'B' 12% Debentures ₹ 5,00,000, Outstanding Interest for one year on Debentures ₹ 1,00,000, Creditors ₹ 4,00,000, Bills Payable ₹ 50,000, Outstanding Audit Fees ₹ 50,000, Profit and Loss A/c. ?

1) The company has incurred heavy losses. The following scheme of Reconstruction is agreed upon.
2) 8% Preference Shares are to be reduced by ₹ 20 per share. Equity shares be reduced by ₹ 5 per share.
3) To settle the claim of holders of 'A' 10% Debentures by issue of new 11% Debentures of ₹ 2,00,000. 'A' Debentureholders agree to forgo their interest.
4) To settle the claim of holders of 'B' 12% Debentures by issue of new 13% Debentures of ₹ 5,00,000. Outstanding debenture interest on 'B' 12% Debentureholders be paid.
5) To write off fictitious assets and debit balance of Profit & Loss A/c.
6) Directors refund ₹ 60,000 fees previously received by them.
7) Computer was to be written down by ₹ 20,000.

ou are required to show :

) Journal Entries to record the above transactions in books of Feel Bad Ltd.
) Capital Reduction Account.

ssume that all the formalities are duly complied. *(T.Y.B.Com., Oct. 2004, adapted)*

olution :

) **Journal of Feel Bad Ltd.**

No.	Particulars		Dr. ₹	Cr. ₹
1.	8% Preference Share Capital A/c	Dr.	40,000	
	To Capital Reduction A/c			40,000
	[Being reduction : 2,000 x ₹ 20]			
2.	Equity Share Capital A/c	Dr.	4,00,000	
	To Capital Reduction A/c			4,00,000
	[Being reduction : 80,000 x ₹ 5]			
3.	A 10% Debenture A/c	Dr.	4,00,000	
	To 11% (New) Debentures)			2,00,000
	To Capital Reduction A/c			2,00,000
	[Being reduction : 4,00,000 - 2,00,000]			
4.	Outstanding Interest on Debenture A/c	Dr.	40,000	
	To Capital Reduction A/c			40,000
	[Being claim given up]			
5.	B 12% Debenture A/c	Dr.	5,00,000	
	To (New) 13% Debentures A/c			5,00,000
	[Being new issue against old balances]			
6.	Outstanding Interest on Debenture A/c	Dr.	60,000	
	To Cash / Bank A/c			60,000
	[Being claim paid]			
7.	Bank A/c	Dr.	60,000	
	To Capital Reduction A/c			60,000
	[Being refund of fees]			
8.	Capital Reduction A/c	Dr.	20,000	
	To Computer A/c			20,000
	[Being write down of Computer]			
9.	Capital Reduction A/c	Dr.	7,20,000	
	To Profit & Loss A/c			7,00,000
	To Share issue Expenses A/c			20,000
	[Being utilisation of balance in reduction a/c see WN]			

)

Capital Reduction Account **Cr.**

rticulars	JV	₹	Particulars	JV	₹
Computer	8	20,000	By 8% Preference		
Share issue Expenses	9	20,000	Share Capital	1	40,000
Profit & Loss A/c	9	7,00,000	By Equity Share Capital	2	4,00,000

			By 10% Debentures	3	2,00,00
			By Interest on Debentures (Outstanding)	4	40,00
			By Bank (Director Fees)	7	60,00
		7,40,000			7,40,00

Note :

Feel Bad Ltd.

Summary of Assets and Liabilities (Before Reconstruction)

Particulars		₹
LIABILITIES		
8% Preference Share Capital		
2,000 shares of ₹ 100 each	... ...	2,00,00
Equity Share Capital		
80,000 shares @ ₹ 10 each	... ...	8,00,00
A 10% Debenture	... ...	4,00,00
B 12% Debenture	... ...	5,00,00
Outstanding Interest on Debentures :		
- A	... ...	40,00
- B	... ...	60,00
Creditors	... ...	4,00,00
Bills Payable	... ...	50,00
Outstanding Audit Fees	... ...	50,00
	... ...	**25,00,00**
ASSETS		
Building	... ...	6,10,00
Furniture	... ...	2,00,00
Computer	... ...	3,00,00
Debtors	... ...	3,00,00
Cash at Bank	... ...	80,00
Bill Receivable	... ...	2,50,00
Stock	... ...	40,00
Share issue Expenses	... ...	20,00
Profit & Loss A/c (Bal. Fig.)	... ...	7,00,00
	... ...	**25,00,00**

6.3 JOURNAL + CAPITAL REDUCTION ACCOUNT + BALANCE SHEET

Illustration 7 :

The following is the Summary Balance Sheet of Sandeep Limited as on 31st March, 2018 :

Liabilities	₹	*Assets*	₹
Issued and Subscribed Capital		Goodwill	25,000
- 10% Preference Shares of		Patents	15,000
₹ 100/- each	4,00,000	Furniture	35,000
- Equity Shares of ₹ 10/- each	10,00,000	Plant and Machinery	6,00,000
12% Debentures	7,50,000	Land and Building	6,50,000
Bank Overdraft	50,000	Stock-In-Trade	80,000
Sundry Creditors	1,40,000	Sundry Debtors	90,000
Bills Payable	35,000	Bills Receivable (Trade)	15,000
		Profit and Loss A/c	8,20,000
		Share issue Expenses	45,000
	23,75,000		23,75,000

The preference dividend is in arrear for four years. The following scheme of capital reduction was sanctioned by the court agreed by shareholders.

(a) The preference shares are to be reduced to ₹ 50/- each and equity shares to ₹ 2 each, both being fully paid.

(b) Of the preference dividend in arrears three-fourth to be waived and remaining to be paid in cash.
(c) The Debenture holders to take over plant and machinery at ₹ 6,50,000 in part satisfaction of their claim. The remaining claim should be converted into 14% debentures.
(d) Creditors agreed to reduce their claim by ₹ 20,000. Bills payable to be paid immediately.
(e) Goodwill, Patents, Profit and Loss A/c and Share issue Expenses are to be written off entirely.
(f) The following assets are to be revalued as under : Furniture ₹ 25,000, Stock-In-Trade ₹ 68,000, Land and Building ₹ 5,80,000, Sundry Debtors ₹ 80,000.
(g) A Secured Loan of ₹ 1,50,000 at 12% per annum is to be obtained by mortgaging Land and Building for repayment of bank overdraft, bills payable and reconstruction expenses ₹ 15,000.

Pass journal entries to record above scheme and draft the balance sheet of Sandeep Limited after reconstruction.

(T.Y.B.Com., Oct. 2019, April 14, Mar. 07, T.Y.B.A.F., Oct. 15, Nov. 17, adapted)

Solution :

IN THE BOOKS OF SANDEEP LTD.

Journal

No.	Particulars		Dr. ₹	Cr. ₹
1.	10% Preference Share Capital A/c (₹ 100)	Dr.	4,00,000	
	To 10% Preference Share Capital A/c (₹ 50)			2,00,000
	To Capital Reduction A/c (4,000 x 50)			2,00,000
	[Being 4,000 10% Preference Shares of ₹ 100 reduced to ₹ 50 each]			
2.	Equity Share Capital A/c (₹ 10)	Dr.	10,00,000	
	To Equity Share Capital A/c (₹ 2)			2,00,000
	To Capital Reduction A/c (1,00,000 x 8)			8,00,000
	[Being 1,00,000 Equity Shares of ₹ 10 reduced to ₹ 2 each]			
3.	12% Debentures A/c	Dr.	7,50,000	
	To Plant & Machinery A/c			6,00,000
	To 14% Debentures A/c			1,00,000
	To Capital Reduction A/c			50,000
	[Being 12% Debentures settled; appreciation in value of Plant & Machinery transferred to Capital Reduction A/c]			
4.	Creditors A/c	Dr.	20,000	
	To Capital Reduction A/c			20,000
	[Being reduction in claim of creditors transferred]			
5.	Bank A/c	Dr.	1,50,000	
	To 12% Secured Loan A/c			1,50,000
	[Being loan obtained against security of Land & Building]			
6.	Bills Payable A/c	Dr.	35,000	
	To Bank A/c			35,000
	[Being Bills payable paid]			
7.	Capital Reduction A/c	Dr.	40,000	
	To Bank A/c			40,000
	[Being Preference Dividend arrears paid - WN]			
8.	Capital Reduction A/c	Dr.	15,000	
	To Bank A/c			15,000
	[Being Reconstruction Expenses paid]			
9.	Capital Reduction A/c	Dr.	10,15,000	
	To Goodwill A/c			25,000
	To Patents A/c			15,000
	To Profit & Loss A/c			8,20,000
	To Share issue Expenses A/c			45,000
	To Furniture (35,000 - 25,000)			10,000
	To Stock-In-Trade (80,000 - 68,000)			12,000
	To Land & Building (6,50,000 - 5,80,000)			70,000

6. Trade Receivables			
a. Debtors	... ...	90,000	
Less : RDD	... ...	(10,000)	80,000
b. Bills Receivable (Trade)	... ...		15,000
Total	... ...		**95,000**

Working Notes :

(1) Preference Dividend : Total 4,00,000 x 10% x 4 years = 1,60,000
Waived (No entry) (3/4) = 1,20,000
Paid (JV 7) 1/4 = 40,000

(2) Dr. **Capital Reduction Account** **Cr.**

Particulars	JV	₹	Particulars	JV	₹
To Bank A/c (Pref. Div.)	7	40,000	By 10% Preference Share Capital A/c	1	2,00,000
To Bank A/c (Exp.)	8	15,000	By Equity Share Capital A/c	2	8,00,000
To Goodwill A/c	9	25,000	By Plant & Machinery A/c	3	50,000
To Patents A/c	9	15,000	By Creditors A/c	4	20,000
To Profit & Loss A/c	9	8,20,000			
To Share issue Expenses A/c	9	45,000			
To Furniture A/c	9	10,000			
To Stock-In-Trade A/c	9	12,000			
To Land & Building A/c	9	70,000			
To Sundry Debtors A/c	9	10,000			
To Capital Reserve	9	8,000			
		10,70,000			10,70,000

(3) Bank Balance = 1,50,000 - 35,000 - 40,000 - 15,000 - 50,000 = 10,000

Illustration 8 :

Following is the Summary Balance Sheet of Paramount Ltd. as on 31-03-2018 :

Liabilities	₹	Assets	₹
Share Capital :		**Fixed Assets :**	
6,000 - 8% Preference shares of ₹ 100 each	6,00,000	Goodwill	60,000
50,000 Equity Shares of ₹ 10 each	5,00,000	Patents & Trade Marks	40,000
Reserves & Surplus :		Building	3,00,000
Capital Reserves	50,000	Plant & Machinery	3,00,000
Secured Loans :		Furniture	1,00,000
5% Debentures of ₹ 100 each	3,00,000	**Current Assets :**	
Debentures Interest Due	50,000	Stock	1,50,000
Current Liabilities :		Sundry Debtors	75,000
Sundry Creditors	1,80,000	Bank	1,00,000
		Cash	25,000
		Misc. Expenditure not w/o :	
		Discount on Debentures	30,000
		Profit & Loss Account	5,00,000
	16,80,000		16,80,000

Note : Preference dividend is in arrears for three years.
The following scheme of reconstruction was prepared and duly approved by the court.

(1) The Preference Shares shall be converted into equal Number of 9% Preference Shares of ₹ 50 each.
(2) The equity shares shall be reduced to ₹ 3 each. However the face value will remain the same.
(3) 5% Debentures shall be converted into equal number of 6% Debentures of ₹ 75 each. The debentureholders also agreed to waive 50% of the accrued interest.
(4) Arrears of preference dividend is to be reduced to one year's dividend which is paid in cash.
(5) The Sundry creditors agreed to waive 30% of their claims and to accept Equity shares for ₹ 30,000 in part settlement of their renewed claims.

(6) The assets are to be revalued as under :

Building	₹ 3,50,000
Plant & Machinery	₹ 2,50,000
Furniture	₹ 80,000
Stock	₹ 1,00,000
Sundry Debtors	₹ 70,000

(7) Intangible assets and fictitious assets are to be written off.

Pass Journal Entries, prepare Capital Reduction Account and Balance Sheet after Reconstruction in the books of the Paramount Ltd. ***(T.Y.B.Com., April 15, Oct. 06, 18, May 2019, adapted)***

Solution :

(1) Journal of Paramount Ltd.

No.	Particulars		Dr. ₹	Cr. ₹
1.	8% Preference Share Capital A/c	Dr.	6,00,000	
	To 9% Preference Share Capital A/c			3,00,000
	To Capital Reduction A/c			3,00,000
	[Being 6,000 Pref. Shares of ₹ 100 each reduced to ₹ 50 each fully paid]			
2.	Equity Share Capital A/c	Dr.	3,50,000	
	To Capital Reduction A/c			3,50,000
	[Being paid-up value of 50,000 Equity Shares of ₹ 10 each fully paid reduced by ₹ 7 per share]			
3.	5% Debentures A/c	Dr.	3,00,000	
	To 6% Debentures A/c			2,25,000
	To Capital Reduction A/c			75,000
	[Being debentures of ₹ 100 each converted into debentures of ₹ 75 each]			
4.	Debentures Interest due A/c	Dr.	25,000	
	To Capital Reduction A/c			25,000
	[Being 50% of accrued interest waived by debentureholders]			
5.	Preference Dividend A/c	Dr.	48,000	
	To Cash / Bank A/c			48,000
	[Being arrears of preference dividend paid]			
6.	Creditors A/c	Dr.	84,000	
	To Equity Share Capital A/c			30,000
	To Capital Reduction A/c			54,000
	[Being waiver of dues by 30% creditors and issue of equity shares to them]			
7.	Building A/c	Dr.	50,000	
	To Capital Reduction A/c			50,000
	[Being appreciation in value of building]			
8.	Capital Reduction A/c	Dr.	8,54,000	
	To Discount on Debenture A/c			30,000
	To Profit and loss A/c			5,00,000
	To Goodwill A/c			60,000
	To Patent and Trademark A/c			40,000
	To Preference Dividend A/c			48,000
	To Plant and Machinery A/c			50,000
	To Furniture A/c			20,000
	To Stock			50,000
	To Debtors			5,000
	To Capital Reserve			51,000
	[Being capital reduction a/c utilised for revaluation of assets, writing off fictitious assets etc. and balance tfd. to Capital Reserve]			

(2) Dr. **Capital Reduction Account** Cr.

Particulars	JV	₹	Particulars	JV	₹
To Discount on Debentures	8	30,000	By 8% Preference Share Capital	1	3,00,000
To Profit and Loss A/c	8	5,00,000	By Equity Share Capital	2	3,50,000
To Goodwill	8	60,000	By 5% Debentures	3	75,000
To Patent and Trademark	8	40,000	By Interest due on debentures	4	25,000
To Preference Dividend	8	48,000	By Creditors	6	54,000
To Plant & Machinery	8	50,000	By Building	7	50,000
To Furniture	8	20,000			
To Stock	8	50,000			
To Debtors	8	5,000			
To Capital Reserve (Bal. Fig.)	8	51,000			
		8,54,000			8,54,000

(3) **PARAMOUNT LTD.**

Balance Sheet (And Reduced)

Particulars	Note	₹
I. EQUITY AND LIABILITIES		
1. Shareholders' Funds		
a. Share Capital	1	4,80,000
b. Reserves and Surplus	2	1,01,000
2. Non-Current Liabilities		
Long-term Borrowings (6% Debentures)		2,25,000
3. Current Liabilities		
a. Trade Payables (1,80,000 – 54,000 – 30,000)		96,000
b. Other Current Liabilities	3	25,000
Total		**9,27,000**
II. ASSETS		
1. Non-Current Assets		
Property, Plant and Equipment	4	6,80,000
2. Current Assets		
a. Inventories	5	1,00,000
b. Trade Receivables	6	70,000
c. Cash and Cash Equivalents (25,000 + 1,00,000 – 48,000)		77,000
Total		**9,27,000**

Notes to Accounts	₹
1. Share Capital	
a. **Equity Share Capital**	
Issued, subscribed & fully paid Shares :	
60,000 Equity Shares of ₹ 10 each (paid up ₹ 3 each)	1,80,000
(5,00,000 – 3,50,000 + 30,000)	
b. **Preference Share Capital**	
Issued, subscribed & fully paid Shares :	
6,000 9% Preference Shares of ₹ 50 each	3,00,000
Total	**4,80,000**
2. Reserves and Surplus	
Capital Reserves	
– Opening	50,000
Add : Tfd. from Capital Reduction A/c	51,000
Total	**1,01,000**
3. Other Current Liabilities	
Interest Accrued and Due on Debentures	25,000

(2) Dr. **Capital Reduction Account** Cr.

Particulars	JV	₹	Particulars	JV	₹
To Discount on Debentures	8	30,000	By 8% Preference Share Capital	1	3,00,000
To Profit and Loss A/c	8	5,00,000	By Equity Share Capital	2	3,50,000
To Goodwill	8	60,000	By 5% Debentures	3	75,000
To Patent and Trademark	8	40,000	By Interest due on debentures	4	25,000
To Preference Dividend	8	48,000	By Creditors	6	54,000
To Plant & Machinery	8	50,000	By Building	7	50,000
To Furniture	8	20,000			
To Stock	8	50,000			
To Debtors	8	5,000			
To Capital Reserve (Bal. Fig.)	8	51,000			
		8,54,000			8,54,000

(3)

PARAMOUNT LTD.

Balance Sheet (And Reduced)

Particulars	Note	₹
I. EQUITY AND LIABILITIES		
1. Shareholders' Funds		
a. Share Capital		
b. Reserves and Surplus	1	4,80,000
2. Non-Current Liabilities	2	1,01,000
Long-term Borrowings (6% Debentures)		2,25,000
3. Current Liabilities		
a. Trade Payables (1,80,000 – 54,000 – 30,000)		96,000
b. Other Current Liabilities	3	25,000
Total		**9,27,000**
II. ASSETS		
1. Non-Current Assets		
Property, Plant and Equipment	4	6,80,000
2. Current Assets		
a. Inventories	5	1,00,000
b. Trade Receivables	6	70,000
c. Cash and Cash Equivalents (25,000 + 1,00,000 – 48,000)		77,000
Total		**9,27,000**

Notes to Accounts	₹
1. Share Capital	
a. Equity Share Capital	
Issued, subscribed & fully paid Shares :	
60,000 Equity Shares of ₹ 10 each (paid up ₹ 3 each)	1,80,000
(5,00,000 – 3,50,000 + 30,000)	
b. Preference Share Capital	
Issued, subscribed & fully paid Shares :	
6,000 9% Preference Shares of ₹ 50 each	3,00,000
Total	**4,80,000**
2. Reserves and Surplus	
Capital Reserves	
– Opening	50,000
Add : Tfd. from Capital Reduction A/c	51,000
Total	**1,01,000**
3. Other Current Liabilities	
Interest Accrued and Due on Debentures	**25,000**

4. Property, Plant and Equipment			
– Land and Buildings		3,00,000	
Add : Appreciation on reconstruction		50,000	3,50,000
– Plant and Equipment		3,00,000	
Less : Written Off on reconstruction		(50,000)	2,50,000
– Furniture and Fixtures		1,00,000	
Less : Written Off on reconstruction		(20,000)	80,000
Total			6,80,000
5. Inventories			1,50,000
Less : Written Off on reconstruction			(50,000)
Total			1,00,000
6. Trade Receivables			75,000
Less : RDD on reconstruction			(5,000)
Total			70,000

Illustration 9 :

Following is the Summary Balance Sheet of Umesh Ltd. as on 31-3-2018 :

Liabilities	₹	*Assets*	₹
6000 10% Cumulative preference shares of ₹ 100/- each fully paid up	6,00,000	Goodwill	2,00,000
15000 Equity Shares of ₹ 100 each, fully paid up	15,00,000	Land and Building	19,50,000
Loans	2,22,000	Plant & Machinery	70,000
Creditors	7,50,000	Stock	4,00,000
		Trade Debtors	2,88,000
		Bank Balance	1,26,000
		Profit & Loss Account	38,000
	30,72,000		30,72,000

Note: Preference Dividend was in arrears ₹ 1,20,000/-. The Board of Directors of the Co. decide upon the following scheme of reconstruction, which was approved by all concerned.

(a) Paid up value of equity shares shall be reduced to ₹ 50/- per share, face value being ₹ 100/-.

(b) Preference shares are to be converted into 13% debentures of ₹ 100/- each with regard to the 80% of dues (including arrears of preference dividend) and for the balance (including dividen arrears) equity shares of ₹ 100/- each (₹ 50/- paid up) shall be issued.

(c) All equity shareholders agreed to pay the balance amount, making shares fully paid up.

(d) The Plant-Machinery was revalued at ₹ 90,000/-.

(e) The value of stock was reduced by ₹ 1,00,000/-.

(f) Land and Building shall be written down to ₹ 15,50,000/-.

(g) Creditors agreed to forego their claims by 10%.

(h) Loan was fully settled for ₹ 2,00,000/-.

(i) Goodwill debit balance of Profit and Loss account shall be written off.

(j) Cost of reconstruction ₹ 5,000/- was paid. Above resolution was carried out.

You are required to :

(i) Pass journal entries in the books of the company.

(ii) Prepare Capital Reduction account.

(iii) Prepare Balance Sheet after reconstruction. ***(T.Y.B.Com., Oct. 08, May 2019, adapted***

Solution :

JOURNAL OF UNMESH LTD.

No.	*Particulars*		*Debit ₹*	*Credit ₹*
1.	Equity Share Capital A/c (15,000 x 50)	Dr.	7,50,000	
	To Capital Reduction A/c			7,50,000
	[Reduction in Equity Share Capital under scheme of reconstruction]			
2.	10% Preference Share Capital A/c	Dr.	6,00,000	
	To 13% Debentures A/c [60,000 x 80%]			4,80,000
	To Equity Share Capital A/c [2,400 x 50]			1,20,000
	[Conversion of Pref. Shares into Debentures and Equity Shares]			

3.	Capital Reduction A/c	Dr.	1,20,000	
	To 13% Debentures A/c [1,20,000 x 80%]			96,000
	To Equity Share Capital A/c [480 x 50]			24,000
	[Arrears of Preference Dividend settled by issue of Debentures and Equity Shares]			
4.	Bank A/c [(15,000 + 2,400 + 480) x 50]	Dr.	8,94,000	
	To Equity Share Capital			8,94,000
	[Uncalled amount on equity shares, now made fully paid up]			
5.	Plant & Machinery A/c (90,000 - 70,000)	Dr.	20,000	
	Sundry Creditors A/c (7,50,000 x 10%)	Dr.	75,000	
	To Capital Reduction A/c			95,000
	[Increase in plant and reduction in creditors under scheme of reconstruction]			
6.	Loan A/c	Dr.	2,22,000	
	To Bank A/c			2,00,000
	To Capital Reduction A/c			22,000
	[Loan settled under scheme of reconstruction]			
7.	Capital Reduction A/c	Dr.	7,47,000	
	To Stock A/c			1,00,000
	To Land & Building A/c (19,50,000 - 15,50,000)			4,00,000
	To Goodwill A/c			2,00,000
	To Profit & Loss A/c			38,000
	To Bank A/c (Expenses)			5,000
	To Capital Reserve A/c (Bal. Fig.)			4,000
	[B/F Losses, assets and expenses written off under scheme of reconstruction]			

Dr. **Capital Reduction Account** **Cr.**

Particulars	JV	₹	Particulars	JV	₹
To 13% Debentures A/c (Pref. Dividend)	3	96,000	By Equity Share Capital	1	7,50,000
To Equity Shares A/c (Pref. Div.)	3	24,000	By Plant & Machinery (90,000 - 70,000)	2	20,000
To Stock A/c	7	1,00,000	By Sundry Creditors	2	75,000
To Land & Building A/c	7	4,00,000	By Loan	6	22,000
To Goodwill A/c	7	2,00,000			
To Profit & Loss A/c	7	38,000			
To Bank (Expenses)	7	5,000			
Total Use		8,63,000			
To Capital Reserve (Bal. Fig.)	7	4,000			
Total		8,67,000	**Total**		8,67,000

UMESH LTD.

Balance Sheet (and Reduced)

Particulars	Note	₹
I. EQUITY AND LIABILITIES		
1. Shareholders' Funds		
a. Share Capital	1	17,88,000
b. Reserves and Surplus	2	4,000
2. Non-Current Liabilities		
Long-term Borrowings (13% Debentures)		5,76,000
3. Current Liabilities		
Trade Payables		6,75,000
Total		**30,43,000**
II. ASSETS		
1. Non-Current Assets		
Property, Plant and Equipment	3	16,40,000

2. Current Assets			
a. Inventories	... ...	4	3,00,000
b. Trade Receivables	... ...		2,88,000
c. Cash and Cash Equivalents (Bank)	... ...		8,15,000
Total	... ...		**30,43,000**

Notes to Accounts			₹
1. Share Capital			
Equity Share Capital			
Issued, subscribed & fully paid			
17,880 Equity Shares of ₹ 100 each	... ...		17,88,000
(2,880 Equity Shares issued for consideration other than cash)			
2. Reserves and Surplus			
Capital Reserves			
– Tfd. from Capital Reduction A/c	... ...		4,000
3. Property, Plant and Equipment			
– Land and Building	... ...	19,50,000	
Less : Written Off on reconstruction	... ...	(4,00,000)	15,50,000
– Plant and Machinery	... ...	70,000	
Add : Appreciation on reconstruction	... ...	20,000	90,000
Total	... ...		**16,40,000**
4. Inventories	... ...		4,00,000
Less : Written Off on reconstruction	... ...		(1,00,000)
Total	... ...		**3,00,000**

Working Note :

Dr. **Bank Account** **Cr.**

Particulars	₹	*Particulars*	₹
To Balance b/d	1,26,000	By Capital Reduction A/c (Expenses)	5,000
To Equity Share Capital	8,94,000	By Loan (paid)	2,00,000
		By Balance c/d	8,15,000
	10,20,000		10,20,000

Illustration 10 :

Following is the Summary Balance Sheet of Fortunate Ltd. as on 31st March 2018.

Liabilities	₹	*Assets*		₹
Share Capital :		Goodwill		1,65,000
7,000, 8% Cumulative Preference		Land and Building		6,00,000
Shares of ₹ 100 each	7,00,000	Stock		2,20,000
80,000 Equity shares of ₹ 10 each	8,00,000	Debtors :		
9% Debentures of ₹ 100 each	3,50,000	Good	3,70,000	
(Secured on Land and Building)		Doubtful	60,000	4,30,000
Accrued Interest on Debentures	15,750	Bank		2,80,000
Director's Loan	70,000	Preliminary Expenses		10,000
Sundry Creditors	3,10,000	Profit and Loss A/c		5,40,750
	22,45,750			22,45,750

Contingent Liabilities :

(1) Arrears of cumulative preference dividend for two years.

(2) Claims for damages pending in the court of law ₹ 1,00,000

The Board of Directors wish to show the realistic picture of the state of affairs of the company's position and the following scheme of reconstruction was duly approved.

(a) 8% Preference Shares of ₹ 100 each were to be reduced to an equal number of fully paid preference shares of ₹ 60 each and Equity shares of ₹ 10 each were to be reduced to an equal number of fully paid equity shares of ₹ 2.50 each.
(b) Intangible and fictitious assets, accumulated losses to be written off.
(c) 8% Preference shareholders agreed to waive one year's dividend and to accept equity shares of ₹ 2.50 each fully paid for the balance of arrears of dividend.
(d) Stock of be revalued at ₹ 2,00,000 and doubtful debtors to be written off.
(e) 9% Debentureholders agreed to take over part of the security of the book value of ₹ 2,00,000 for ₹ 2,50,000 in part satisfaction of their claim and agreed to waive interest payable to them.
(f) Sundry creditors agreed to forego ₹ 10,000 subject to the condition that the company must pay them half of the remaining amount immediately.
(g) The contingent liability for the claim for damages materialised to the extent of 50%, which the company paid immediately.
(h) The directors agreed to convert their loan into equity shares of ₹ 2.50 each fully paid.

You are required to :

(i) Pass Journal Entries and prepare Capital Reduction A/c in the books of Fortunate Ltd.
(ii) Prepare Balance Sheet of the company after reconstruction.

Solution :

(T.Y.B.Com., Nov. 2017, Oct. 09, adapted)

Journal of Fortunate Ltd.

No.	Particulars		Dr. ₹	Cr. ₹
31-3-18				
1.	**Reduction in Equity Capital**			
	Equity Share Capital A/c (₹ 10)	Dr.	8,00,000	
	To Equity Share Capital A/c (₹ 2.5)			2,00,000
	To Capital Reduction A/c			6,00,000
	[Being reduction of 80,000 Equity Share Capital of ₹ 10 each to equal no. of shares of ₹ 2.5 each vide Scheme of Reconstruction dated .....]			
2.	**Reduction in Preference Share Capital**			
	8% Preference Share Capital A/c (₹ 100)	Dr.	7,00,000	
	To 8% Preference Share Capital A/c (₹ 60)			4,20,000
	To Capital Reduction A/c			2,80,000
	[Being reduction of 7,000 Preference Shares of ₹ 100 each to equal no. of shares of ₹ 40 each]			
3.	**Arrears of Preference Dividends**			
	Capital Reduction A/c	Dr.	56,000	
	To Equity Share Capital A/c			56,000
	[Being discharge of 1/2 arrears of Preference Dividends by issue of Equity Shares : 8% x 7,00,000]			
4.	**Settlement of Debentures**			
	9% Debentures A/c	Dr.	2,50,000	
	To Land and Building A/c			2,00,000
	To Capital Reduction A/c			50,000
	[Being debentures partly settled by way of property; appreciation in value, credited to Capital Reduction A/c]			
5.	Debenture Interest Accrued A/c	Dr.	15,750	
	To Capital Reduction A/c			15,750
	[Being waiver of accrued interest]			
6.	**Settlement of Creditors**			
	Sundry creditors A/c	Dr.	1,60,000	
	To Bank A/c			1,50,000
	To Capital Reduction A/c			10,000
	[Being creditors settlement]			

7.	**Contingent Liabilities for Damages**			
	Capital Reduction A/c	Dr.	50,000	
	To Bank A/c			50,000
	[Being Contingent Liability paid]			
8.	**Director's Loans**			
	Director's Loan A/c	Dr.	70,000	
	To Equity Share Capital A/c (₹ 2.5)			70,000
	[Being Directors Loans settled by issue of Equity Shares]			
9.	**Utilisation of Capital Reduction A/c**			
	Capital Reduction A/c	Dr.	7,95,750	
	To Goodwill A/c			1,65,000
	To Preliminary Expenses A/c			10,000
	To Profit and Loss A/c			5,40,750
	To Stock A/c			20,000
	To Debtors A/c			60,000
	[Being value of assets and P & L A/c adjusted against Capital Reduction A/c vide Scheme of Reconstruction dated ....]			
10.	**Balance of Capital Reduction A/c**			
	Capital Reduction A/c	Dr.	54,000	
	To Capital Reserve A/c			54,000
	[Being balance transferred]			

Fortunate Limited

Balance Sheet as on 31-3-2018 (and Reduced)

Particulars	*Note*	₹
I. EQUITY AND LIABILITIES		
1. Shareholders' Funds		
a. Share Capital	1	7,46,000
b. Reserves and Surplus	2	54,000
2. Non-Current Liabilities		
Long-term Borrowings		
- 9% Debentures		1,00,000
3. Current Liabilities		
Trade Payables		1,50,000
Total		**10,50,000**
II. ASSETS		
1. Non-Current Assets		
Property, Plant and Equipment	3	4,00,000
2. Current Assets		
a. Inventories	4	2,00,000
b. Trade Receivables	5	3,70,000
c. Cash and Cash Equivalents (Cash at Bank)		80,000
Total		**10,50,000**

Notes to Accounts	₹
1. Share Capital	
Issued, subscribed & fully paid:	
a. 1,30,400 Equity Shares of ₹ 2.5 each	3,26,000
b. 7,000 8% Preference Shares of ₹ 60 each	4,20,000
Total	**7,46,000**
2. Reserves and Surplus	
Capital Reserves	
– Tfd. From Capital Reduction A/c	54,000
Total	**54,000**

3. Property, Plant and Equipment		
Land & Buildings - Opening	... ...	6,00,000
Less: Taken over by debentureholders	... ...	(2,00,000)
Total	... ...	**4,00,000**
4. Inventories - Opening	... ...	2,20,000
Less: written off on reconstruction	... ...	(20,000)
Total	... ...	**2,00,000**
5. Trade Receivables - Opening	... ...	4,30,000
Less: RDD	... ...	(60,000)
Total	... ...	**3,70,000**

Dr. **Capital Reduction Account** **Cr.**

Utilisation	*JV*	₹	*Sacrifice*	*JV*	₹
To Equity Share Capital (Pref. Div.)	3	56,000	By Equity Share Capital	1	6,00,000
			By Preference Share Capital	2	2,80,000
To Bank (Damages)	7	50,000	By Debentures	4	50,000
To Goodwill	9	1,65,000	By Debenture Interest	5	15,750
To Preliminary Expenses	9	10,000	By Creditors	11	10,000
To Profit and Loss A/c (Dr.)	9	5,40,750			
To Stock	9	20,000			
To Debtors	9	60,000			
Total Use		9,01,750			
To Capital Reserve (Bal. Fig.)	10	54,000			
		9,55,750			9,55,750

Illustration 11 :

Following is the Summary Balance-sheet of M/s. Siddhant Ltd. as on 31-03-2018.

Liabilities	₹	*Assets*	₹
Equity shares of ₹ 10 each	10,00,000	Fixed Assets	21,00,000
12% Cumulative Preference		Stock	20,00,000
Shares of ₹ 100 each	7,00,000	Sundry Debtors	15,00,000
10% Debentures	3,00,000	Bank	1,10,000
Sundry Creditors	36,00,000	Share issue Expenses	40,000
Provision for Tax	5,00,000	Profit and Loss Account	3,50,000
	61,00,000		61,00,000

Note : Preference dividend for 3 years was in arrears.

Following scheme of reconstruction was approved:

(1) Write off Fixed assets by 20%, Sundry Debtors by 15%, and reduce the value of stock to 55% of its book-value.

(2) Preference shareholders to forego arrears of preference dividend.

(3) Directors to give temporary loan of ₹ 5,00,000 to Company.

(4) The Company settled tax liability to the extent of ₹ 5,40,000 and to meet the expenses of reconstruction amounted to ₹ 10,000.

(5) Sundry Creditors to give a remission of 20% of their claims and a company to allot 11% Preference shares of ₹ 100 each fully paid up in settlement of the balance amount.

(6) 10% debentures to be converted into 13% Debentures of ₹ 1,60,000 in full settlement of their claim.

(7) Equity shares to be reduced to ₹ 2 each fully paid up and 12% cumulative Preference shares to be reduced to 1,00,000 cumulative Preference shares of ₹ 2 each fully paid up.

(8) Write off debit balance in Profit and Loss Account and Share issue Expenses.

Draft journal entries and prepare Capital Reduction Account and Balance sheet after reconstruction.

(T.Y.B.Com., March 2005, Oct. 2014, T.Y.B.A.F., Oct. 2014, 2015, 2023, adapted)

Solution :

M/s. Siddhant Ltd.

Journal

No.	Particulars		Dr. ₹	Cr. ₹
1.	Capital Reduction A/c	Dr.	15,45,000	
	To Fixed Assets A/c			4,20,000
	To Sundry Debtors A/c			2,25,000
	To Stock A/c			9,00,000
	[Being reduction in the values of assets]			
2.	Bank A/c	Dr.	5,00,000	
	To Director's Loan A/c			5,00,000
	[Being temporary loan received from Directors]			
3.	Provision for Tax A/c	Dr.	5,00,000	
	Capital Reduction A/c	Dr.	40,000	
	To Bank A/c			5,40,000
	[Being settlement of tax liability]			
4.	Capital Reduction A/c	Dr.	10,000	
	To Bank A/c			10,000
	[Being payment of reconstruction expenses]			
5.	Sundry Creditors A/c	Dr.	36,00,000	
	To Capital Reduction A/c			7,20,000
	To 11% Preference Share Capital A/c			28,80,000
	[Being remission of liability of Sundry Creditors and allotment of 11% Preference Shares in settlement of balance amount]			
6.	10% Debentures A/c	Dr.	3,00,000	
	To 13% Debentures			1,60,000
	To Capital Reduction A/c			1,40,000
	[Being exchange of 13% Debentures in full settlement of 10% Debentures]			
7.	Equity Share Capital (₹ 10) A/c	Dr.	10,00,000	
	12% Cumulative Preference Share Capital (₹ 100) A/c	Dr.	7,00,000	
	To Equity Share Capital (₹ 2) A/c			2,00,000
	To 12% Cumulative Preference Share Capital (₹ 2) A/c			2,00,000
	To Capital Reduction A/c			13,00,000
	[Being reduction of Equity Share Capital and Preference Share Capital]			
8.	Capital Reduction A/c	Dr.	3,90,000	
	To Share issue Expenses A/c			40,000
	To Profit & Loss A/c			3,50,000
	[Being Profit & Loss A/c & Share issue Expenses written off]			
9.	Capital Reduction A/c	Dr.	1,75,000	
	To Capital Reserves A/c			1,75,000
	[Being balance of Capital Reduction A/c transferred to Capital Reserves A/c]			

Dr. Capital Reduction Account Cr.

Particulars	JV	₹	Particulars	JV	₹
To Fixed Assets A/c	1	4,20,000	By Sundry Creditors A/c	5	7,20,000
To Sundry Debtors A/c	1	2,25,000	By 10% Debentures A/c	6	1,40,000
To Stock A/c	1	9,00,000	By Equity Share Capital A/c	7	8,00,000
To Bank A/c	3	40,000	By 12% Cumulative Preference Share Capital A/c	7	5,00,000
To Bank A/c	4	10,000			
To Share issue Expenses A/c	8	40,000			
To Profit & Loss A/c	8	3,50,000			
To Capital Reserve (Bal. Fig.)	9	1,75,000			
		21,60,000			21,60,000

Balance Sheet of M/s. Siddhant Ltd. (and reduced)
as on 31st March, 2018

Particulars	*Note*	₹
I. EQUITY AND LIABILITIES		
1. Shareholders' Funds		
a. Share Capital	1	32,80,000
b. Reserves and Surplus	2	1,75,000
2. Non-Current Liabilities		
Long-term Borrowings (13% Debentures)		1,60,000
3. Current Liabilities		
Short Term Borrowings	3	5,00,000
Total		**41,15,000**
II. ASSETS		
1. Non-Current Assets		
Property, Plant and Equipment	4	16,80,000
2. Current Assets		
a. Inventories	5	11,00,000
b. Trade Receivables	6	12,75,000
c. Cash and Cash Equivalents	7	60,000
Total		**41,15,000**

Notes to Accounts	₹
1. Share Capital	
a. Equity Share Capital	
Issued, subscribed & fully paid Shares :	
1,00,000 Equity shares of ₹ 2 each	2,00,000
b. Preference Share Capital	
Issued, subscribed & fully paid Shares :	
1,00,000 12% Preference Shares of ₹ 2 each	2,00,000
28,800 11% Preference Shares of ₹ 100 each	28,80,000
Total	**32,80,000**
2. Reserves and Surplus	
Capital Reserves	
– Tfd. from Capital Reduction A/c	1,75,000
Total	**1,75,000**
3. Short Term Borrowings	
Loans and Advances from Related Parties (Directors)	**5,00,000**
4. Property, Plant and Equipment - Opening	21,00,000
Less : Written Off on reconstruction	(4,20,000)
Total	**16,80,000**
5. Inventories - Opening	20,00,000
Less : Written Off on reconstruction	(9,00,000)
Total	**11,00,000**
6. Trade Receivables - Opening	15,00,000
Less : RDD created on reconstruction	(2,25,000)
Total	**12,75,000**
7. Cash and Cash Equivalents	
Bank (1,10,000 + 5,00,000 – 5,40,000 – 10,000)	60,000
Total	**60,000**

Illustration 12 :

The summarised assets and liabilities position of Hopeful Ltd. as on 1-4-2018 was as follows :

Particulars		₹
LIABILITIES		
Authorised Capital :		
80,000 Equity Shares of ₹ 10 each	... ...	8,00,000
2,000 9% Preference Shares of ₹ 100 each	... ...	2,00,000
Issued and Paid-up Capital :		
40,000 Equity Shares of ₹ 10 each		
Amount paid on each share ₹ 7.50	... ...	3,00,000
2,000 9% Preference Shares of ₹ 100 each fully paid	... ...	2,00,000
Unsecured Loans	... ...	80,000
Trade Creditors	... ...	48,000
Bank Overdraft	... ...	16,800
Total	... ...	6,44,800
ASSETS		
Goodwill	... ...	20,000
Land and Buildings	... ...	1,60,000
Plant and Machinery	... ...	1,20,000
Investments	... ...	24,000
Stock	... ...	54,000
Debtors	... ...	1,18,000
Cash in Hand	... ...	6,000
Profit and Loss Account	... ...	1,42,800
Total	... ...	6,44,800

Notes :

(a) Dividend on Preference Shares has not been declared for 2 years.

(b) No provision has been made for sales tax liability of ₹ 9,600.

Following Scheme of Reconstruction has been approved by the Court.

1. Uncalled capital is to be called-up in full and Equity shares are to be reduced to ₹ 5 per share.
2. Sales Tax Liability of ₹ 9,000 is to be paid immediately.
3. Land and Buildings are to be shown in the Balance Sheet on full market value of ₹ 2,20,000 and Goodwill is to be written off.
4. Trade Creditors have consented for 25% of remission of liability on a condition that 25% of the net liability after remission is paid forthwith and the balance is paid within one year.
5. Investments are to be taken over by Bank in full settlement of the overdraft balance.
6. Preference shareholders have agreed to give up their right for the two years dividend and accept 12 fully paid equity shares of ₹ 5 each for each fully paid preference share.

You are required to :

1. Pass necessary Journal Entries recording the above transactions, and
2. Draw up a fresh Balance Sheet after giving effect to the Scheme of Reconstruction.

Workings should form part of your answer. ***(TYBAF, Nov. 2016, CA-Inter, Nov. 1988, adapted)***

Solution :

In the Books of Hopeful Ltd.

Journal

No.	Particulars		Dr. ₹	Cr. ₹
1-4-18				
1.	Bank A/c	Dr.	1,00,000	
	To Equity Share Capital A/c			1,00,000
	[Being the amount of call money received on 40,000 shares @ ₹ 2.50 per share, credited to Share Capital A/c]			

2.	Equity Share Capital A/c (₹ 10) Dr.		4,00,000	
	To Equity Share Capital A/c (₹ 5)			2,00,000
	To Capital Reduction A/c			2,00,000
	[Being 40,000 equity shares of ₹ 10 each fully paid reduced to 40,000 equity shares of ₹ 5 each fully paid as per special resolution no... dated ... as confirmed by the Tribunal]			
3.	Capital Reduction A/c Dr.		9,600	
	To Provision for Sales Tax A/c			9,600
	[Being the adjustment for sales tax provision]			
4.	Provision for Sales Tax A/c Dr.		9,000	
	To Bank A/c			9,000
	[Being the payment of sales tax to the extent of ₹ 9,000]			
5.	Land and Building A/c Dr.		60,000	
	To Capital Reduction A/c			60,000
	[Being the appreciation in the value of land and building credited to Capital Reduction A/c as per scheme of reconstruction]			
6.	Capital Reduction A/c Dr.		20,000	
	To Goodwill A/c			20,000
	[Being goodwill written off as per scheme of reconstruction dated....]			
7.	Trade Creditors A/c Dr.		21,000	
	To Bank A/c			9,000
	To Capital Reduction A/c			12,000
	[Being the amount paid to creditors ₹ 9,000 and amount sacrificed ₹ 12,000 credited to Capital Reduction A/c as per scheme of reconstruction, dated....]			
8.	Bank Overdraft A/c Dr.		16,800	
	Capital Reduction A/c Dr.		7,200	
	To Investment A/c			24,000
	[Being the investment of ₹ 24,000 taken over by bank in full settlement of bank overdraft of ₹ 16,800, the difference debited to Capital Reduction A/c as per scheme of reconstruction dated...]			
9.	9% Preference Share Capital A/c Dr.		2,00,000	
	To Equity Share Capital A/c			1,20,000
	To Capital Reduction A/c			80,000
	[Being the amount sacrificed by the 9% Preference Shareholders @ ₹ 40 on 2,000 shares credited to Capital Reduction A/c, the balance converted into equity shares of ₹ 5 each fully paid as per scheme of reconstruction, dated ....]			
10.	Capital Reduction A/c Dr.		3,15,200	
	To Profit and Loss A/c			1,42,800
	To Capital Reserve A/c (WN 1)			1,72,400
	[Being the balance of Capital Reduction A/c used for writing off the debit balance of Profit and Loss A/c and the balance transferred to Capital Reserve A/c as per scheme of reconstruction, dated....]			

Balance Sheet of Hopeful Ltd. (and reduced) as at 1st April, 2018

Particulars	Note	₹
I. EQUITY AND LIABILITIES		
1. Shareholders' Funds		
a. Share Capital	1	3,20,000
b. Reserves and Surplus	2	1,72,400
2. Current Liabilities		
a. Short Term Borrowings (Unsecured)		80,000
b. Trade Payables		27,000
c. Short-Term Provisions (Sales Tax)		600
Total		6,00,000

II. ASSETS			
1. Non-Current Assets			
Property, Plant and Equipment	... ...	3	3,40,000
2. Current Assets			
a. Inventories	... ...		54,000
b. Trade Receivables	... ...		1,18,000
c. Cash and Cash Equivalents (82,000 + 6,000)	... ...		88,000
Total	... ...		**6,00,000**

Notes to Accounts	₹
1. Share Capital	
Equity Share Capital	
Authorised Capital :	
80,000 Equity Shares of ₹ 10 each reduced to shares of ₹ 5 each vide scheme of reconstruction	4,00,000
2,000, 9% Preference Shares of ₹ 100 each	2,00,000
Total	**6,00,000**
Issued and Subscribed Capital :	
64,000 Shares of ₹ 5 each fully paid (including 24,000 shares issued to Preference Shareholders for consideration other than cash)	**3,20,000**
2. Reserves and Surplus	
Capital Reserve	**1,72,400**
4. Property, Plant and Equipment and Intangible Assets	
a. Property, Plant and Equipment	
Land and Building	2,20,000
Plant and Machinery	1,20,000
Total	**3,40,000**
b. Intangible Assets	
Goodwill	20,000
Less : Written-off as per scheme	20,000
Total	**Nil**

Working Notes :

1. Dr. Capital Reduction Account Cr.

Particulars	₹	*Particulars*	₹
To Provision for Sales Tax A/c	9,600	By Equity Share Capital A/c (₹ 10)	2,00,000
To Goodwill A/c	20,000	By Land and Building A/c	60,000
To Investment A/c	7,200	By Trade Creditors A/c	12,000
To Profit and Loss A/c	1,42,500	By 9% Preference Share Capital A/c	80,000
To Capital Reduction A/c (Bal. Fig.)	1,72,400		
	3,52,000		3,52,000

2. Total amount provided for sales tax is ₹ 9,600. ₹ 9,000 is paid immediately. Therefore, ₹ 600 is to be shown as a current liability in the Balance Sheet.
3. Cash at bank = ₹ 1,00,000 – ₹ 9,000 – ₹ 9,000 = ₹ 82,000.

Illustration 13 :

Following balances appeared in the books of Nervous Ltd. as on 31st March, 2018.

Debit Balances	₹	*Credit Balances*	₹
Goodwill	2,50,000	10,000 7% Cumulative Preference	
Land and Building	12,00,000	shares of ₹ 100 each fully paid	10,00,000
Plant and Machinery	11,00,000	2,00,000 Equity shares of ₹ 10	
Investments	1,20,000	each fully paid	20,00,000
Current Assets	17,20,000	8% Debentures of ₹ 100 each	10,00,000
Profit and Loss Account	8,50,000	(secured on Land and Building)	
		Debenture interest due	40,000

		Loan from Directors	2,00,000
		Current Liabilities	10,00,000
	52,40,000		52,40,000

Note :

(a) Claims for damages against the company pending in the court of law amounted to ₹ 1,00,000.

(b) Arrears of preference dividend ₹ 70,000.

The Board of Directors agreed to present the realistic picture of the state of affairs of the company's position and the following scheme of reconstruction was sanctioned, approved and implemented :

(i) Preference Shares were reduced to equal number of fully paid Preference Shares of ₹ 80 each.

(ii) Equity Shares were reduced to equal number of fully paid Equity Shares of ₹ 2.50 each.

(iii) Preference Shareholders waived half of the arrears of dividend and 14,000 equity shares of ₹ 2.50 each fully paid were issued to them in lieu of the balance.

(iv) 8% Debentureholders took over part of the security having book value ₹ 3,60,000 at ₹ 5,00,000 in part satisfaction of their loan and 1,20,000 Equity shares of ₹ 2.50 each fully paid were issued to them for the balance loan.

(v) Debentureholders waived their interest due on Debentures.

(vi) The claims for damages pending in the court of law were settled by issue of 12,000 Equity shares of ₹ 2.50 each fully paid.

(vii) Directors converted their loan into equity shares of ₹ 2.50 each fully paid.

(viii) All intangible and fictitious assets were written off.

(ix) The assets were revalued as under :

Plant and Machinery - ₹ 7,00,000

Investments - ₹ 1,00,000.

You are required to prepare :

(i) Necessary Journal Entries to record the above scheme of reconstruction in the books of Nervous Ltd.

(ii) Capital Reduction Account in the books of Nervous Ltd. and

(iii) Balance Sheet of Nervous Ltd. after reconstruction.

Solution : ***(T.Y.B.Com., April 2010, Nov. 2016, adapted)***

NERVOUS LTD.

Journal

No.	Particulars		Dr. ₹	Cr. ₹
31-3-18				
1.	**Reduction in Preference Share Capital :**			
	7% Preference Share Capital (₹ 100) A/c	Dr.	10,00,000	
	To Preference Share Capital (₹ 80) A/c			2,00,000
	To Capital Reduction A/c			8,00,000
	[Reduction of 10,000 Preference Shares of ₹ 100 each to equal no. of shares of ₹ 80 each]			
2.	**Reduction in Equity Capital :**			
	Equity Share Capital A/c (₹ 10)	Dr.	20,00,000	
	To Equity Share Capital A/c (₹ 2.50)			5,00,000
	To Capital Reduction A/c			15,00,000
	[Reduction of 2,00,000 Equity Share Capital of ₹ 10 each of equal no. of shares of ₹ 2.50 each vide Scheme of Reconstruction dated .....]			
3.	**Arrears of Preference Dividends :**			
	Capital Reduction A/c	Dr.	35,000	
	To Equity Share Capital A/c (₹ 2.50)			35,000
	[Discharge of 1/2 arrears of Preference Dividends ₹ 70,000 by issue of 14,000 Equity Shares of ₹ 2.50 each]			

4.	**Settlement of Debentures :**			
	8% Debentures A/c	Dr.	10,00,000	
	To Land and Building A/c			3,60,000
	To Equity Share Capital A/c (1,20,000 x 2.50)			3,00,000
	To Capital Reduction A/c			3,40,000
	[Debentures partly settled by way of Land and Building; balance by equity shares; appreciation in value, credited to Capital Reduction A/c]			
5.	**Settlement of Debenture Interest :**			
	Debenture Interest Due A/c	Dr.	40,000	
	To Capital Reduction A/c			40,000
	[Interest due waived by debenture-holders]			
6.	**Contingent Liabilities for Damages :**			
	Capital Reduction A/c	Dr.	30,000	
	To Equity Share Capital A/c (₹ 2.50)			30,000
	[Contingent Liability settled by issue of 12,000 equity shares @ ₹ 2.50 each]			
7.	**Director's Loans :**			
	Director's Loan A/c	Dr.	2,00,000	
	To Equity Share Capital A/c (80,000 x 2.50)			2,00,000
	[Directors Loans settled by issue of Equity Shares]			
8.	**Intangible & Fictitious Assets w/o :**			
	Capital Reduction A/c	Dr.	11,00,000	
	To Goodwill A/c			2,50,000
	To Profit & Loss A/c			8,50,000
	[Value of intangible and fictitious assets adjusted against Capital Reduction A/c vide Scheme of Reconstruction dated.....]			
9.	**Revaluation of Assets :**			
	Capital Reduction A/c	Dr.	4,20,000	
	To Plant & Machinery A/c			4,00,000
	To Investments A/c			20,000
	[Value of assets adjusted against Capital Reduction A/c vide Scheme of Reconstruction dated.....]			
10.	**Balance of Capital Reduction A/c :**			
	Capital Reduction A/c	Dr.	4,95,000	
	To Capital Reserve A/c			4,95,000
	[Balance transferred]			

Dr. **Capital Reduction Account** **Cr.**

Utilisation	*JV*	₹	*Sacrifice*	*JV*	₹
To Equity Share Capital	3	35,000	By Pref. Share Capital	1	2,00,000
To Equity Share Capital	6	30,000	By Equity Share Capital	2	15,00,000
To Goodwill	8	2,50,000	By 8% Debentures	4	3,40,000
To Profit & Loss A/c (Dr.)	8	8,50,000	By Debenture Interest Due	5	40,000
To Plant & machinery	9	4,00,000			
To Investments	9	20,000			
Total Use		15,85,000			
To Capital Reserve (Bal. Fig.)	10	4,95,000			
		20,80,000			20,80,000

Nervous Ltd.

Balance Sheet As at 31st March 2018 (and Reduced)

Particulars	*Note*	₹
I. EQUITY AND LIABILITIES		
1. Shareholders' Funds		
a. Share Capital	1	18,65,000
b. Reserves and Surplus (Capital Reserves)		4,95,000

2. Current Liabilities	... ...		10,00,000
Total	... ...		**33,60,000**
II. ASSETS			
1. Non-Current Assets			
a. Property, Plant and Equipment	... ...	2	15,40,000
b. Non Current Investments	... ...	3	1,00,000
2. Current Assets	... ...		17,20,000
Total	... ...		**33,60,000**

Notes to Accounts			₹
1. Share Capital			
a. Equity Share Capital			
Issued, subscribed & fully paid Shares :			
4,26,000 Equity Shares of ₹ 2.50 each	... ...		10,65,000
b. Preference Share Capital			
Issued, subscribed & fully paid Shares :			
10,000 7% Preference Shares of ₹ 80 each	... ...		8,00,000
Total	... ...		**18,65,000**
2. Property, Plant and Equipment			
– Land and Building	... ...	12,00,000	
Less : Written Off on reconstruction	... ...	(3,60,000)	8,40,000
– Plant and Machinery	... ...	11,00,000	
Less : Written Off on reconstruction	... ...	(4,00,000)	7,00,000
Total			**15,40,000**
3. Non-Current Investments			
Balance	... ...		1,20,000
Less : Written off on reconstruction	... ...		(20,000)
Total	... ...		**1,00,000**

Illustration 14 : (Working Back)

You are furnished with following information in respect of Navneet Ltd. which had undergone internal reconstruction.

(A) Summary Balance Sheet of Navneet Ltd. as on 31st March 2018 (Before Internal Reconstruction)

Liabilities	₹	*Assets*	₹
50,000 Equity Shares of ₹ 10 each, fully paid	5,00,000	Fixed Assets	5,60,000
		Patents	40,000
3,000 - 8% Preference Shares of ₹ 100 each, fully paid	3,00,000	Investments (Market value ₹ 27,500)	32,500
		Sundry Debtors	60,000
9% Debentures	3,00,000	Stock	1,64,500
Accrued Interest on Debenture	54,000	Profit and Loss A/c	4,14,000
Bank Overdraft	70,000		
Interest on above Overdraft	7,000		
Sundry Creditors	40,000		
	12,71,000		12,71,000

(B)

Dr. Capital Reduction Account Cr.

J.E. No.	*Particulars*	₹	*J.E. No.*	*Particulars*	₹
6	To Bank A/c (Reconstruction Exps.)	18,500	1	By Equity Share Capital (50,000.x 7)	3,50,000
7	To Profit and Loss A/c	4,14,000	2	By 8% Preference Share Capital (3,000 x 30)	90,000
7	To Patents	40,000			
8	To Investments	5,000	3	By Debenture Interest	54,000

9	To Sundry Debtors	15,000	4	By Interest on Bank O/D	3,500
9	To Fixed Assets	10,000	5	By Sundry Creditors	5,000
		5,02,500			5,02,500

(C)

Dr. **Bank Account** **Cr.**

J.E. No.	Particulars	₹	J.E. No.	Particulars	₹
8	To Investment A/c	27,500		By Balance b/d	70,000
11	To Equity Share Call A/c (50,000 x 7)	3,50,000	2	By 8% Preference Share Capital A/c (3,000 x 70)	2,10,000
			4	By Interest on Bank O/D	3,500
			5	By Creditors	35,000
			6	By Capital Reduction A/c (Reconstruction Exp.)	18,500
				By Balance c/d	40,500
		3,77,500			3,77,500

You are required to :

1. Pass necessary Journal Entries from which above accounts are prepared, and
2. Prepare Revised Balance Sheet of the company after reconstruction.

(T.Y.B.Com., Oct. 11, adapted)

Solution :

IN THE BOOKS OF NAVNEET LTD.

Journal Entries

No.	Particulars		Dr. ₹	Cr. ₹
1.	Equity Share Capital A/c	Dr.	3,50,000	
	To Capital Reduction A/c			3,50,000
	[Being reduction of 50,000 shares paid up value from ₹ 10 to ₹ 3]			
2.	8% Preference Share Capital A/c	Dr.	3,00,000	
	To Capital Reduction A/c			90,000
	To Bank A/c			2,10,000
	[Being repayment of 3,000 Preference shares @ ₹ 70 each after reduction]			
3.	Debenture Interest A/c	Dr.	54,000	
	To Capital Reduction A/c			54,000
	[Being accrued debenture interest not payable]			
4.	Interest on Bank Overdraft A/c	Dr.	7,000	
	To Bank A/c			3,500
	To Capital Reduction A/c			3,500
	[Being interest on bank overdraft : 1/2 paid, 1/2 waived]			
5.	Sundry Creditors A/c	Dr.	40,000	
	To Bank A/c			35,000
	To Capital Reduction A/c			5,000
	[Being creditors reduced by ₹ 5,000 and paid-off]			
6.	Capital Reduction A/c	Dr.	18,500	
	To Bank A/c			18,500
	[Being reconstruction expenses paid]			
7.	Capital Reduction A/c	Dr.	4,54,000	
	To Profit and Loss A/c			4,14,000
	To Patents A/c			40,000
	[Being Intangible assets w/o]			
8.	Capital Reduction A/c	Dr.	5,000	
	Bank A/c	Dr.	27,500	
	To Investments A/c			32,500
	[Being investments sold at a loss]			

9.	Capital Reduction A/c	Dr.	25,000	
	To Sundry Debtors A/c			15,000
	To Fixed Assets A/c			10,000
	[Being reduction in asset values]			
10.	Equity Share Call A/c	Dr.	3,50,000	
	To Equity Share Capital A/c			3,50,000
	[Being ₹ 7 per share called up on 50,000 shares]			
11.	Bank A/c	Dr.	3,50,000	
	To Equity Share Call A/c			3,50,000
	[Being call money received]			

Balance Sheet of M/s Navneet Ltd. (and Reduced) as on 1st April, 2018

Particulars	*Note*	₹
I. EQUITY AND LIABILITIES		
1. Shareholders' Funds		
Share Capital	1	5,00,000
2. Non-Current Liabilities		
Long Term Borrowings (9% Debentures)		3,00,000
Total		**8,00,000**
II. ASSETS		
1. Non-Current Assets		
Property, Plant and Equipment (5,60,000 – 10,000)		5,50,000
2. Current Assets		
a. Inventories		1,64,500
b. Trade Receivables	2	45,000
c. Cash and Cash Equivalents (Bank)		40,500
Total		**8,00,000**

Notes to Accounts	₹
1. Share Capital	
Equity Share Capital	
Issued, subscribed & fully paid-up : 50,000 Equity Shares of ₹ 10 each	**5,00,000**
2. Trade Receivables	
Debtors	60,000
Less : RDD	(15,000)
Total	**45,000**

Illustration 15 : (BS Before and After Reconstruction)

Following balances appeared in the books of Anmol Ltd. as on 31-03-2018.

10,000 Equity Shares of ₹ 100 each, ₹ 80 per share paid up

5,000 10% Preference Shares of ₹ 100 each fully paid up

4,000 13% Debentures of ₹ 100 each.

4,000 12% Debentures of ₹ 100 each.

Outstanding interest on above Debentures for one year ₹ 52,000 and ₹ 48,000 respectively.

Sundry Creditors - ₹ 4,00,000, Bank Overdraft - ₹ 1,00,000, Goodwill - ₹ 2,00,000, Land - ₹ 3,00,000, Building - ₹ 7,00,000, Plant and Machinery - ₹ 4,00,000, Computer - ₹ 2,00,000, Stock - ₹ 3,00,000, Debtors - ₹ 1,00,000.

The company has suffered heavy losses in the past.

Hence the following scheme of reconstruction was agreed by the shareholders and sanctioned by the court and implemented by the company.

(a) The existing equity shareholders paid ₹ 20 per share in cash to make their shares fully paid up and then agreed to reduce them to ₹ 20 each fully paid.

(b) 10% Preference shares were reduced by ₹ 40 each, however face value remained unchanged.

(c) The claim of 13% Debentureholders alongwith outstanding interest was settled by issue of 4,000 - 14% Debentures of ₹ 100 each.

(d) The claim of 12% Debentureholders alongwith outstanding interest was settled by issue of 4,200 - 12.5% Debentures of ₹ 100 each.

(e) The assets were revalued as under :

Land - ₹ 5,00,000 Building - ₹ 4,00,000
Plant and Machinery - ₹ 2,50,000 Computer - ₹ 1,20,000
Stock - ₹ 2,50,000

Fictitious and intangible assets were written off.

You are required to :

1. Prepare Summary of Assets and Liabilities of Anmol Ltd. before reconstruction.
2. Pass necessary journal entries to record the above scheme of reconstruction in the books of Anmol Ltd.
3. Prepare Balance Sheet of Anmol Ltd. after reconstruction. *(T.Y.B.Com., Oct. 10, adapted)*

Solution :

(1) Summary of Assets and Liabilities of Anmol Ltd. before Reconstruction

Liabilities	₹	*Assets*	₹
Share Capital		Goodwill	2,00,000
10,000 Equity Shares of ₹ 100		Land	3,00,000
each, ₹ 80 per share paid up	8,00,000	Building	7,00,000
5,000 10% Preference Shares of		Plant and Machinery	4,00,000
₹ 100 each fully paid up	5,00,000	Computer	2,00,000
4,000 13% Debentures of ₹ 100 each	4,00,000	Stock	3,00,000
4,000 12% Debentures of ₹ 100 each	4,00,000	Debtors	1,00,000
Interest due on 13% Debentures	52,000	Profit and Loss A/c (Bal. Fig.)	5,00,000
Interest due on 12% Debentures	48,000		
Sundry Creditors	4,00,000		
Bank Overdraft	1,00,000		
	27,00,000		27,00,000

(2) In the Books of Anmol Ltd.

Journal

No.	*Particulars*		*Dr. ₹*	*Cr. ₹*
1.	Equity Share Call A/c (10,000 x 20)	Dr.	2,00,000	
	To Equity Share Capital A/c			2,00,000
	[Being call of ₹ 20 made on 10,000 Equity shares vide Scheme of Reconstruction]			
2.	Bank A/c	Dr.	2,00,000	
	To Equity Share Call A/c			2,00,000
	[Being call money received]			
3.	Equity Share Capital (₹ 100) A/c (10,000 x 100)	Dr.	10,00,000	
	To Capital Reduction A/c (10,000 x 80)			8,00,000
	To Equity Share Capital (₹ 20) A/c (10,000 x 20)			2,00,000
	[Being reduction of 10,000 ₹ 100 Equity shares to ₹ 20 Equity shares vide Scheme of Reconstruction]			
4.	10% Preference Share Capital A/c (5,000 x 40)	Dr.	2,00,000	
	To Capital Reduction A/c			2,00,000
	[Being reduction in Preference Share Capital vide Scheme of Reconstruction]			
5.	13% Debentures A/c (4,000 x 100)	Dr.	4,00,000	
	Interest on 13% Debentures A/c (Given)	Dr.	52,000	
	To Capital Reduction A/c (Sacrifice)			52,000
	To 14% Debentures A/c (4,000 x 100)			4,00,000
	[Being claims of 13% Debentureholders settled vide Scheme of Reconstruction]			

6.	12% Debentures A/c (4,000 x 100)	Dr.	4,00,000	
	Interest on 12% Debentures A/c (Given)	Dr.	48,000	
	To Capital Reduction A/c (Bal. Sacrifice)			28,000
	To 12.5% Debentures A/c (4,200 x 100)			4,20,000
	[Being claims of 12% Debentureholders settled vide Scheme of Reconstruction]			
7.	Land A/c (5,00,000 - 3,00,000)	Dr.	2,00,000	
	To Capital Reduction A/c			2,00,000
	[Being increase in value transferred vide Scheme of Reconstruction]			
8.	Capital Reduction A/c	Dr.	12,80,000	
	To Building A/c (7,00,000 - 4,00,000)			3,00,000
	To Plant and Machinery A/c (4,00,000 - 2,50,000)			1,50,000
	To Computer A/c (2,00,000 - 1,20,000)			80,000
	To Stock A/c (3,00,000 - 2,50,000)			50,000
	To Goodwill A/c (Book Value)			2,00,000
	To Profit and Loss A/c (Book Value)			5,00,000
	[Being reduction in value of assets and writing off losses vide Scheme of Reconstruction]			

(3) Balance Sheet of Anmol Ltd. as on 31-3-2018 (Reduced)

Particulars	Note	₹
I. EQUITY AND LIABILITIES		
1. Shareholders' Funds		
Share Capital	1	5,00,000
2. Non-Current Liabilities		
Long Term Borrowings	2	8,20,000
3. Current Liabilities		
Trade Payables		4,00,000
Total		**17,20,000**
II. ASSETS		
1. Non-Current Assets		
Property, Plant and Equipment	3	12,70,000
2. Current Assets		
a. Inventories	4	2,50,000
b. Trade Receivables		1,00,000
c. Cash and Cash Equivalents (Bank)		1,00,000
Total		**17,20,000**

Notes to Accounts		₹
1. Share Capital		
a. Equity Share Capital		
Issued, subscribed & fully paid : 10,000 Equity Shares of ₹ 20 each		2,00,000
b. Preference Share Capital		
Issued, subscribed but paid		
5,000 10% Preference Shares of ₹ 100 each, ₹ 60 paid-up		3,00,000
Total		**5,00,000**
2. Long Term Borrowings (Secured)		
a. 14% Debentures		4,00,000
b. 12.5% Debentures		4,20,000
Total		**8,20,000**
3. Property, Plant and Equipment		
– Land	3,00,000	
Add : Appreciation on reconstruction	2,00,000	5,00,000
– Building	7,00,000	
Less : Written Off on reconstruction	(3,00,000)	4,00,000
– Plant and Machinery	4,00,000	
Less : Written Off on reconstruction	(1,50,000)	2,50,000

– Computer	... ...	2,00,000	
Less : Written Off on reconstruction	... ...	(80,000)	1,20,000
Total	... ...		12,70,000
4. Inventories	... ...		3,00,000
Less : Written Off on reconstruction	... ...		(50,000)
Total	... ...		**2,50,000**

Working Note :

Dr. **Capital Reduction Account** **Cr.**

Particulars	*JV*	₹	*Particulars*	*JV*	₹
To Building	8	3,00,000	By Equity Share Capital A/c	3	8,00,000
To Plant and Machinery	8	1,50,000	By 10% Preference Share Capital A/c	4	2,00,000
To Computer	8	80,000	By Interest on 13% Debentures A/c	5	52,000
To Stock	8	50,000	By Interest on 12% Debentures A/c	6	28,000
To Goodwill	8	2,00,000	By Land	7	2,00,000
To Profit and Loss A/c	8	5,00,000			
		12,80,000			12,80,000