

Internal Reconstruction

Meaning	Internal reconstruction is a financial restructuring process adopted by companies suffering from accumulated losses, overvalued assets, or fictitious assets
Internal Reconstruction	Financial structure of the company is reorganized without liquidating the company. It includes: <ul style="list-style-type: none"> • Reduction of share capital • Writing off fictitious assets • Revaluation of assets & liabilities • Adjustment of reserves & losses
External Reconstruction	Existing company is liquidated, and a new company is formed to take over its assets and liabilities. It is used when internal reconstruction is not possible or fails

Internal vs External reconstruction

Feature	Internal Reconstruction	External Reconstruction
Entity Status	Company continues	Original liquidated, New Co formed
Capital	Reduced/altered	No change in old company's capital
Asset Transfer	Internal adjustment	Assets/liabilities transfer out
Loss Carry-Forward	Yes	No (new company begins fresh)

Accounting of Internal Reconstruction:

In internal reconstruction, a **Reconstruction Account (also known as Capital Reduction Account)** is created to record the adjustments made during the process. This account functions similarly to a **revaluation or profit and loss account**.

1. For increase in value of assets	Assets A/c To Reconstruction A/c (Being appreciation in values of assets as per reconstruction scheme)	Dr.
2. For Decrease in value of assets/Fictitious assets/Intangible Assets written off Share Issue expenses, Discount on issue of debenture/Deferred Exp	Reconstruction A/c To Assets A/c/Fictitious Assets A/c (Being assets written off as per reconstruction scheme)	Dr.
Goodwill = Mandatory write-off Other Intangible = As instructed in QP		
3. Creditors: Sacrifice by Creditors	Creditors A/c To Reconstruction A/c To Bank A/c	Dr.

(a) Creditors of ₹10000 paid 70% in full settlement:

Paid = 7,000; Sacrifice = 3,000

Particulars	Dr. (₹)	Cr. (₹)
Creditors A/c Dr.	10,000	
To Bank A/c		7,000
To Reconstruction A/c		3,000

Example: Creditors 10,000 - Sacrificed 25% and 60% of balance paid

Particulars	Amount (₹)
Total Creditors	10,000
Less: Sacrificed (25%)	(2,500)
Balance Payable	7,500
Paid (60% of ₹7,500)	(4,500)
Balance Unpaid	3,000 [New Balance sheet]

Particulars	Dr. (₹)	Cr. (₹)
Creditors A/c Dr.	7,000	
To Bank A/c		4,500
To Reconstruction A/c		2,500

4. Debenture Holders	Old Debenture A/c Dr.
Amount Due = Debenture + Int. Accrued	To New Debenture A/c
	To Reconstruction A/c

Example: 10% of Debenture of 1,00,000 converted to 12% Debenture of 80,000.

Solution:

Particulars	Dr. (₹)	Cr. (₹)
10% Debenture A/c Dr.	1,00,000	
To 12% Debenture A/c		80,000
To Reconstruction A/c		20,000
(Being 10% debenture of 100,000 converted into 12% debenture of 80,000 as per re-construction scheme)		

Example: 10% Debenture 50,000, Accrued interest on Debenture 10,000, Debenture Holder sacrificed accrued interest provided debenture converted to 12% Debenture.

Solution:

Particulars	Dr. (₹)	Cr. (₹)
Acc. Int. on Deb. Dr.	10,000	
To Reconstruction A/c		10,000
10% Debenture A/c Dr.	50,000	
To 12% Debenture A/c		50,000
10% Debenture A/c Dr.	50,000	
Acc. Int. A/c Dr.	10,000	
To 12% Debenture A/c		50,000
To Reconstruction A/c		10,000

Example: 10% Debenture = 120,000. Debenture Holders will be issued 12% Debenture of such amount so that they earn same amount of interest. [vvi]

Solution: 12% Debenture issued = (10% of 1,20,000)/12%

Particulars	Dr. (₹)	Cr. (₹)
10% Debenture A/c Dr.	120,000	
To 12% Debenture A/c		100,000
To Reconstruction A/c		20,000

5. Preference Shareholders:	Old Pref. Share Capital A/c Dr.
Preference Shareholder Claim = Pref Shares + Arrear Div	To New Pref. Share Capital A/c
	To Reconstruction A/c
Arrear Pref. Dividend is not shown in balance sheet it is contingent liability,	If arrear dividend is paid
	Reconstruction A/c Dr.
	To Bank A/c
	If arrear dividend is sacrificed
	Not recorded in accounts.

Example: 10% Pref. Share Capital of 1L converted into 12% Pref. Share Capital of 80,000

Particulars	Dr. (₹)	Cr. (₹)
10% Pref Share Capital A/c Dr.	1,00,000	
To 12% Pref. Share Capital A/c		80,000
To Reconstruction A/c		20,000

Example: Arrear dividend 10,000.

Particulars	Dr. (₹)	Cr. (₹)
(i) Sacrificed fully = NO ENTRY		
(ii) Paid fully		
Reconstruction A/C Dr.	10,000	
To Bank A/C		10,000
(iii) Paid 70% and Sacrificed 30%		
For Paid		
Reconstruction A/C Dr.	7,000	
To Bank A/C		7,000
For Sacrificed : NO ENTRY		

6. Equity Shareholders.

(a) Face Value Reduced:

Equity Share Capital (Old FV) A/c Dr.
To Equity Share Capital (New FV) A/c
To Reconstruction A/c

Example:

Particulars	No. of Shares	Face Value (₹)	Amount (₹)
Equity Shares @ ₹10 each	10,000	10	1,00,000
Equity Shares @ ₹2 each	10,000	2	20,000
Sacrifice (Loss/Reduction)	—	—	80,000

Particulars	Dr. (₹)	Cr. (₹)
Equity Share Capital (₹10) A/c Dr.	100,000	
To Equity Share Capital (₹2) A/c		20,000
To Bank A/c		80,000
(Being 10,000 E/S of 10 each converted into 10,000 E/S of ₹2 each as per new scheme)		

(b) Face Value Same but Paid-up Value Reduced:

Equity Share Capital A/c Dr.
To Reconstruction A/c

Example: 10,000 shares of 10 each fully paid converted into 10,000 shares of 10 each 8 paid up.

Explanation: Only paid-up value reduced, FV remaining same, so total capital is not required to be cancelled.

Particulars	Dr. (₹)	Cr. (₹)
Equity Share Capital A/c Dr.	20,000	
To Reconstruction A/c		20,000
(Being 10,000 equity shares of 10 each fully paid converted into 10,000 shares of 10 each 8 paid up as per requirement scheme)		

(c) Sub-division and Consolidation of Shares:

Equity Share Capital (Old FV) A/c
To Equity Share Capital (New FV) A/c

Dr.

Example: 2,000 E/S of ₹100 each, Each share of ₹100 sub-divided into 10 shares of 10 each

Solution:**Calculation:**

Particulars	No. of Shares	Face Value (₹)	Amount (₹)
Equity Shares @ ₹100 each	2,000	100	2,00,000
Sub-divided into 10 shares of ₹10	2,000 × 10 = 20,000	10	2,00,000

Particulars	Dr. (₹)	Cr. (₹)
Equity Share Capital (₹100) A/c Dr.	2,00,000	
To Equity Share Capital (₹10)		2,00,000
(20,000 E/S of 10 each converted into 2,000 E/S of ₹100 each)		

(d) Conversion of E/S into Equity Stock A/c AND VICE VERSA :

Equity Share Capital A/c
To Equity Stock A/c
Equity Stock A/c
To Equity Share Capital A/c A/c

Dr.

Dr.

Example: 10,000 E/S shares of ₹10 each converted into stock

Solution:

Particulars	Dr. (₹)	Cr. (₹)
Equity Share Capital A/c Dr.	1,00,000	
To Equity Stock A/c		1,00,000

Example: Equity Stock of ₹1,00,000 converted into equity shares of ₹10 each

Solution:

Particulars	Dr. (₹)	Cr. (₹)
Equity Stock A/c Dr.	1,00,000	
To Equity Share Capital A/c		1,00,000

(e) Shares Surrender

It means shareholders surrender shares which will be issued to creditors/debenture holders for settlement of their claim and balance of shares surrendered will be cancelled & transferred to reconstruction account.

For Shares surrendered:

Equity Share Capital A/c
To Shares Surrendered A/c

Dr.

For share re-issued out of shares surrendered for settlement of liability:

Shares Surrendered A/c
To Equity Share Capital A/c

Dr.

For Liabilities settled:

Liabilities A/c
To Reconstruction A/c

Dr.

For Balance of Shares surrendered

Shares Surrendered A/c
To Reconstruction A/c

Dr.

Example: Equity shareholders surrendered 5,000 shares of ₹10 each out of which 4,000 shares of ₹10 each issued to creditors in settlement of 45,000, and balance shares surrendered cancelled.

Solution:

Particulars	Dr. (₹)	Cr. (₹)
Equity Share Capital A/c Dr.	50,000	
To Shares Surrendered A/c		50,000
(Being ESH surrendered 5,000 shares of ₹10 each)		
Shares Surrendered A/c Dr.	40,000	
To Equity Share Capital		40,000
(Being 4,000 E/S of ₹10 each issued out of shares surrendered to creditors)		
Creditors A/c Dr.	45,000	
To Reconstruction A/c		45,000
(Being claim of creditors settled)		
Shares Surrendered A/c Dr.	10,000	
To Reconstruction A/c		10,000
7.Reconstruction Expenses	Reconstruction A/c Dr.	
	To Bank A/c	
8.Unrecorded Liabilities i.e. not in balance sheet	<u>Paid</u>	
	Reconstruction A/c Dr.	
	To Bank A/c	
	<u>Not required to be paid</u> → No Entry	
9. Profit /Loss on reconstruction	<u>Profit</u>	
	Reconstruction A/c Dr.	
	To Capital Reserve A/c	
	<u>Loss</u>	
	Capital Reserve /SP / GR A/c Dr.	
	To Reconstruction A/c	

After Reconstruction:

“And Reduced” is added only if Court orders[“XYZ Ltd. and Reduced”], and fixed asset write-offs are disclosed for 5 years.

Example: There were capital commitments amounting to ₹ 4,50,000. These contracts are to be cancelled on payment of 5% of the contract price as a penalty.

Reconstruction A/c Dr.	22,500	
To Bank A/c		22,500
(Being payment for cancellation of capital commitment.)		

MCQ 1.

A process of reconstruction, which is carried out without liquidating the company and forming a new one is called [MTP MAY 25]

- (a) Internal reconstruction. (b) External reconstruction.
(c) Amalgamation in the nature of merger. (d) Amalgamation in the nature of purchase.

MCQ 2.

During the process of Internal Reconstruction, JAY Ltd has come across the following adjustment:

There is a contingent liability for which no provision had been made. This contingent liability was settled at ₹ 7,500 and also ₹ 6,000 was recovered from the insurance company in this regard. Which of the following is the correct treatment for the above adjustment? [MAY 25]

- (a) Reconstruction A/c Dr ₹ 1,500 and Bank A/c Cr ₹ 1,500
(b) Reconstruction A/c Dr ₹ 7,500 and Bank A/c Cr ₹ 7,500
(c) Contingent Liability A/c Dr ₹ 1,500 and Bank A/c Cr ₹ 1,500
(d) Profit and Loss A/c Dr 1,500 and Bank A/c Cr ₹ 1,500

Example:

6% Debentures (secured on the freehold property)	3,75,000
Freehold property	4,25,000

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

(ii) Remaining freehold property after giving to debenture holders, to be re-valued at ₹ 3,87,500.

Solution:

Freehold Property A/c	Dr.	82,500	
To Capital Reduction A/c			82,500
(Appreciation in the value of property:			
	Book value	Revalued Figure	
	₹ 1,00,000	₹ 1,20,000	
	₹ 3,25,000	₹ 3,87,500	
Total	₹ 4,25,000	₹ 5,07,500	
Profit on revaluation: ₹ 82,500)			
6% Debentures A/c	Dr.	1,20,000	
To Freehold Property A/c			1,20,000
(Claims of debenture-holders, in part, in respect of principal discharged by transfer of freehold property vide Scheme of Reconstruction)			
Bank A/c	Dr.	1,30,000	
To 8% Debentures A/c			1,30,000
(8% Debentures issued for cash)			

P1. On 31-12-20X1, B Ltd. had 20,000, ₹10 Equity Shares as authorised capital and the shares were all issued on which ₹ 8 was paid up.

In June, 20X2 the company in general meeting decided to sub-divide each share into two shares of ₹5 with ₹4 paid up.

In June, 20X3 the company in general meeting resolved to consolidate 20 shares of ₹5, ₹4 per share paid up into one share of ₹ 100 each, ₹ 80 paid up.

Pass entries and show how share capital will appear in notes to Balance Sheet as on 31-12- 20X1, 31-12-20X2 and 31-12-20X3.

Solution:**Journal Entries**

20X2		₹	₹
June	Equity Share Capital (₹10) A/c	Dr.	1,60,000
	To Equity Share Capital (₹ 5) A/c		1,60,000
	(Being the sub-division of 20,000 shares of ₹ 10 each with ₹ 8 paid up into 40,000 shares ₹ 5 each with ₹ 4 paid up by resolution in general meeting dated....)		
20X3 June	Equity Share Capital (₹ 5) A/c	Dr.	1,60,000
	To Equity Share Capital (₹ 100) A/c		1,60,000
	(Being consolidation of 40,000 shares of ₹ 5 with ₹ 4 paid up into 2,000 ₹ 100 shares with ₹ 80 paid up)		

Notes to Balance Sheet

Liabilities:	₹
As on 31-12-20X1	
1. Share Capital	
Authorized:	
20,000 Equity Shares of ₹ 10 each	<u>2,00,000</u>
Issued, Subscribed and Paid up:	
20,000 Equity Shares of ₹ 10 each ₹ 8 per share paid up	1,60,000
As on 31-12-20X2	
1. Share Capital	
Authorized:	
40,000 Equity Shares of ₹ 5 each	<u>2,00,000</u>
Issued, Subscribed and Paid up:	
40,000 Equity Shares of ₹ 5 each ₹ 4 per share paid up	1,60,000
As on 31-12-20X3	
1. Share Capital	
Authorized:	
2,000 Equity Shares of ₹ 100 each	<u>2,00,000</u>
Issued, Subscribed and Paid up:	
2,000 Equity Shares of ₹ 100 each ₹ 80 per share paid up	1,60,000

P2. C Ltd. had ₹ 5,00,000 authorised capital on 31-12-20X1 divided into shares of ₹ 100 each out of which 4,000 shares were issued and fully paid up. In June 20X2 the Company decided to convert the issued shares into stock. But in June, 20X3 the Company re-converted the stock into shares of ₹ 10 each, fully paid up. Pass entries and show how Share Capital will appear in Notes to Balance Sheet as on 31-12-20X1, 31-12-20X2 and 31-12-20X3.

Solution:

Journal Entries

		₹	₹
20X2 June	Equity Share Capital A/c Dr.	4,00,000	
	To Equity Stock A/c		4,00,000
	(Being conversion of 4,000 fully paid Equity Shares of ₹ 100 into ₹ 4,00,000 Equity Stock as per resolution in general meeting dated...)		
20X3 June	Equity Stock A/c Dr.	4,00,000	
	To Equity Share Capital A/c		4,00,000
	(Being re-conversion of ₹ 4,00,000 Equity Stock into 40,000 shares of ₹ 10 fully paid Equity Shares as per resolution in General Meeting dated...)		

Notes to Balance Sheet

	₹
As on 31-12-20X1	
Share Capital	
Authorized	
5,000 Equity Shares of ₹ 100 each	<u>5,00,000</u>
Issued and Subscribed	
4,000 Equity Shares of ₹ 100 each fully called up	<u>4,00,000</u>
As on 31-12-20X2	
Share Capital	
Authorized	
5,000 Equity Shares of ₹ 100 each	<u>5,00,000</u>

Issued and Subscribed Equity Stock- 4,000 Equity Shares of ₹ 100 converted into Stock As on 31-12-20X3	<u>4,00,000</u>
Share Capital	
Authorized 50,000 Equity Shares of ₹ 10 each	<u>5,00,000</u>
Issued and Subscribed 40,000 Equity Shares of ₹ 10 each fully called up	4,00,000

P3. Vaibhav Ltd. gives the following ledger balances as at 31st March 20X1:

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

The following scheme of Internal Reconstruction is sanctioned:

[SIMILAR MTP JAN 25]

- (i) All the existing equity shares are reduced to ₹ 40 each.
- (ii) All preference shares are reduced to ₹ 60 each.
- (iii) The rate of Interest on Debentures increased to 6%. The Debenture holders surrender their existing debentures of ₹ 100 each and exchange the same for fresh debentures of ₹ 70 each for every debenture held by them.
- (iv) Property, Plant and Equipment is to be written down by 20%.
- (v) Current assets are to be revalued at ₹ 90,00,000.
- (vi) Investments are to be brought to their market value.
- (vii) One of the creditors of the company to whom the company owes ₹ 40,00,000 decides to forgo 40% of his claim. The creditor is allotted with 60000 equity shares of ₹ 40 each in full and final settlement of his claim.
- (viii) The taxation liability is to be settled at ₹ 3,00,000.
- (ix) It is decided to write off the debit balance of Profit & Loss A/c.

Pass journal entries and show the Balance Sheet of the company after giving effect to the above.

Solution:

Journal Entries in the books of Vaibhav Ltd.

		₹	₹
(i)	Equity share capital (₹ 100) A/c	2,00,00,000	
	To Equity Share Capital (₹ 40) A/c		80,00,000
	To Capital Reduction A/c		1,20,00,000
	(Being conversion of equity share capital of 100 each into ₹40 each as per reconstruction scheme)		
(ii)	6% Cumulative Preference Share capital (₹ 100) A/c Dr.	1,00,00,000	
	To 6% Cumulative Preference Share Capital (₹ 60)cA/c		60,00,000
	To Capital Reduction A/c		40,00,000
	(Being conversion of 6% cumulative preference Shares capital of ₹100 each into ₹ 60 each as per reconstruction scheme)		

(iii)	5% Debentures (₹ 100) A/c	Dr.	80,00,000	
	To 6% Debentures (₹ 70) A/c			56,00,000
	To Capital Reduction A/c			24,00,000
	(Being 6% debentures of ₹ 70 each issued to existing 5% debenture holders. The balance transferred to capital reduction account as per reconstruction scheme)			
(iv)	Sunday Creditors A/C	Dr.	40,00,000	
	To Equity Share Capital ('40)A/c			24,00,000
	To Capital Reduction A/c			16,00,000
	(Being a creditor of ₹ 40,00,000 agreed to surrender his claim by 40% and was allotted 60,000 equity shares of ₹ 40 each in full settlement of his dues as per reconstruction scheme)			
(v)	Provision for Taxation A/c	Dr.	2,00,000	
	Capital Reduction A/c	Dr.	1,00,000	
	To Liability for Taxation A/c			3,00,000
	(Being conversion of the provision for taxation into liability for taxation for settlement of the amount due)			
(vi)	Capital Reduction A/c	Dr.	199,00,000	
	To P & L A/c			12,00,000
	To Property, Plant and Equipment A/c			50,00,000
	To Current Assets A/c			110,00,000
	To Investments A/c			1,00,000
	To Capital Reserve A/c (Bal. fig.)			26,00,000
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, PPE, Current Assets, Investments and the Balance transferred to Capital Reserve)			
(vii)	Liability for Taxation A/c	Dr.	3,00,000	
	To Current Assets (Bank A/c)			3,00,000
	(Being the payment of tax liability)			

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

		Particulars	Notes	₹
		Equity and Liabilities		
1		Shareholders' funds		
	a	Share capital	1	164,00,000
	b	Reserves and Surplus	2	26,00,000
2		Non-current liabilities		
		Long-term borrowings	3	56,00,000
3		Current liabilities		
		Trade Payables (1,00,00,000 - 40,00,000)		60,00,000
		Total		3,06,00,000
		Assets		
1		Non-current assets		
	a	Property, plant and equipment	4	2,00,00,000
	b	Investments	5	19,00,000
2		Current assets	6	87,00,000
		Total		3,06,00,000

Notes to accounts

1. Share Capital		
Equity share capital		
Issued, subscribed and paid up		
2,60,000 equity shares of ₹ 40 each		
(of the above 60,000 shares have been issued for consideration other than cash)		1,04,00,000
Preference share capital		
Issued, subscribed and paid up		
1,00,000 6% Cumulative Preference shares of ₹ 60 each		60,00,000
Total		1,64,00,000
2. Reserves and Surplus		
Capital Reserve		26,00,000
3. Long-term borrowings		
Secured		
6% Debentures		56,00,000
4. Property, Plant and Equipment		
Carrying value	2,50,00,000	
Adjustment under scheme of reconstruction	(50,00,000)	2,00,00,000
5. Investments		
	20,00,000	
Adjustment under scheme of reconstruction	(1,00,000)	19,00,000
6. Current aassets		
	2,00,00,000	
Adjustment under scheme of reconstruction	(1,10,00,000)	
	90,00,000	
Taxation liability paid	3,00,000	87,00,000

Working Note:

Capital Reduction Account

To Liability for taxation A/c	1,00,000	By Equity share capital	1,20,00,000
To P & L A/c	12,00,000	By 6% Cumulative	40,00,000
To Property, planted equipment	50,00,000	preferences	
To Current assets	1,10,00,000	Share capital	
To Investment	1,00,000	By 5% Debentures	24,00,000
To Capital Reserve (Bal.fig.)	26,00,000	By Sunday creditors	16,00,000
	2,00,00,000		2,00,00,000

P4. The summarized Balance Sheet of Bad Luck Ltd. as on 31st March, 2023 was as follows

	Note	Amount ₹	Amount ₹
A. Equity and Liabilities			
1. Shareholders' Fund			
(a) Share Capital	1	7,50,000	
(b) Reserves and Surplus	2	<u>(10,00,000)</u>	(2,50,000)
2. Non-current Liabilities			
(a) Long Term borrowings	3		5,00,000
3. Current Liabilities			
(a) Short Term Borrowings	4	5,00,000	
(b) Trade Payables		<u>2,50,000</u>	<u>7,50,000</u>
Total			<u>10,00,000</u>
B. Assets			
1. Non-current assets			
(a) Fixed Assets			
(i) Tangible assets	5	5,50,000	
(ii) Intangible assets	6	<u>1,50,000</u>	7,00,000
2. Current Assets			
(a) Inventories		1,50,000	
(b) Trade Receivables		1,25,000	
(c) Deferred revenue expenditure		<u>25,000</u>	<u>3,00,000</u>
Total			<u>10,00,000</u>

Notes to Accounts

	Amount ₹	Amount ₹
1. Share Capital		
Authorised, issued & fully paid		
5,000 equity shares of ₹ 100 each	5,00,000	
2,500 8% preference shares of ₹ 100 each	<u>2,50,000</u>	7,50,000
2. Reserves and Surplus		
Profit and Loss Account		(10,00,000)
3. Long Term borrowings		
8% Debentures		5,00,000
4. Short Term Borrowings		
Loan from Directors	3,00,000	
Bank overdraft	<u>2,00,000</u>	5,00,000
5. Tangible Assets		
Freehold property	4,00,000	
Plant	<u>1,50,000</u>	5,50,000
6. Intangible Assets		
Goodwill	1,00,000	
Trademark	<u>50,000</u>	1,50,000

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

- The preference shares to be written down to ₹ 25 each and the equity shares to ₹ 20 each. Each class of shares then to be converted into shares of ₹ 100 each.
- The debenture holders to take over freehold property (book value ₹ 2,00,000) at a valuation of ₹ 2,50,000 in part repayment of their holdings. Remaining freehold property to be revalued at ₹ 6,00,000.
- Loan from directors to be waived off in full.
- Stock of ₹ 50,000 to be written off, ₹ 12,500 to be provided for bad debts.
- Profit and Loss account balance, Trademark, goodwill and deferred revenue expenditure to be written off.

Pass Journal Entries for all the above mentioned transactions. Also Prepare Capital Reduction account and company's Balance Sheet immediately after reconstruction. **[May-2013]**

Solution:**Journal entries in the books of Bad Luck Ltd.**

	Particulars	Debit(₹)	Credit(₹)
i	8% Preference Share Capital A/c (₹ 100 each) Dr.	2,50,000	
	To 8% Preference Share Capital A/c (₹ 25 each)		62,500
	To Capital Reduction A/c		1,87,500
	(Being the preference shares of ₹ 100 each reduced to ₹ 25 each as per the approved scheme)		
ii	Equity Share Capital A/c (₹ 100 each) Dr.	5,00,000	
	To Equity Share Capital A/c (₹ 20 each)		1,00,000
	To Capital Reduction A/c		4,00,000
	(Being the equity shares of ₹100 each reduced to ₹ 20 each)		
iii	Preference Share Capital A/c (₹ 25) Dr.	62,500	
	To Preference Share Capital A/c (₹ 100)		62,500
	(Being conversion of 2500 shares of ₹ 25 each to 625 shares of ₹ 100 each)		
iv	Equity Share Capital A/c (₹ 20) Dr.	1,00,000	
	To Equity Share Capital A/c (₹100)		1,00,000
	(Being conversion of 5,000 shares of ₹ 20 each to 1000 shares of ₹ 100 each)		
v	Freehold Property Dr.	50,000	
	To Capital Reduction A/c		50,000
	(Being value of freehold property appreciated)		
vi	8% Debentures A/c Dr	2,50,000	
	To Freehold Property		2,50,000
	(Being claim of Debenture holders settled in part by transfer of freehold property)		
vii	Freehold Property Dr.	4,00,000	
	To Capital Reduction A/c		4,00,000
	(Being appreciation in the value of freehold property)		
viii	Director's Loan A/c Dr.	3,00,000	
	To Capital Reduction A/c		3,00,000
	(Being director's loan waived in full)		
ix	Capital Reduction A/c Dr.	13,37,500	
	To Deferred Revenue Expenditure	25,000	
	To Profit and Loss A/c	10,00,000	
	To Provision of Doubtful Debts A/c	12,500	
	To Inventories		50,000
	To Goodwill A/c		1,00,000
	To Trademark		50,000
	To Capital Reserve A/c		1,00,000
	(Being certain value of various assets (tangible & intangible), profit and loss account debit balance written off and balance transferred to capital reserve account as per the scheme)		

(b) Capital Reduction Account

	(₹)		(₹)
To Provision for Doubtful Debts	12,500	By Preference Share Capital	1,87,500
To Inventories	50,000	By Equity Share Capital	4,00,000
To Profit & Loss A/c	10,00,000	By Freehold Property (50,000+4,00,000)	4,50,000
To Trademark	50,000	By Director's Loan	3,00,000
To Goodwill	1,00,000		
To Deferred Revenue Expenditure	25,000		
To Capital Reserve	1,00,000		
	13,37,500		13,37,500

**Balance Sheet of Bad Luck Ltd. (And Reduced)
As on 31st March 2023**

Particulars	Note No.	₹
I. Equity and Liabilities		
(1) <u>Shareholder's Funds</u>		
(a) Share Capital	1	1,62,500
(b) Reserves and Surplus	2	1,00,000
(2) <u>Non-Current Liabilities</u>		
(a) Long-term borrowings	3	2,50,000
(3) <u>Current Liabilities</u>		
(a) Short Term borrowings	4	2,00,000
(b) Trade payable		<u>2,50,000</u>
		<u>9,62,500</u>
II. Assets		
(1) <u>Non-current assets</u>		
(a) Fixed assets		
Tangible assets	5	7,50,000
(2) <u>Current assets</u>		
(a) Inventories		1,00,000
(b) Trade receivables	6	<u>1,12,500</u>
Total		<u>9,62,500</u>

Notes to Accounts

1. Share Capital	
Authorised, issued and fully paid up	
1,000 Equity shares of ₹100 each fully paid-up	1,00,000
625, 8% Preference Share of ₹ 100 each	<u>62,500</u>
	<u>1,62,500</u>
2. Reserve and Surplus	
Capital Reserve	1,00,000
3. Long Term Borrowings	
8% Debentures ₹ (5,00,000-2,50,000)	2,50,000
4. Short-Terms Borrowings	
Bank Overdraft	2,00,000
5. Tangible assets	
Freehold Property	6,00,000
Plant	<u>1,50,000</u>
	<u>7,50,000</u>
6. Trade Receivables	1,25,000
Less: Provision for doubtful debts	<u>(12,500)</u>
	<u>1,12,500</u>

P5. Repair Ltd. is in the hands of a receiver for debenture holders who hold a charge on all assets except uncalled capital. Repair Ltd. gives the following information as regards creditors on 31st March, 20X1:

	₹
Property, plant and equipment (Cost ₹ 3,90,000) - estimated at	1,50,000
Cash in hand of the receiver	2,70,000
Charged under debentures	4,20,000
Uncalled capital	1,80,000
Deficiency	7,50,000
6,000 shares of ₹ 60 each, ₹ 30 paid up	1,80,000
First debentures	3,00,000
Second debentures	6,00,000
Unsecured trade payables	4,50,000

A holds the first debentures for ₹ 3,00,000 and second debentures for ₹ 3,00,000. He is also an unsecured creditor for ₹ 90,000. B holds second debentures for ₹ 3,00,000 and is an unsecured trade payables for ₹ 60,000. The following scheme of reconstruction is proposed:

1. A is to cancel ₹ 2,10,000 of the total debt owing to him, to bring ₹ 30,000 in cash and to take first debentures (in cancellation of those already issued to him) for ₹ 5,10,000 in satisfaction of all his claims.
2. B is to accept ₹ 90,000 in cash in satisfaction of all claims by him.
3. In full settlement of 75% of the claim, unsecured creditors (other than A and B) agreed to accept four shares of ₹ 7.50 each, fully paid against their claim for each share of ₹ 60. The balance of 25% is to be postponed and to be payable at the end of three years from the date of Court's approval of the scheme. The nominal share capital is to be increased accordingly.
4. Uncalled capital is to be called up in full and ₹ 52.50 per share cancelled, thus making the shares of ₹ 7.50 each.

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

Solution:

Journal Entries

Particulars		Debit (₹)	Credit (₹)
First debentures A/c	Dr.	3,00,000	
Second debentures A/c	Dr.	3,00,000	
Unsecured creditors A/c	Dr.	90,000	
To A's A/c			6,90,000
(Being A's total liability ascertained)			
A's A/c	Dr.	2,10,000	
To Capital reduction A/c			2,10,000
(Being cancellation of debt upto ₹ 2,10,000)			
Bank A/c	Dr.	30,000	
To A's A/c			30,000
(Being cash received in course of settlement)			
A's A/c	Dr.	5,10,000	
To First debentures A/c			5,10,000
(Being liability of A, discharged against first debentures)			
Second debentures A/c	Dr.	3,00,000	
Unsecured creditors A/c	Dr.	60,000	
To B's A/c			3,60,000
(Being B's liability ascertained)			
B's A/c	Dr.	3,60,000	
To Bank A/c			90,000
To Capital reduction A/c			2,70,000
(Being B's liability discharged)			

Unsecured trade payables A/c	Dr.	3,00,000	
To Equity share capital A/c			1,12,500
To Loan (Unsecured) A/c			75,000
To Capital reduction A/c			1,12,500
(Being settlement of unsecured creditors)			
Share call A/c	Dr.	1,80,000	
To Share capital A/c			1,80,000
(Being final call money due)			
Bank A/c	Dr.	1,80,000	
To Share call A/c			1,80,000
(Being final call money received)			
Share capital A/c (Face value ₹ 60)	Dr.	3,60,000	
To Share capital (Face value ₹ 7.50)			45,000
To Capital reduction A/c			3,15,000
(Being share capital reduced to ₹ 7.50 each)			
Capital reduction A/c	Dr.	9,07,500	
To Profit and loss A/c			8,70,000
To Capital Reserve			37,500
(Being reconstruction surplus used to write off losses and balance transfer to capital reserve)			

Working Notes:

1.	Settlement of claim of remaining unsecured creditors		₹
	75% of ₹ 3,00,000		2,25,000
	Considering their claim for share of ₹ 60 each		
	$2,25,000/60 = 3,750$ shares		
	Less: Number of shares to be issued		
	$3,750 \times 4 = 15,000$ shares of ₹ 7.5 each		
	Total value = $15,000 \times 7.50$		(1,12,500)
	Transferred to Capital reduction A/c		1,12,500

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

	₹	₹
Asset		
Property, plant and equipment	3,90,000	
Cash	2,70,000	6,60,000
Less: Capital & Liabilities:		
Share capital	1,80,000	
1st Debenture	3,00,000	
2nd Debenture	6,00,000	
Unsecured trade payables	4,50,000	(15,30,000)
Profit and loss A/c (Debit balance)		(8,70,000)

P6. The Balance Sheet of A & Co. Ltd. as at 31-03-20X2 is as follows:

		Particulars	Note s	₹
		Equity and Liabilities		
1		Shareholders' funds		
	A	Share capital	1	11,50,000
	B	Reserves and Surplus	2	(5,35,000)
2		Non-current liabilities		
	A	Long-term borrowings	3	3,75,000
3		Current liabilities		
	A	Trade Payables		3,00,000
	B	Short term borrowings - Bank Overdraft		1,95,000
	C	Other current liabilities	4	1,22,500
		Total		16,07,500
		Assets		
1		Non-current assets		
	A	Property, plant and equipment	5	4,75,000
	B	Intangible assets	6	1,67,500
	C	Non-current investments	7	55,000
2		Current assets		
	A	Inventories		4,25,000
	B	Trade receivables		4,85,000
		Total		16,07,500

Notes to accounts

		₹
1	Share Capital	
	Equity share capital:	
	75,000 Equity Shares of ₹ 10 each	7,50,000
	Preference share capital:	
	4,000 6% Cumulative Preference Shares of ₹ 100 each	4,00,000
		11,50,000
2	Reserves and Surplus	
	Debit balance of Profit and loss Account	(5,35,000)
		(5,35,000)
3	Long-term borrowings	
	Secured	
	6% Debentures (secured on the freehold property)	3,75,000
		3,75,000
4	Other current liabilities	
	Loan from directors	1,00,000
	Interest payable on 6% debentures	22,500
		1,22,500
5	Property plant and Equipment	
	Freehold property	4,25,000
	Plant	50,000
		4,75,000
6	Intangible assets	
	Goodwill	1,30,000
	Patents	37,500
		1,67,500
7	Non-current investments	
	Investments at cost	55,000
		55,000

The Court approved a Scheme of re-organisation to take effect on 1-4-20X2, whereby:

- (i) The Preference Share to be written down to ₹ 75 each and Equity Shares to ₹ 2 each.
- (ii) Of the Preference Share dividends which are in arrears for four years, three fourths to be waived and Equity Shares of ₹ 2 each to be allotted for the remaining quarter.
- (iii) Interest payable on debentures to be paid in cash.
- (iv) Debenture-holders agreed to take over freehold property, book value ₹1,00,000 at a valuation of ₹1,20,000 in part repayment of their holdings and to provide additional cash of ₹1,30,000 secured by a floating charge on company's assets at an interest rate of 8% p.a.
- (v) Patents and Goodwill to be written off.
- (vi) Inventory to be written off by ₹ 65,000.
- (vii) Amount of ₹ 68,500 to be provided for bad debts.
- (viii) Remaining freehold property after giving to debenture holders, to be re-valued at ₹ 3,87,500.
- (ix) Investments be sold for ₹ 1,40,000.
- (x) Directors to accept settlement of their loans as to 90% thereof by allotment of equity shares of ₹2 each and as to 5% in cash, and balance 5% being waived.
- (xi) There were capital commitments totaling ₹ 2,50,000. These contracts are to be cancelled on payment of 5% of the contract price as a penalty.
- (xii) Ignore taxation and cost of the scheme.

You are requested to show Journal entries reflecting the above transactions (including cash transactions) and prepare the Balance Sheet of the company after completion of the Scheme.

Solution:

Journal of A & Co. Ltd.

		Dr.	Cr.	₹
20X2	Equity Share Capital A/c (₹ 10) Dr.	7,50,000		
April 1	To Capital Reduction A/c		6,00,000	
	To Equity Share Capital A/C (₹ 2)		1,50,000	
	(Reduction of equity shares of ₹ 10 each to shares of ₹ 2 each as per Reconstruction Scheme dated...)			
	6% Cum. Preference Share Capital A/C (₹ 100) Dr.	4,00,000		
	To Capital Reduction A/c		1,00,000	
	To Pref. Share Capital A/c (₹ 75)		3,00,000	
	(Reduction of preference shares of ₹ 100 each to shares of ₹ 75 each as per reconstruction scheme)			
	Capital Reduction Account Dr.	24,000		
	To Equity Share Capital Account		24,000	
	(Arrears of preference dividends satisfied by the issue of equity shares, 25% of the amount due, ₹ 96,000)			
	Freehold Property A/c Dr.	82,500		
	To Capital Reduction A/c		82,500	
	(Appreciation in the value of property:			
	Book value Revalued Figure			
	₹ 1,00,000 ₹ 1,20,000			
	₹ 3,25,000 ₹ 3,87,500			
	Total ₹ 4,25,000 ₹ 5,07,500			
	Profit on revaluation: ₹ 82,500)			
	6% Debentures A/c Dr.	1,20,000		
	To Freehold Property A/c		1,20,000	
	(Claims of debenture-holders, in part, in respect of principal discharged by transfer of freehold property vide Scheme of Reconstruction)			
	Interest payable A/c Dr.	22,500		
	To Bank A/c		22,500	
	(Debenture interest paid)			

Bank A/c	Dr.	1,30,000	
To 8% Debentures A/c			1,30,000
(8% Debentures issued for cash)			
Bank A/c	Dr.	1,40,000	
To Investment A/c			55,000
To Capital Reduction A/c			85,000
(Sale of Investment for ₹ 1,40,000 cost being ₹55,000; profit credited to Capital Reduction Account)			
Directors' Loan A/c	Dr.	1,00,000	
To Equity Share Capital A/c			90,000
To Bank A/c			5,000
To Capital Reduction A/c			5,000
(Directors' loan discharged by issue of equity shares of ₹ 90,000, cash payments of ₹ 5,000 and surrender of ₹ 5,000, vide Scheme of Reconstruction)			
Capital Reduction A/c	Dr.	8,48,500	
To Patents			37,500
To Goodwill			1,30,000
To Inventory			65,000
To Provision for Doubtful Debts			68,500
To Bank			12,500
To Profit & Loss Account			5,35,000
(Writing off patents, goodwill, profit and loss account and reducing the value of stock, making the required provision for doubtful debts and payment for cancellation of capital commitments)			

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

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

		Particulars	Notes	₹
		Equity and Liabilities		
1		Shareholders' funds		
	A	Share capital	1	5,64,000
2		Non-current liabilities		
	A	Long-term borrowings	2	3,85,000
3		Current liabilities		
	A	Trade Payables		3,00,000
		Total		<u>12,49,000</u>
		Assets		
1		Non-current assets		
	A	Property, plant and equipment	3	4,37,500
	B	Intangible assets	4	-
2		Current assets		
	A	Inventories		3,60,000
	B	Trade receivables	5	4,16,500
	C	Cash and cash equivalents		35,000
		Total		<u>12,49,000</u>

Notes to accounts

1	Share Capital		
	Equity share capital		
	1,32,000 Equity shares of ₹ 2 each (of the above 57,000 shares have been issued for consideration other than cash)		2,64,000
2	Preference share capital		
	4,000 6% Preference shares of ₹ 75 each		<u>3,00,000</u>
	Total		<u>5,64,000</u>
	Long-term borrowings		
	Secured		
	6% Debentures		2,55,000
	8% Debentures		<u>1,30,000</u>
	Total		<u>3,85,000</u>
3	Property, plant and equipment		
	Freehold property	4,25,000	
	Add: Appreciation under scheme of Reconstruction	82,500	
	Less: Disposed of	<u>(1,20,000)</u>	3,87,500
	Plant		<u>50,000</u>
	Net carrying value		<u>4,37,500</u>
4	Intangible assets		
	Goodwill	1,30,000	
	Less: Written off under scheme of Reconstruction	<u>(1,30,000)</u>	
	Net carrying value		NIL
	Patents	37,500	
	Less: Written off under scheme of Reconstruction	<u>(37,500)</u>	-
	Net carrying value	-	<u>NIL</u>
5	Trade Receivables	4,85,000	
	Less: Provision for doubtful debts	<u>68,500</u>	
			<u>4,16,500</u>

P7. X Ltd. whose Balance sheet as at 31st December 20X1 appears below formulated a scheme of reconstruction, details of which follow, and secured approval of all concerned Parties.

Liabilities	₹	Assets	₹
Equity share capital:		Fixed Assets:	5,60,000
50,000 shares of ₹ 20 each ₹ 10 paid	5,00,000	Patents and copyrights	40,000
8% pre share 4,000 shares of ₹ 100 each ₹ 75 paid up	3,00,000	Investments at cost (Market value ₹ 27,500)	32,500
Secured Loans:		Current Assets	4,24,500
9% debentures 3,00,000		Profit and Loss A/c	2,14,000
Interest accrued 54,000	3,54,000		
Bank overdraft	75,000		
Sundry creditors (including interest of ₹7,500 due Bank)	42,000		
	12,71,000		12,71,000

Contingent Liabilities: Preference dividend is in arrears for one year:

1. Preference shareholders to give up their claims, inclusive of dividends, to the extent of 30 percent and desire to be paid off.
2. Debenture- holders agree to give up their claims to interest in consideration of their rate of interest being enhanced to 10%.
3. Bank agrees to give up 50% of their interest outstanding in consideration of their being paid off at once.
4. Sundry creditors would like to grant a discount of 5% if they were to be paid off immediately.
5. Balance on profit and Loss account patents and copyright and 25% of the total sundry debtors of ₹ 60,000 to be written off, fixed assets to be written down by ₹ 7,000. Investments to reflect their market value.
6. To the extent not specifically stated, equity shareholders suffer on reduction of their rights.
7. Costs of reconstruction ₹ 1,675.

Pass journal entries in the books of the company assuming that the scheme has been put through fully with equity shareholders bringing in necessary cash to pay of the parties and to leave a working capital of ₹ 10,000.

Solution:

Journal Entries In the books of X Ltd

Particulars	Debit (₹)	Credit (₹)
8% PSC A/c Dr.	3,00,000	
To Bank A/c		2,10,000
To Reconstruction A/c		90,000
Reconstruction A/c Dr.	16,800	
To Bank A/c		16,800
9% Debentures A/c Dr.	3,00,000	
Interest Accrued Dr.	54,000	
To 10% Debentures A/c		3,00,000
To Reconstruction A/c		54,000
Bank Overdraft A/c Dr.	75,000	
Sundry Creditors (Interest) Dr.	7,500	
To Bank A/c		78,750
To Reconstruction A/c		3,750
Sundry Creditors A/c Dr.	34,500	
To Bank A/c		32,775
To Reconstruction A/c		1,725

Reconstruction A/c	Dr.	2,81,000	
To P/L A/c			2,14,000
To Patents			40,000
To C.A. (Debtor)			15,000
To Furniture & Fixtures			7,000
To Investments			5,000
Reconstruction A/c	Dr.	1,675	
To Bank A/c			1,675
Bank A/c	Dr.	3,50,000	
To Equity Share Capital A/c [50000 sh @ 7]			3,50,000

Working Note**I. Cash to be introduced by ESH**

Particulars	Amount (₹)	Particulars	Amount (₹)
To ESC A/C	3,50,000	By 8% PSC A/c	2,10,000
[Call on 50000 shares @7]		By Bank A/c	16,800
		By BOD A/c	75,000
		By S.C. (Int.)	3,750
		By Sundry Creditors	32,775
		By Reconstruction A/c	1,675
		By Balance c/d	10,000
	3,50,000		3,50,000

II. Share Capital Adjustment Entry

Particulars	Debit (₹)	Credit (₹)
Equity Share Capital A/c (₹20) [50000 sh @ 17]	8,50,000	
To Equity Share Capital A/c (50000 sh @ ₹14)		7,00,000
To Reconstruction A/c [50000sh @ 3]		1,50,000
(Being 50,000 equity shares of ₹20 each @ ₹17 paid reduced and converted into 50,000 equity shares of ₹14 each fully paid as per reconstruction scheme.)		

III. Reduction in Rights of ESH**Reconstruction Account**

Particulars	Amount (₹)	Particulars	Amount (₹)
To Bank A/c	16,800	By 8% PSC	90,000
To P/L A/c	2,14,000	By Debenture Interest	54,000
To Patents	40,000	By S.C. (Int.)	3,750
To C.A.	15,000	By Sundry Creditors	1,725
To Intangible Assets	7,000	By ESH Capital (B/F)	1,50,000
To Investments	5,000		
To Bank A/c	1,675		
	2,99,475		2,99,475

P8. The Balance Sheet of Revise limited as at 31st March 20X2 was as follows:

		Particulars	Notes	₹
		Equity and Liabilities		
1		Shareholders' funds		
	A	Share capital	1	10,00,000
	B	Reserves and surplus	2	(6,00,000)
2		Non-current liabilities		
	A	Long-term borrowings	3	2,00,000
3		Current liabilities		
	A	Trade Payables		72,000
	B	Other current liabilities	4	24,000
	C	Short term provisions	5	<u>24,000</u>
		Total		<u>7,20,000</u>
		Assets		
1		Non-current assets		
	A	Property, Plant and Equipment	6	1,00,000
2		Current assets		
	A	Inventory		3,20,000
	B	Trade receivables		2,70,000
	C	Cash and cash equivalents		<u>30,000</u>
		Total		<u>7,20,000</u>

Notes to accounts

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

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

- Each share be sub-divided into ten fully paid equity shares of ₹ 10 each.
- After sub division each shareholder shall surrender to the company 50 per cent of his holding for the purpose of re-issue to debenture holders and trade payable as necessary.
- Out of share surrendered, 10,000 shares of ₹ 10 each shall be converted into 12% preference shares of ₹ 10 each, fully paid up.
- The claims of the debenture-holders shall be reduced by 75%. In consideration of the reduction the debenture holders shall receive preference shares of ₹ 1,00,000 which are out of shares surrendered.
- Trade Payables claim shall be reduced to 50 per cent, it is to be settled by the issue of equity shares of ₹ 10 each out of shares surrendered.

6. Balance of profit and loss account to be written off.

7. The share surrendered and not re-issued shall be cancelled.

You are required to show the journal entries giving effect to the above and the resultant Balance sheet.

Solution:

		Dr. ₹	Cr. ₹
Equity Share Capital (₹ 100) A/c	Dr.	10,00,000	
To Share Surrender A/c			5,00,000
To Equity Share Capital (₹ 10) A/c (Subdivision of 10,000 equity shares of ₹ 100 each into 1,00,000 equity shares of ₹ 10 each and surrender of 50,000 of such subdivided shares as per capital reduction scheme)			5,00,000
12% Debentures A/c	Dr.	1,50,000	
Interest payable A/c	Dr.	18,000	
To Reconstruction A/c			1,68,000
(Transferred 75% of the claims of the debenture holders to reconstruction account in consideration of which 12% preference shares are being issued out of share surrender account as per capital reduction scheme)			
Trade payables A/c	Dr.	72,000	
To Reconstruction A/c			72,000
(Transferred claims of the trade payables to reconstruction account, 50% of which is being clear reduction and equity shares are being issued in consideration of the balance)			
Share Surrender A/c	Dr.	5,00,000	
To 12% Preference Share Capital A/c			1,00,000
To Equity Share Capital A/c			36,000
To Reconstruction A/c			3,64,000
(Issued preference and equity shares to discharge the claims of the debenture holders and the trade payables respectively as a per scheme and the balance in share surrender account is being transferred to reconstruction account)			
Reconstruction A/c	Dr.	6,04,000	
To Profit and Loss A/c			6,00,000
To Capital Reserve A/c (Adjusted debit balance of profit and loss account against the reconstruction account and the balance in the latter is being transferred to capital reserve)			4,000

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

Particulars	Note No.	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	6,36,000
(b) Reserves and Surplus	2	4,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	50,000
(3) Current Liabilities		
(a) Other current liabilities	4	6,000
(b) Short-term provisions	5	24,000
Total		7,20,000

II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	6	1,00,000
(2) Current assets		
(a) Inventories		3,20,000
(b) Trade receivables		2,70,000
(c) Cash and cash equivalents		30,00
Total		7,20,000

Notes to Accounts

		₹
1.	Share Capital	
	<u>Equity Share Capital</u>	
	Issued Capital: 53,600 Equity Shares of ₹ 10 each	5,36,000
	<u>Preference Share Capital</u>	
	Preference Shares	1,00,000
	(Of the above shares all are allotted as fully paid up pursuant to capital reduction scheme by conversion of equity shares without payment being received in cash)	
		6,36,000
	Reserve and Surplus	
	Capital Reserve	4,000
	Long-term borrowings	
	Unsecured Loans	
	12% Debentures	50,000
	Other current liabilities	
	Interest payable on debentures	6,000
	Short-term provisions	
	Provision for Income-tax	24,000
	Property, plant and Equipment	
	Machinery	1,00,000

P9. Recover Ltd decided to reorganize its capital structure owing to accumulated losses and adverse market condition. The Balance Sheet of the company as on 31 st March 2023 is as follows-

		Particulars	Notes	₹
		Equity and Liabilities		
1		Shareholders' funds		
	A	Share capital	1	3,50,000
	B	Reserves and surplus	2	(70,000)
2		Non-current liabilities		
	A	Long-term borrowings	3	55,000
3		Current liabilities		
	A	Trade Payables		80,000
	B	Short term Borrowings – Bank overdraft		90,000
				5,05,000
		Assets		
1		Non-current assets		
	A	Property, Plant Equipment	4	3,35,000
	B	Intangible assets	5	50,000
	C	Non-current investments	6	40,000
2		Current assets		
	A	Inventories		30,000
	B	Trade receivables		50,000
				5,05,000

Notes to accounts:

1	Share Capital		₹
	Equity share capital:		
	20,000 Equity Shares of ₹ 10 each		20,00,000
	Preference share capital:		
	15,000 8% Cumulative Preference Shares of ₹ 10 each (preference dividend has been in arrears for 4 years)		<u>1,50,000</u>
			<u>3,50,000</u>
2	Reserves and surplus		
	Securities premium		10,000
	Profit and loss account (debit balance)		<u>(80,000)</u>
			<u>(70,000)</u>
3	Long-term borrowings		
	Secured		
	9% Debentures (secured on the freehold property)		50,000
	Accrued interest on 9% debentures		<u>5,000</u>
			<u>55,000</u>
4	Property, Plant and Equipment		
	Freehold property		1,20,000
	Leasehold property		85,000
	Plant and machinery		<u>1,30,000</u>
			<u>3,35,000</u>
5	Intangible assets		
	Goodwill		<u>50,000</u>
			<u>50,000</u>
6	Non-current investments		
	Non-Trade investments at cost		<u>40,000</u>
			<u>40,000</u>

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

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

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

[RTP May-2021]

Solution:**In the books of Recover Ltd**
Journal entries

Particulars	Dr. ₹	Cr. ₹
8% Cumulative Preference share capital (10₹) A/c Dr.	1,50,000	
To 8% Cumulative Preference share capital (₹2.5) A/c		37,5000
To Capital reduction (₹ 7.5) A/c		1,12,500
(Preference shares being reduced to shares of ₹ 2.5 per share and remaining transferred to capital reduction account as per capital reduction scheme)		
Equity share capital A/c (₹10) Dr.	2,00,000	
To Equity Share capital A/c (₹ 1)		20,000
To Capital reduction A/c (₹ 9)		1,80,000
(Equity shares reduced to ₹ 1 per share with the remaining amount transferred to capital reduction a/c as a part of the internal reconstruction scheme.)		
Capital reduction A/c Dr.	48,000	
To Equity share capital A/c		48,000
(Equity shares of ₹ 1 issued in lieu of the arrears of preference dividend for 4 years as a part of the internal reconstruction scheme)		
Securities Premium A/c Dr	10,000	
To Capital reduction A/c		10,000
(Amount from the securities premium utilized towards the capital reduction a/c as a part of the internal reconstruction scheme)		
9% Debentures A/c Dr.	50,000	
Accrued interest on debentures A/c Dr.	5,000	
Bank A/c Dr.	20,000	
Capital reduction A/c Dr.	45,000	
To Freehold property A/c		1,20,000
(Debenture holders being paid by the sale of property, which is sold at a loss debited to the capital reduction account. Amount received in excess being refunded to company by debenture holders as a part of the internal reconstruction scheme.)		
Capital reduction A/c Dr.	90,000	
To Plant and Machinery Ac		30,000
To Goodwill A/c		50,000
To Inventory A/c		10,000
(The assets written off as a part of the internal reconstruction scheme)		
Bank A/c Dr.	32,000	
Capital reduction A/c Dr.	8,000	
To Investments A/c		40,000
(Investments sold at a loss debited to capital Reduction account as a part of the internal reconstruction scheme)		
Contingent Liability A/c Dr.	7,000	
To Bank A/c		7,000
(Contingent liability paid as a part of the internal Reconstruction scheme)		
Bank A/c Dr.	6,300	
Capital reduction A/c Dr.	700	
To Contingent Liability A/c		7,000
(The insurance company remitting part of the Contingency payment amount)		

Capital reduction A/c		
To Profit and loss A/c	Dr.	80,000
(Accumulated losses written off to capital reduction account as a part of the internal reconstruction scheme).		80,000
Capital reduction A/c	Dr.	30,800
To Capital reserve A/c		30,800
(The balance in capital reduction account transferred to capital reserve as a part of the internal reconstruction scheme)		

Balance sheet of Recover Ltd. as at 31st March 2023 (and reduced)

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

Notes to accounts:

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

P10. Given below is the Balance sheet of Rebuilt Ltd. as at 31.3.20X1:

		Particulars	Notes	₹
		Equity and Liabilities		
1		Shareholders' funds		
	A	Share capital	1	13,50,000
	B	Reserves and Surplus	2	(4,51,000)
2		Non-current liabilities		
	A	Long-term borrowings (Loan)	3	5,73,000
3		Current liabilities		
	A	Trade Payables		2,07,000
	B	Other current liabilities		35,000
		Total		17,14,000
		Assets		
1		Non-current assets		
	A	Property, plant and equipment	4	6,68,000
	B	Intangible assets	5	3,18,000
2		Current assets		
	A	Inventories		4,00,000
	B	Trade receivables		3,28,000
		Total		17,14,000

Notes to accounts

		₹
1	Share Capital	
	<u>Equity share capital</u>	7,50,000
	15,000 Equity Shares of ₹ 50 each	
	<u>Preference share capital</u>	
	12,000, 7% Cumulative Preference Shares of ₹ 50 each	
	(Preference dividend is in arrears for five years)	6,00,000
	Total	13,50,000
2	Reserves and Surplus	
	Debit balance of Profit and loss Account	(4,51,000)
		(4,51,000)
3	Long-term borrowings	
	Loan	5,73,000
		5,73,000
4	Property, plant and Equipment	
	Building at cost less depreciation	4,00,000
	Plant at cost less depreciation	2,68,000
		6,68,000
5	Intangible assets	
	Trademarks and Goodwill at cost	3,18,000
		3,18,000

The Company is not earning profits, short of working capital and a scheme of reconstruction has been approved by both the classes of shareholders. A summary of the scheme is as follows:

- The equity shareholders have agreed that their ₹ 50 shares should be reduced to ₹ 2.50 by cancellation of ₹ 47.50 per share. They have also agreed to subscribe for three new equity shares of ₹ 2.50 each for each equity share held.
- The preference shareholders have agreed to cancel the arrears of dividends and to accept for each ₹ 50 share, 4 new 5% preference shares of ₹ 10 each, plus 6 new equity shares of ₹ 2.50 each, all credited as fully paid.
- Lenders to the company for ₹ 1,50,000 have agreed to convert their loan into share and for this purpose they will be allotted 12,000 new preference shares of ₹ 10 each and 12,000 new equity shares of ₹ 2.50 each.

- (d) The directors have agreed to subscribe in cash for 40,000, new equity shares of ₹ 2.50 each in addition to any shares to be subscribed by them under (a) above.
- (e) Of the cash received by the issue of new shares, ₹ 2,00,000 is to be used to reduce the loan due by the company.
- (f) The equity share capital cancelled is to be applied:
- to write off the debit balance in the profit and loss A/c; and
 - to write off ₹ 35,000 from the value of plant.

Any balance remaining is to be used to write down the value of trademarks and goodwill.

Show by journal entries how the financial books are affected by the scheme and prepare the balance sheet of the company after reconstruction. The nominal capital as reduced is to be increased to ₹ 6,50,000 for preference share capital and ₹ 7,50,000 for equity share capital.

[MTP JAN 25]

Solution:

In the books of Rebuilt Ltd. Journal Entries

	Particulars	Debit(₹)	Credit(₹)
1.	Equity share capital A/c (₹ 50) Dr.	7,50,000	
	To Equity share capital A/c (₹ 2.50)		37,500
	To Capital reduction A/c		7,12,500
	(Being equity capital reduced to nominal value of ₹ 2.50 each)		
2.	Bank A/c Dr.	1,12,500	
	To Equity share capital		1,12,000
	(Being 3 right shares against each share was issued and subscribed)		
3.	7% Preference share capital A/c (₹ 50) Dr.	6,00,000	
	Capital reduction A/c Dr.	60,000	
	To 5% Preference share capital (₹ 10)		4,80,000
	To equity share capital		1,80,000
	(Being 7% preference shares of ₹ 50 each converted to 5% preference shares of ₹ 10 each and also given to them 6 equity shares for every share held)		
4.	Loan A/c Dr.	1,50,000	
	To 5% Preference share capital A/c		1,20,000
	To Equity share capital A/c		30,000
	(Being loan to the extent of ₹ 1,50,000 converted into share capital)		
5.	Bank A/c Dr.	1,00,000	
	To Equity share application money A/c		1,00,000
	(Being shares subscribed by the directors)		
6.	Equity share application money A/c Dr.	1,00,000	
	To Equity share capital A/c		1,00,000
	(Being application money transferred to capital A/c)		
7.	Loan A/c Dr.	2,00,000	
	To Bank A/c		2,00,000
	(Being loan repaid)		
8.	Capital reduction A/c Dr.	6,52,500	
	To Profit and loss A/c		4,51,000
	To Plant A/c		35,000
	To Trademarks and Goodwill A/c (Bal.fig.)		1,66,500
	(Being losses and assets written off to the extent required)		

Balance sheet of Rebuilt Ltd. (and reduced) as at 31.3.20X1

	Particulars	Notes	₹
	Equity and Liabilities		
1	Shareholders' funds		
a	Share capital	1	10,60,000
2	Non-current liabilities		
a	Long-term borrowings		2,23,000
3	Current liabilities		
a	Trade Payables		2,07,000
b	Other current liabilities		35,000
	Total		15,25,000
	Assets		
1	Non-current assets	2	6,33,000
a	Property, plant and equipment	3	1,51,500
b	Intangible assets		
2	Current assets		
a	Inventories		4,00,000
b	Trade receivables		3,28,000
c	Cash and cash equivalents	4	12,500
	Total		15,25,000

Notes to accounts

		₹	₹
1.	Share Capital		
	Authorized capital:	6,50,000	
	65,000 Preference shares of ₹ 10 each	7,50,000	14,00,000
	3,00,000 Equity shares of ₹ 2.50 each		
	Issued, subscribed and paid up:		
	1,80,000 equity shares of ₹ 2.5 each	4,60,000	
	60,000, 5% Preference shares of ₹ 10 each	6,00,000	10,60,000
2.	Property plant and equipment		
	Building at cost less depreciation	4,00,000	
	Plant at cost less depreciation	2,33,000	6,23,000
3.	Intangible assets		
	Trademarks and goodwill		1,51,500
4.	Cash and cash equivalents		
	Bank (1,12,500+1,00,000-2,00,000)		12,500

P11. Z Limited provides the following information as on 31st March, 2023:

Particulars	Amount in ₹
Share Capital:	
5,00,000 Equity shares of ₹ 10 each fully paid up	50,00,000
9%, 20,000 Preference shares of ₹ 100 each fully paid up	20,00,000
Reserves and Surplus:	
Profit and Loss Account (Dr. balance)	14,60,000
Non-Current Liabilities:	
10% Secured Debentures	16,00,000
Current Liabilities:	
Interest due on Debentures	1,60,000
Trade Payables	5,00,000
Loan from Directors	1,00,000
Bank Overdraft	1,00,000
Provision for Tax	1,00,000

Non-Current Assets:	
Property, plant and Equipment:	
Land & Buildings	30,00,000
Plant & Machinery	12,50,000
Furniture & Fixtures	2,50,000
Intangible Assets:	
Goodwill	11,00,000
Patents	5,00,000
Current Assets:	
Trade Investments	5,00,000
Trade Receivables	5,00,000
Inventory	10,00,000

Note: Preference dividend is in arrears for last 2 years.

Mr. Y holds 60% of debentures and Mr. Z holds 40% of debentures. Moreover ₹ 1,00,000 and ₹ 60,000 were also payable to Mr. Y and Mr. Z respectively as trade payable.

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

- All the equity shares to be converted into fully paid equity shares of ₹ 5.00 each.
- The Preference shares be reduced to ₹ 50 each and the preference shareholders agreed to forego their arrears of preference dividends, in consideration of which 9% preference shares are to be converted into 10% preference shares.
- Mr. Y and Mr. Z agreed to cancel 50% each of their respective total debt including interest on debentures. Mr. Y and Mr. Z also agreed to pay ₹ 1,00,000 and ₹ 60,000 respectively in cash and to receive new 12% debentures for the balance amount.
- Persons relating to trade payables, other than Mr. Y and Mr. Z also agreed to forego their 50% claims.
- Directors also waived 60% of their loans and accepted equity shares for the balance.
- Capital commitments of ₹ 3.00 lacs were cancelled on payment of ₹ 15,000 as penalty.
- Directors refunded ₹ 1,00,000 of the fees previously received by them.
- Reconstruction expenses paid ₹ 15,000.
- The taxation liability of the company was settled for ₹ 75,000 and was paid immediately.
- The Assets were revalued as under:

Land and Building	32,00,000
Plant and Machinery	6,00,000
Inventory	7,50,000
Trade Receivables	4,00,000
Furniture and Fixtures	1,50,000
Trade Investments	4,50,000

You are required to pass journal entries for all the above-mentioned transactions including amounts to be written off for Goodwill, Patents and Loss in Profit and Loss account. Also prepare Bank Account and Reconstruction A/c.

[RTP May-2022, RTP Nov-2020, RTP Nov-2018]

Solution:

Journal Entries in the Books of Z Ltd.

		₹	₹
(i)	Equity Share Capital (₹ 10 each) A/c Dr.	50,00,000	
	To Equity Share Capital (₹ 5 each) A/c		25,00,000
	To Reconstruction A/c		25,00,000
	(Being conversion of 5,00,000 equity shares of ₹ 10 each fully paid into same number of fully paid equity shares of ₹ 5 each as per scheme of reconstruction.)		
(ii)	9% Preference Share Capital (₹ 100 each) A/c Dr.	20,00,000	
	To 10% Preference Share Capital (₹ 50 each) A/c		10,00,000
	To Reconstruction A/c		10,00,000
	(Being conversion of 9% preference share of ₹ 100 each into same number of 10% preference share of ₹ 50 each and claims of preference dividends settled as per scheme of reconstruction.)		

(iii)	10% Secured Debentures A/c	Dr.	9,60,000	
	Trade payables A/c	Dr.	1,00,000	
	Interest on Debentures payable A/c	Dr.	96,000	
	Bank A/c	Dr.	1,00,000	
	To 12% Debentures A/c			6,78,000
	To Reconstruction A/c			5,78,000
	(Being ₹ 11,56,000 due to Y (including trade payables) cancelled and 12% debentures allotted for the amount after waving 50% as per scheme of reconstruction.)			
(iv)	10% Secured Debentures A/c	Dr.	6,40,000	
	Trade Payables		60,000	
	Interest on debentures payable A/c		64,000	
	Bank A/c		60,000	
	To 12% debentures A/c			4,42,000
	To Reconstruction A/c			3,82,000
	(Being ₹ 7,64,000 due to Z (including trade payables) cancelled and 12% debentures allotted for the amount after waving 50% as per scheme of reconstruction.)			
(v)	Trade payables A/c	Dr.	1,70,000	
	To Reconstruction A/c			1,70,000
	(Being remaining trade payables sacrificed 50% of their claim.)			
(vi)	Directors' Loan A/c	Dr.	1,00,000	
	To Equity Share Capital (₹ 5) A/c			40,000
	To Reconstruction A/c			60,000
	(Being Directors' loan claim settled by issuing 8,000 equity shares of ₹ 5 each as per scheme of reconstruction.)			
(vii)	Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment made towards penalty of 5% for cancellation of capital commitments of ₹ 3 Lakhs.)			
(viii)	Bank A/c	Dr.	1,00,000	
	To Reconstruction A/c			1,00,000
	(Being refund of fees by directors credited to reconstruction A/c.)			
(ix)	Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment of reconstruction expenses.)			
(x)	Provision for Tax A/c	Dr.	1,00,000	
	To Bank A/c			75,000
	To Reconstruction A/c			25,000
	(Being payment of tax liability in full settlement against provision for tax)			
(xi)	Land and Building A/c			
	To Reconstruction A/c	Dr.	2,00,000	
	(Being appreciation in value of Land & Building recorded)			2,00,000
(xii)	Reconstruction A/c			
	To Goodwill A/c	Dr.	49,85,000	
	To Patent A/c			11,00,000
	To Profit and Loss A/c			5,00,000
	To Plant and Machinery A/c			14,60,000
	To Furniture & Fixture A/c			6,50,000
	To Trade Investment A/c			1,00,000
	To Inventory A/c			50,000
	To Trade Receivables A/c			2,50,000
	To Capital Reserve (bal. fig.)			1,00,000

(Being writing off of losses and reduction in the value of assets as per scheme of reconstruction, balance of reconstruction A/c transfer to Capital Reserve.)		7,75,000

Bank Account

	₹		₹
To Reconstruction (Y)	1,00,000	By Balance b/d (overdraft)	1,00,000
To Reconstruction (Z)	60,000	By Reconstruction A/c	15,000
To Reconstruction A/C	1,00,000	(capital commitment	
(refund of earlier fees by directors)		penalty paid)	
		By Reconstruction A/c	15,000
		(reconstruction)	
		expenses paid)	
		By Provision for tax A/c	75,000
		(tax paid)	
		By Balance c/d	55,000
	<u>2,60,000</u>		<u>2,60,000</u>

Reconstruction Account

	₹		₹
To Bank (penalty)	15,000	By Equity Share	
To Bank (reconstruction expenses)	15,000	Capital A/c	25,00,000
To Goodwill	11,00,000	By 9% pref.Share	
To Patent	5,00,000	Capital A/c	10,00,000
To P & L A/c	14,60,000	By Mr. Y(Settlement)	5,78,000
To P & M	6,50,000	By Mr .Z (Settlement)	3,82,000
To Furniture and Fixtures	1,00,000	By Trade Payables A/c	1,70,000
To Trade investment	50,000	By Director's loan	60,000
To inventory	2,50,000	By Bank	1,00,000
To Trade Receivables	1,00,000	By Provision for tax	25,000
To Capital Reserve (bal.fig)	7,75,000	By Land and building	2,00,000
	<u>50,15,000</u>		<u>50,15,000</u>

P12. The following is the Balance Sheet of Star Ltd. as on 31st March, 2023:

	₹
A. Equity & Liabilities	
1. Shareholders' Fund:	
(a) Share Capital:	
9,000 7% Preference Shares of ₹ 100 each fully paid	9,00,000
10,000 Equity Shares of ₹ 100 each fully paid	10,00,000
(b) Reserve & Surplus :	
Profit & Loss Account	(2,00,000)
2. Non-current liabilities:	
"A" 6% Debentures (Secured on Bombay Works)	3,00,000
"B" 6% Debentures (Secured on Chennai Works)	3,50,000
3. Current Liabilities and Provisions:	
(a) Workmen's Compensation Fund:	
Bombay Works	10,000
Chennai Works	5,000
(b) Trade Payables	<u>1,25,000</u>
Total	<u>24,90,000</u>

B. Assets:	
Non- current Assets:	
1. PPE:	
Bombay Works	9,50,000
Chennai Works	7,75,000
2. Investment:	
Investments for Workman's Compensation Fund	15,000
3. Current Assets:	
(a) Inventories	4,50,000
(b) Trade Receivables	2,50,000
(c) Cash at Bank	50,000
	<u>24,90,000</u>

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

- (i) Paid up value of 7% Preference Share to be reduced to ₹ 80, but the rate of dividend being raised to 9%.
- (ii) Paid up value of Equity Shares to be reduced to ₹ 10.
- (iii) The directors to refund ₹ 50,000 of the fees previously received by them.
- (iv) Debenture holders forego their interest of ₹ 26,000 which is included among the trade payables.
- (v) The preference shareholders agreed to waive their claims for preference share dividend, which is in arrears for the last three years.
- (vi) "B" 6% Debenture holders agreed to take over the Chennai Works at ₹ 4,25,000 and to accept an allotment of 1,500 equity shares of ₹ 10 each at par, and upon their forming a company called Zia Ltd. (to take over the Chennai Works) they allotted 9,000 equity shares of ₹ 10 each fully paid at par to Star Ltd.
- (vii) The Chennai Workmen's compensation fund disclosed that there were actual liabilities of ₹ 1,000 only. As a consequence, the investments of the fund were realized to the extent of the balance. Entire investments were sold at a profit of 10% on book value and the proceeds were utilized for part payment of the creditors.
- (viii) Inventory was to be written off by ₹ 1,90,000 and a provision for doubtful debts is to be made to the extent of ₹ 20,000.
- (ix) Chennai works completely written off.
- (x) Any balance of the Capital Reduction Account is to be applied as two-third to write off the value of Bombay Works and one-third to Capital Reserve.

Pass necessary Journal Entries in the books of Star Ltd. after the scheme has been carried into effect. [RTP May 2020]

Solution:

In the books of Star Ltd. Journal Entries

Particulars	Amount ₹	Amount ₹
7% Preference share capital (₹ 100) Dr.	9,00,000	
To 9% Preference share capital (₹ 80)		7,20,000
To Capital reduction A/c		1,80,000
(Being preference shares reduced to ₹ 80 and also rate of dividend raised from 7% to 9%)		
Equity share capital A/c (₹ 100 each) Dr.	10,00,000	
To Equity share capital A/c (₹ 10 each)		1,00,000
To Capital reduction A/c		9,00,000
(Being reduction of nominal value of one share of ₹ 100 each to ₹ 10 each)		
Bank A/c Dr.	50,000	
To Capital reduction A/c		50,000
(Being directors refunded the fee amount)		

Trade payables A/c (Interest on debentures) Dr. To Capital reduction A/c (Being interest forgone by the debenture holders)	26,000	26,000
No entry required		
'B' 6% Debentures A/c Dr. To Debentures holders A/c (Being amount due to Debentures holders)	3,50,000	3,50,000
Debentures holders A/c Dr. To Chennai Works A/c To Equity share capital A/c (Being Chennai works taken over and equity shares issued to 'B' 6% Debenture holders)s	4,40,000	4,25,000 15,000
Equity share of Zia Ltd. A/c Dr. To Debentures holders A/c (Being 9,000 equity shares of Zia Ltd. Issued by Debentures holders)	90,000	90,000
Chennai Works – Workmen Compensation Fund Dr. To Capital reduction A/c (Being difference due to reduced amount of actual liability transferred to capital reduction)	4,000	4,000
Bank A/c Dr. To Investment for Workmen Compensation Fund To Capital reduction A/c (Being investment for Workmen Compensation Fund sold @ 10% profit)	15,400	14,000 1,400
Trade Payables A/c Dr. To Bank A/c (Being part payment made to trade payables)	15,400	15,400
Capital reduction A/c To Provision for Doubtful Debts A/c To Inventory A/c (Being assets revalued)	2,10,000	20,000 1,90,000
Capital reduction A/c Dr. To Profit & Loss A/c To PPE – Chennai Works (Being assets revalued and losses written off)	5,50,000	2,00,000 3,50,000
Capital reduction A/c Dr. To PPE – Bombay Works To Capital reserve A/c (Being assets revalued and remaining amount transferred to capital reserve account)	4,01,400	2,67,600 1,33,800

P13. The shareholders of Lili Ltd. decided on a corporate restructuring exercise necessitated because of economic recession. From the given summarised balance sheet as on 31 -3-2023 and the information supplied, you are required to prepare (i) Journal entries reflecting the scheme of reconstruction, (ii) Capital reduction account, (iii) Cash account in the books of Lili Ltd.

Summarised Balance Sheet of Lili Ltd. as on 31.3.2023

Liabilities	₹	Assets	₹
<u>Share Capital</u>		<u>Fixed Assets</u>	
30,000 Equity shares of ₹10 each	3,00,000	Trademarks and Patents	1,10,000
40,000 8% Cumulative Preference shares Rs.10 each	4,00,000	Goodwill at cost	36,100
		Freehold Land	1,20,000
<u>Reserves and Surplus</u>		Freehold Premises	2,44,000
Securities Premium Account	10,000	Plant and Equipment	3,20,000
Profit and Loss Account	(1,38,400)	<u>Investment</u> (marked to market)	64,000
<u>Secured Borrowings</u>			
9% Debentures (₹ 100) 1,20,000		<u>Current Assets</u>	
Accrued Interest 5,400	1,25,400	Inventories:	
<u>Current liabilities</u>		Raw materials and packing	
Trade payables	1,20,000	Materials 60,000	
Tax payable	50,000	Finished goods 16,000	76,000
Temporary bank overdraft	2,23,100	Trade receivables	1,20,000
	10,90,100		10,90,100

Note: Preference dividends are in arrears for 4 years.

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

- (1) The authorized capital of the Company to be re-fixed at ₹ 10 lakhs (preference capital of ₹ .3 lakhs and equity capital of ₹ 7 lakhs). Both classes of shares are of ₹ Rs.10 each.
- (2) The preference shares are to be reduced to ₹ 5 each and equity shares reduced by ₹ 3 per share. Post reduction, both classes of shares to be re-consolidated into ₹ 10 shares.
- (3) Trade Investments are to be liquidated in open market.
- (4) One fresh equity shares of ₹10 to be issued for every ₹40 of preference dividends in arrears (ignore taxation).
- (5) Expenses for the scheme were ₹10,000.
- (6) The debenture holders took over freehold land at ₹2,10,000 and settled the balance after adjusting their dues.
- (7) Unprovided contingent liabilities were settled at ₹ 54,000 and a pending insurance claim receivable settled at ₹ 12,500.
- (8) The intangible assets were all to be written off along with ₹ 10,000 worth obsolete packing material and 10% of the receivables.
- (9) Remaining cash available as a result of the above transactions is to be utilized to pay off the bank overdraft to that extent.
- (10) The Equity shareholders agree that they will bring in necessary cash to liquidate the balance outstanding on the overdraft account by subscribing the fresh shares. The equity shares will be issued at par for this purpose.

[MTP Mar 2019]

Solution:

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

2017		Dr. ₹	Cr. ₹
March 31	Equity Share Capital A/c (₹10) Dr.	3,00,000	
	To Capital Reduction A/c		90,000
	To Equity Share Capital A/c (₹7)		2,11,000
	(Being reduction of equity shares of ₹10 each to shares of ₹7 each as per Reconstruction Scheme dated...)		

8% Cum. Preference Share Capital A/c (₹10) Dr. To Capital Reduction A/c To Preference Share Capital A/c (₹5) (Being reduction of preference shares of ₹10 each to shares of ₹5 each as per reconstruction scheme)	4,00,000	2,00,000 2,00,000
Equity Share Capital A/c (30,000 x ₹7) Dr. Preference Share Capital A/c (40,000 x ₹5) Dr. To Equity Share Capital A/c (21,000 x ₹10) To Preference Share Capital A/c (20,000 x ₹10) (Being post reduction, both classes of shares re consolidated into ₹10 each)	2,10,000 2,00,000	2,10,000 2,00,000
Cash Account Dr. To Trade Investments (Being trade investments liquidated in the open market)	64,000	64,000
Capital Reduction Account Dr. To Equity Share Capital Account (Being arrears of preference dividends of 4 years satisfied by the issue of 3,200 equity shares of ₹10 each)	32,000	32,000
Capital Reduction Account Dr. To Cash Account (Being expenses of reconstruction scheme paid in cash)	10,000	10,000
9% Debentures Account Dr. Accrued Interest Account Dr. To Debenture holders Account (Being amount due to debenture holders)	1,20,000 5,400	1,25,400
Debenture holders Account Dr. Cash Account (2,10,000 – 1,25,400) Dr. To Freehold Land To Capital Reduction Account (2,10,000 – 1,20,000) (Being Debenture holders took over freehold land at ₹2,10,000 and settled the balance)	1,25,400 84,600	1,20,000 90,000
Capital Reduction Account Dr. To Cash Account (Being contingent liability of ₹.54,000 paid)	54,000	54,000
Cash Account Dr. To Capital Reduction Account (Being pending insurance claim received)	12,500	12,500
Capital Reduction Account Dr. To Trademarks and Patents To Goodwill To Raw materials & Packing materials To Trade receivables (Being intangible assets written off along with raw materials and packing materials worth ₹10,000 and 10% of trade receivables)	1,68,100	1,10,000 36,100 10,000 12,000

Cash Account To Equity Share Capital Account (Being 12,600 shares issued to existing shareholders)	Dr.	1,26,000	1,26,000
Bank Overdraft Account To Cash Account (Being cash balance utilized to pay off bank overdraft)	Dr.	2,23,100	2,23,100
Capital Reduction Account To Capital reserve Account (Being balance of capital reduction account transferred to capital reserve account)	Dr.	1,28,400	1,28,400

(ii) **Capital Reduction Account**

Particulars	₹	Particulars	₹
To Equity Share capital	32,000	By Preference share capital	2,00,000
To cash (contingent liability settled)	54,000	By Equity share capital	90,000
To Trademarks and Patents	1,10,000	By Freehold land	90,000
To Goodwill	36,100	By Cash (insurance claim)	12,5000
To Raw material and Packing materials	10,000		
To Trade receivables	12,000		
To Cash account	10,000		
To Capital reserve account	1,28,400		
	<u>3,92,500</u>		<u>3,92,500</u>

(iii) **Cash Account**

Particulars	₹	Particulars	₹
To Investment	64,000	By Capital reduction (contingent liability)	54,000
To 9% Debenture holders (2,10,000-1,25,400)	84,600	By Expenses	10,000
To Capital reduction (insurance Claim)	12,500	By Temporary bank overdraft – From available cash (64,000+84,600+12,500 -54,000-10,000) 97,100	
		-From proceeds of equity Share capital (2,23,100-97,100)	
To Equity share capital 12,600 Shares @ ₹10 each	1,26,000		<u>1,26,000</u>
	<u>2,87,100</u>		<u>2,87,100</u>

Note: Shares issued to existing equity shareholders for bringing cash for payment of balance of bank overdraft = ₹2,23,100 – ₹97,100 = ₹1,26,000

P14. Sustain Limited is incurring losses due to adverse market conditions. It decided to reorganize its capital structure. The summarized Balance Sheet of the company as on 31st March, 2024 is as follows:

Particulars	Notes	₹
Equity and Liabilities		
1. Shareholders' Fund	1	10,00,000
(a) Share Capital	2	(2,50,000)
(b) Reserves and Surplus		
2. Non-current liabilities		
Long term borrowing	3	4,50,000
3. Current liabilities		
(a) Trade Payables		1,30,000
(b) Short term borrowings – Bank Overdraft		65,000
(c) Other Current Liabilities (Interest payable on Debentures)		45,000
(d) Short term provision (Provision for Income Tax)		<u>1,00,000</u>
Total		<u>15,40,000</u>
Assets		
1. Non-current assets		
(a) Property, Plant & Equipment	4	8,50,000
(b) Intangible assets	5	60,000
(c) Non-current investments	6	2,80,000
2. Current assets		
(a) Inventories		1,20,000
(b) Trade receivables		<u>2,30,000</u>
Total		<u>15,40,000</u>

Notes to accounts:

	₹
1. Share Capital	
Equity share capital:	
50,000 Equity shares of ₹ 10 each fully paid up	5,00,000
25,000 Equity shares of ₹ 10 each, ₹ 8 paid up	2,00,000
Preference share capital:	
30,000 8% Cumulative Preference shares of ₹ 10 each (Preference dividend has been in arrears for 3 years)	<u>3,00,000</u>
	<u>10,00,000</u>
2. Reserves and Surplus	
Profit and Loss account (debit balance)	<u>(2,50,000)</u>
3. Long-term borrowings	
Secured:	
10% Debentures of ₹ 100 each	<u>4,50,000</u>
4. Property, Plant and Equipment	<u>4,50,000</u>
Freehold property	1,00,000
Plant and machinery	<u>7,50,000</u>
5. Intangible assets	<u>8,50,000</u>
Goodwill	<u>60,000</u>
6. Non-current investments	<u>60,000</u>
Non-trade investments at cost	<u>2,80,000</u>
	2,80,000

Subsequent to approval by court and all interested parties, the following scheme of reconstruction were agreed:-

- (1) Uncalled capital is to be called up in full and such shares and other fully paid -up equity shares to be reduced to ₹ 5 per share.
- (2) The preference shareholders will accept a reduction of ₹ 2.5 per share, in exchange the rate of dividend is to be increased to 9%.
- (3) Preference shareholders will forgo their claim of dividend for one year and one equity share of ₹ 5 each is to be issued for the remaining arrears of dividend.
- (4) Mr. X holds 10% debentures for ₹ 2,50,000. He is also a creditor for ₹ 50,000. He agreed to cancel 50% of his total debt, including interest on debentures, pay ₹ 20,000 to the company and to receive new 12% debentures for the balance amount.
- (5) The remaining claim of the debenture holders, including outstanding interest to be reduced to 60%. In consideration of the reduction, the debenture holders are to receive new 9% preference shares at new face value.
- (6) The taxation liability is to be settled at ₹ 1,20,000.
- (7) Market value of Non-current Investments is ₹ 2,50,000. Investments to be brought to their market value.
- (8) Inventory equal to ₹ 1,00,000 at book value will be taken over by remaining creditors in full settlement of their claim.
- (9) A bad debt provision of 2% is to be created on trade receivables.
- (10) Plant and Machinery is to be written down by 20%.
- (11) The company will further issue 12% debentures for such amount which is sufficient to pay off bank overdraft and other outstanding liabilities and maintain its cash/bank balance at ₹ 85,000.
- (12) The amount available by the scheme shall be utilized in writing of Goodwill, debit balance of profit and loss a/c and balance of inventory.

You are required to:

- (a) Show the journal entries, necessary to record the above transaction in the company's books and
- (b) Prepare a note to show revised Share capital structure of the company after completion of the scheme.

[JAN 25]

Solution:

(a) Journal Entries in books of Sustain Limited

		₹	₹
1.	Bank Account Dr.	50,000	
	To Equity Share Capital Account		50,000
	(Balance of ₹ 2 per share on 25,000 equity shares called up)		
2.	Equity Share Capital (₹ 10) Account Dr.	7,50,000	
	To Equity Share Capital (₹ 5) Account		3,75,000
	To Capital Reduction Account		3,75,000
	(Reduction of equity shares of ₹ 10 each to shares of ₹ 5 each as per reconstruction scheme)		
3.	8 % Cumulative Preference Share Capital (₹ 10) A/c Dr.	3,00,000	
	To 9% Cumulative Preference Share Capital (₹ 7.5) A/c		2,25,000
	To Capital Reduction A/c		75,000
	(Being Preference shares of ₹ 10 each reduced by ₹ 2.5 each per share by changing the rate of dividend from 8% to 9% and the balance transferred to Capital Reduction A/c.)		
4.	Capital Reduction A/c Dr.	48,000	
	To Preference share dividend payable A/c		48,000

	(Being arrear of Preference share dividend payable for one year)		
5.	Preference share dividend payable A/c Dr.	48,000	
	To Equity Share Capital (₹ 5) A/c		48,000
	(Being Equity Shares of ₹ 5 each issued against arrears of 2 years Preference Share dividend) (W.N.1)		
6.	10% Debentures Account Dr.	2,50,000	
	Interest on Debentures Outstanding A/c Dr.	25,000	
	Trade payables Account Dr.	50,000	
	To Mr. X		3,25,000
	(The total amount due to X, transferred to his account)		
7.	Bank Account Dr.	20,000	
	To Mr. X		20,000
	(The amount paid by X under the reconstruction scheme)		
8.	Mr. X	3,45,000	
	To 12% Debentures Account		1,82,500
	To Capital Reduction A/c		1,62,500
	(The cancellation of 50% of the total debt of Mr. X and the issue of 12% new debentures for the balance amount as per the reconstruction scheme)		
9.	10% Debentures A/c Dr.	2,00,000	
	Interest on Debentures Outstanding A/c Dr.	20,000	
	To 9% Cumulative Preference Share capital A/c		1,32,000
	To Capital Reduction A/c		88,000
	(Being 9% preference share capital issued to 10% debenture-holders for 60% of their claims. The balance is transferred to capital reduction account as per the reconstruction scheme)		
10.	Provision for Tax A/c Dr.	1,00,000	
	Capital Reduction A/c Dr.	20,000	
	To Bank A/c		1,20,000
	(Being payment of tax liability in full settlement)		
11.	Trade payables A/c (1,30,000-50,000) Dr.	80,000	
	Capital reduction A/c Dr.	20,000	
	To Inventory A/c		1,00,000
	(Being settlement of creditors by giving inventory)		
12	Capital reduction A/c Dr.	1,84,600	
	To Investment A/c		30,000

	To Provision for bad debt A/c (2,30,000 x 2%)		4,600
	To Plant & Machinery (7,50,000x 20%)		1,50,000
	(Investment brought to their market value, Plant & machinery is written down by 20% & Provision for Bad debts of 2% created under the scheme of reconstruction)		
13	Bank A/c Dr.	2,00,000	
	To 12% debentures A/c		2,00,000
	(New 12 % debentures issued to pay off bank overdraft and maintain cash balance)		
14.	Bank Overdraft A/c Dr.	65,000	
	To Bank A/c		65,000
	(Bank overdraft paid)		
15.	Capital reduction A/c Dr.	4,27,000	
	To Goodwill A/c		60,000
	To Profit and loss A/c		2,50,000
	To Inventory		20,000
	To Capital reserve A/c		97,900
	[Being goodwill and profit and loss account (Dr. bal.), balance inventory; and balance of capital reduction account transferred to capital reserve]		

Notes to accounts

		₹
1.	Share Capital	
	Equity share capital	
	Issued, subscribed and paid up	4,23,000
	84,600 equity shares of ₹ 5 each each (75,000+9,600)	
	47,600, 9 % Cumulative Preference Shares of ₹ 7.50 each (30,000+17,600)	3,57,000
	Total	7,80,000

Working note

1. **Calculation of the number of equity shares issued for 2 years arrear of preference share dividend**

$$3,00,000 \times 8\% \times 2 = 48,000$$

$$\text{Equity share of ₹ 5 per share issued} = 48,000/5 = 9,600 \text{ shares}$$

2. **Cash & bank Account**

To Uncalled capital	50,000	By Bank Overdraft	65,000
To Mr. X	20,000	By Tax	1,20,000
To 12% Debentures A/c (bal. fig.)	2,00,000	By Balance C/d	<u>85,000</u>
	<u>2,70,000</u>		<u>2,70,000</u>

3. **The new face value of preference share is $10 - 2.5 = ₹ 7.5$**

Calculation of Number of 9% Preference shares issued in consideration of reduction:

$$1,32,000/7.5 = 17,600$$

P15. Sky Limited has decided to reconstruct the Balance Sheet since it has accumulated huge losses. The following is the balance sheet of the company as on 31st March, 2025 before reconstruction:

Particulars	Note No.	Amount (₹ in lakh)
[I] Equity and Liabilities		
(1) Shareholders' Funds		
(a) Share Capital	1	4,200
(b) Reserves and Surplus	2	(1,566)
(2) Non-Current Liabilities		
(a) Long term Borrowings	3	2,100
(3) Current Liabilities		
(a) Trade Payables	4	306
(b) Other Liabilities	5	72
Total		5,112
[II] Assets		
(1) Non-Current Assets:		
(a) PPE	6	2,250
(2) Current Assets		
(a) Current Investments	7	600
(b) Inventories	8	900
(c) Trade Receivables	9	1,350
(d) Cash and Cash Equivalents	10	12
Total		5,112

Notes to Accounts:

Note No.	Particulars	Amount (₹ in lakh)
(1)	Share Capital	
	Authorised:	
	600 lakh shares of ₹ 10 each	6,000
	24 lakh, 8% Preference Shares of ₹ 100 each	2,400
		8,400
	Issued, Subscribed and Paid up:	
	300 lakh Equity Shares of ₹ 10 each, fully paid up	3,000
	12 lakh 8% Preference Shares of ₹ 100 each, fully paid up	1,200
		4,200
(2)	Reserves and Surplus	
	Debit balance of Profit and Loss A/c	(1,566)
(3)	Long Term Borrowings	
	6% Debentures (Secured by Freehold Property)	1,200
	Director's Loan	900
		2,100
(4)	Trade Payables	
	Trade payables for Goods	306
(5)	Other Liabilities	
	Interest Accrued and Due on 6% Debentures	72
(6)	PPE	
	Freehold Property	1,650
	Plant & Machinery	600
	Total	2,250
(7)	Current Investment	
	Investment in Equity Instruments	600
(8)	Inventories	
	Finished Goods	900
(9)	Trade Receivables	

	Trade receivables for Goods	1,350
(10)	Cash and Cash Equivalents	
	Balance with Bank	12

The Board of Directors of the company decided upon the following scheme of reconstruction:

1. Preference Shares are to be written down to 75 each and Equity Shares to 2 each.
2. Preference Shares Dividend in arrears for 3 years to be waived by 2/3rd and for balance 1/3rd, Equity Shares of ₹ 2 each to be allotted.
3. Debenture holders agreed to take one Freehold Property at its book value of ₹ 900 lakh in part payment of their holding. Balance Debentures to remain as liability of the company. The Board of Directors of the company decided upon the following scheme of reconstruction with the consent of respective shareholders:
4. Interest accrued and due on Debentures to be paid in cash.
5. Remaining Freehold Property to be valued at ₹1,100 lakh.
6. All investments sold out for ₹850 lakh.
7. 70% of Directors' loan to be waived and for the balance, Equity Shares of ₹2 each issue.
8. 40% of Trade receivables and 80% of Inventories to be written off.
9. Company's contractual commitments amounting to ₹1,800 lakh have been settled by paying 8% penalty of contract value.

You are required to:

- (a) Pass Journal Entries for all the transactions related to internal reconstruction;
- (b) Prepare Capital Reduction Account, Bank Account; and
- (c) Prepare Notes to Accounts on Share Capital & PPE, immediately after the implementation of internal reconstruction.

[MTP SEP 25]

Solution:

Journal Entry of Sky Ltd - As on 31st March, 2025

Sr. No.	Particulars	Amount (₹ in lakh) Dr.	Amount (₹ in lakh) Cr.
1	8% Preference Share Capital A/c Dr.	1,200	
	To 8% Preference Share Capital A/c		900
	To Capital Reduction A/c		300
	(Being Preference Shares of 100 each reduced to 75 each, balance transferred to Reconstruction A/c)		
2.	Equity Share Capital A/c Dr.	3,000	
	To Equity Share Capital A/c		600
	To Capital Reduction A/c		2,400
	(Being equity shares of 10 each reduced to 2 each, and balance transferred to Reconstruction A/c)		
3.	Capital Reduction A/c Dr.	96	
	To Equity Share Capital A/c		96
	(Being Preference Share dividend in arrears of 3 years waived by 2/3rd and for balance 1/3rd equity shares of ₹ 2 each allotted)		
4.	6% Debentures A/c Dr.	900	
	To Freehold Property A/c		900
	(Being transfer of title deed on freehold property to debenture holders of the company)		
5.	Interest Accrued & due on Debentures A/c Dr.	72	
	To Cash A/c		72
	(Being Interest Accrued and due on debentures paid in cash)		
6.	Freehold Property A/c Dr.	350	
	To Capital Reduction A/c		350
	(Being balance freehold property re-valued)		

7.	Bank A/c Dr.	850	
	To Investment A/c		600
	To Capital Reduction A/c		250
	(Being investments sold for ₹ 850 lakhs)		
8.	Loan for Director's A/c Dr.	900	
	To Capital Reduction A/c		630
	To Equity Share Capital A/c		270
	(Being 70% of Director's loan waived off and the balance equity shares allotted)		
9.	Capital Reduction A/c Dr.	2,970	
	To Stock A/c		720
	To Trade Receivables A/c		540
	To Profit & Loss A/c		1,566
	To Bank A/c		144
	(Being writing off of losses, penalty paid for contractual commitments, and reduction in the value of assets)		
10.	Capital Reduction A/c Dr.	864	
	To Capital Reserve A/c		864
	(Being balance in Capital Reduction A/c transferred to Capital Reserve)		

(b) Capital Reduction A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
To Equity Share Capital A/c	96	By 8% Preference Share Capital A/c	300
To Stock A/c	720	By Equity Share Capital A/c	2,400
To Trade Receivable A/c	540	By Freehold Property A/c	350
To Profit & Loss A/c	1,566	By Loan from directors A/c	630
To Bank A/c	144	By Bank	250
To Capital Reserve A/c	864		
	3,930		3,930

Bank A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d	12	By Interest accrued & due on debentures A/c	72
To Investment A/c	600	By Capital Reduction A/c	144
To Capital Reduction A/c (Gain of Sale)	250	By Balance c/d	646
	862		862

(c) Notes to Accounts on Share Capital & PPE after implementation of internal reconstruction

Particulars	(₹. In lakhs)	(₹ in lakhs)
Authorised: Share Capital		
600 lakh shares of ₹ 2 each		1,200
24 lakh, 8% Preference shares of ₹ 75 each		1,800
		3,000
Issued, subscribed and paid up:		
483 lakhs Equity shares of ₹ 2 each		966
(Out of which 183 lakh shares have been issued for consideration other than cash)		
12 lakhs, 8% Preference shares of ₹ 75 each fully paid up		900
Total		1,866
PPE:		
Freehold property	1,650	
Less: Utilized to pay Debenture holders	(900)	
Add: Appreciation	350	1,100
Plant and machinery		600
Total		1,700

Working Note: Calculation of number of equity shares issued:

Particulars	No. of Shares (lakhs)
i) To equity shareholders	300
ii) To Preference Shareholders	48
iii) To Directors	135
Total	483

P16. The summarized Balance Sheet of Vijay Ltd. as on 31st March, 2025 is given below

Liabilities	Amount
Equity Shares of ₹ 10 each	3,50,000
8%, Cumulative Preference Shares of ₹ 100 each	1,75,000
6% Debentures of ₹ 100 each	1,40,000
Sundry Creditors	1,75,000
Provision for taxation	3,500
Total	8,43,500
Assets	
Property Plant and Equipment	4,37,500
Investments (Market value ₹ 33,250)	35,000
Current Assets (Including Bank Balance)	3,50,000
Profit and Loss Account	21,000
Total	8,43,500

The following Scheme of Internal Reconstruction is approved and put in effect on 31st March, 2025.

- Investments are to be brought to their market value.
- The Taxation Liability is settled at ₹5,250 out of Current Assets
- The balance of Profit and Loss Account to be written off.
- All the existing equity shares are reduced to Rs 4 each.
- All preference shares are reduced to ₹60 each.
- The rate of interest on debentures is increased to 9%. The Debenture holders surrender their existing debentures of 100 each and exchange them for fresh debentures of 80 each. Each old debenture is exchanged for one new debenture.
- Balance of Current Assets left after settlement of taxation liability are revalued at ₹ 1,57,500.
- Property Plant and Equipment are written down to 80%.
- One of the creditors of the Company for 70,000 gives up 50% of his claim. He is allotted 8,750 equity shares of 4 each in full and final settlement of his claim.

Pass Journal entries for the above transactions.

[MTP JAN 26]

Solution:**Journal Entries in the books of Vijay Ltd.**

Particulars	₹	₹
(1) Capital Reduction A/c Dr.	1,750	
To Investments A/c		1,750
(Being investments revalued to Market Value)		
(2) (a) Provision for taxation A/c Dr.	3,500	
Capital Reduction A/c Dr.	1,750	
To Liability for taxation		5,250
(Being tax liability ascertained)		
(b) Liability for Taxation Dr.	5,250	
To Current Assets (Bank A/c)		5,250
(Being the payment of tax liability).		
(3) Capital Reduction A/c Dr.	21,000	
To Profit & Loss A/c		21,000
(Being debit balance of P&L written off)		
4) Equity Share Capital (₹ 10) Dr.	3,50,000	
To Equity Share Capital (₹ 4)		1,40,000
To Capital Reduction A/c		2,10,000

(Being conversion of equity share capital of 10 each into 4 each).		
5) 8% Cumulative Preference Share Cap A/c Dr.	1,75,000	
To 8% Cumulative Preference Share Capital A/c		1,05,000
To Capital Reduction		70,000
(Being conversion of 8% cumulative preference shares capital of 100 each into 60 each)		
6) 6% Debentures A/c Dr.	1,40,000	
To 9% Debentures		1,12,000
To Capital Reduction		28,000
(Being 9% debentures of ₹ 80 each issued to existing to 6% debenture holders)		
7) Capital Reduction A/c Dr.	1,87,250	
To Current Assets A/c		1,87,250
(Being current assets revalued)		
8) Capital Reduction A/c Dr.	87,500	
To Property, Plant & Equipment A/c		87,500
(Being PPE revalued)		
9) Sundry Creditors A/c Dr.	70,000	
To Equity Share Capital (₹ 4)		35,000
To Capital Reduction A/c		35,000
(Being claims of a creditor satisfied)		
10) Capital Reduction A/c Dr.	43,750	
To Capital Reserve (Bal. Fig.)		43,750
(Being balance of Capital Reduction transferred to Capital Reserve)		

P17. Following is the summarized Balance Sheet of Star Ltd. as on 31st March, 2025.

Particulars	Amount (₹)
Liabilities	
Authorized and Issued Share Capital	
(a) 15,000 8% Preference shares of ₹ 50 each	7,50,000
(b) 18,750 Equity shares of ₹ 50 each	9,37,500
Profit and Loss Account	(5,63,750)
Loan	7,16,250
Trade Payables	2,58,750
Other Liabilities	43,750
Total	21,42,500
Assets	
Building at cost less depreciation	5,00,000
Plant at cost less depreciation	3,35,000
Trademarks and goodwill at cost	3,97,500
Inventory	5,00,000
Trade Receivables	4,10,000
Total	21,42,500

(Note: Preference shares dividend is in arrear for last five years).

The Company is running with the shortage of working capital and not earnings profits.

A scheme of reconstruction has been approved by both the classes of shareholders.

The summarized scheme of reconstruction is as follows:

- (i) The equity shareholders have agreed that their 50 shares should be reduced to 5 by cancellation of 45.00 per share. They have also agreed to subscribe for three new equity shares of 5.00 each for each equity share held.
- (ii) The preference shareholders have agreed to forego the arrears of dividends and to accept for each 50 preference share, 4 new 6% preference shares of 10 each, plus 3 new equity shares of ₹ 5.00 each, all credited as fully paid.

- (iii) Lenders to the company for 1,87,500 have agreed to convert their loan into shares and for this purpose they will be allotted 15,000 new preference shares of ₹ 10 each and 7,500 new equity shares of ₹ 5.00 each.
- (iv) The directors have agreed to subscribe in cash for 25,000 new equity shares of ₹ 5.00 each in addition to any shares to be subscribed by them under (i) above.
- (v) Of the cash received by the issue of new shares, ₹ 2,50,000 is to be used to reduce the loan due by the company.
- (vi) The equity share capital cancelled is to be applied:
 - (a) To write off the debit balance in the Profit and Loss A/c, and
 - (b) To write off ₹ 43,750 from the value of plant.

Any balance remaining is to be used to write down the value of trademarks and goodwill. The nominal capital, as reduced, is to be increased to 8,12,500 for preference share capital and 9,37,500 for equity share capital.

You are required to pass journal entries to show the effect of above scheme and prepare the Balance Sheet of the Company after reconstruction. **[MTP JAN 26]**

Solution:

In the books of Star Ltd. Journal Entries

Particulars	Debit (₹)	Credit (₹)
1. Equity share capital A/c (₹ 50) Dr.	9,37,500	
To Equity share capital A/c (₹ 5)		93,750
To Capital reduction A/c*		8,43,750
(Being equity capital reduced to nominal value of ₹ 5 each)		
2. Bank A/c Dr.	2,81,250	
To Equity share capital		2,81,250
(Being 3 right shares against each share was issued and subscribed)		
3. 8% Preference share capital A/c (₹ 50) Dr.	7,50,000	
Capital reduction A/c Dr.	75,000	
To 6% Preference share capital (₹ 10)		6,00,000
To equity share capital (₹ 50)		2,25,000
(Being 8% preference shares of 50 each converted to 6% preference shares of 10 each and also given to them 3 equity shares for every share held)		
4. Loan A/c Dr.	1,87,500	
To 6% Preference share capital A/c (15,000 x ₹ 10)		1,50,000
To Equity share capital A/c (7,500 x ₹ 5)		37,500
(Being loan to the extent of ₹ 1,50,000 converted into share capital)		
5. Bank A/c (25,000 x ₹ 5) Dr.	1,25,000	
To Equity share application A/c		1,25,000
(Being shares subscribed by the directors)		
6. Equity share application A/c Dr.	1,25,000	
To Equity share capital A/c		1,25,000
(Being application money transferred to capital A/c)		
7. Loan A/c Dr.	2,50,000	
To Bank A/c		2,50,000
(Being loan repaid)		
8. Capital reduction A/c Dr.	7,68,750	
To Profit and loss A/c		5,63,750
To Plant A/c		43,750
To Trademarks and Goodwill A/c (Bal. fig.)		1,61,250
(Being losses and assets written off to the extent required)		

Balance sheet of Star Ltd. (and reduced) as on 31.3.2025

Particulars	Notes	₹
Equity and Liabilities		
1 Shareholders' funds		
a Share capital	1	15,12,500
2 Non-current liabilities		
a Long-term borrowings (7,16,250-1,87,500-2,50,000)		2,78,750
3 Current liabilities		
a Trade Payables		2,58,750
b Other current liabilities		43,750
Total		20,93,750
Assets		
1 Non-current assets		
a Property, Plant and Equipment	2	7,91,250
b Intangible assets	3	2,36,250
2 Current assets		
a Inventories		5,00,000
b Trade receivables		4,10,000
c Cash and cash equivalents	4	1,56,250
Total		20,93,750

Notes to accounts:

			₹
1	Share Capital Authorized capital: 81,250 Preference shares of ₹ 10 each 1,87,500 Equity shares of ₹ 5 each	8,12,500	
	Issued, subscribed and paid up: 1,52,500 equity shares of ₹ 5 each 75,000, 6% Preference shares of ₹ 10 each	<u>9,37,500</u> 7,62,500 <u>7,50,000</u>	<u>17,50,000</u> 15,12,500
2	Property, Plant and Equipment Building at cost less depreciation Plant at cost less depreciation	5,00,000 <u>2,91,250</u>	 7,91,250
3.	Intangible assets Trademarks and goodwill		2,36,250
4	Cash and cash equivalents Bank (2,81,250+1,25,000-2,50,000)		1,56,250

Note: *In place of Capital Reduction Account, Reconstruction Account or Internal Reconstruction Account may also be used.