***Internal Reconstruction***

**Theory:**

Financial restructuring of a company without its liquidation is known as “Internal Reconstruction”. Section 100 of Companies Act, allows sick companies to implement the scheme of internal reconstruction resulting in to reduction of capital. For implementing such a scheme a separate account called “Capital Reduction Account” is opened.

This account is a nominal account which takes on credit side all income and profits and on debit side all expenses and losses.

At the end, Capital Reduction Account either tallies or it shows credit balance which is transferred to **“Capital Reserve A/c”**.

The scheme of Internal Reconstruction is implemented by sick company suffering from huge losses over past few years but not interested in closing down or liquidating its business.

Directors of such company decides the quantum of loss on account of-

1. Profit & Loss Account Debit Balance.
2. Fictitious & Intangible assets like preliminary expenses, deferred revenue expenditure, goodwill, patent etc.
3. Contingent liabilities like arrears of cumulative preference dividend and liability for damages.
4. Over valuation of fixed and current assets.

**Problem-1**

Following is Balance Sheet of ABC Ltd. as on 31st March 2000.

|  |  |  |  |
| --- | --- | --- | --- |
| **Liabilities** | **(Rs.)** | **Assets** | **(Rs.)** |
| 20000 Equity Shares of Rs.10 each | 200000 | Land & Building | 100000 |
| 10000 Preference Shares of Rs.10 each | 100000 | Other Fixed Assets | 100000 |
| 1000 8% Debentures of Rs.100 each | 100000 | Current Asset | 35000 |
| Creditors | 50000 | Profit & Loss Account | 215000 |
|  | **450000** |  | **450000** |

The terms of scheme are as under:

1. Each equity share is reduced to Rs. 2.50 each.
2. Each preference share is reduced to Rs. 5 paid up. (face value remains same)
3. Debentures are reduced to Rs.60 each.
4. Creditors gave up 50% of their claim.
5. Land & Building depreciated by 30% other fixed assets by 15%.
6. Current assets are revalued to Rs.30000.

Pass necessary journal entries and prepare new balance sheet.

**Problem-2**

Following is the Balance Sheet of M/s Careless Ltd as on 31/3/2009

|  |  |  |  |
| --- | --- | --- | --- |
| **Liabilities** | **(Rs.)** | **Assets** | **(Rs.)** |
| 40000-8% Cum. Pref. Shares of Rs.10 each | 400000 | Goodwill | 110000 |
| 30000 Equity Shares of Rs.10 each | 300000 | Freehold Property | 120000 |
| Securities Premium | 10000 | Leasehold Property | 244000 |
| 9% Debentures | 120000 | Plant & Machinery | 320000 |
| Accrued Debenture Interest | 5400 | Furniture | 80000 |
| Sundry Creditors | 170000 | Stock | 60000 |
| Bank Overdraft | 192000 | Debtors | 120000 |
|  |  | Preliminary Expenses | 5000 |
|  |  | Profit & Loss Account | 138400 |
|  | **1197400** |  | **1197400** |

Note:

1. Preference dividend was in arrears for four years.
2. There was a contingent liability of Rs. 20000 for workmen compensation.

Following scheme of reconstruction was approved and implemented:

1. The preference shares were reduced to Rs.7.50 per share fully paid and Equity Shares to Rs.2 per share fully paid.
2. After reduction, both classes of shares were consolidated into Rs.10 shares.
3. One new equity share of Rs.10 each was issued for every Rs.40 of gross preference dividend in arrears.
4. The balance of securities premium was utilised.
5. Plant and Machinery was written down to Rs.280000.
6. Furniture was sold for Rs.64000.
7. Goodwill, preliminary expenses, debit balance in Profit & Loss Account, debtors of Rs.17200 and obsolete stock of Rs.20000 were to be written off.
8. Contingent liability for which no provision had been made was settled at Rs.14000 however the amount of Rs.12600 was recovered from insurance company.
9. Debenture holders agreed to forego principal amount by Rs.30000 and accrued debenture interest in full.

Pass journal entries; prepare capital reduction account and Balance Sheet after reconstruction.

**Problem-3**

The following is the Balance Sheet of Sandeep Limited as on 31/03/2009:

|  |  |  |  |
| --- | --- | --- | --- |
| **Liabilities** | **(Rs.)** | **Assets** | **(Rs.)** |
| 10% Pref. Shares of Rs.100 each | 400000 | Goodwill | 25000 |
| Equity Shares of Rs.10 each | 1000000 | Patents | 15000 |
| 12% Debentures | 750000 | Furniture | 35000 |
| Bank Overdraft | 50000 | Plant and Machinery | 600000 |
| Sundry Creditors | 140000 | Land and Building | 650000 |
| Bills Payable | 35000 | Stock in Trade | 80000 |
|  |  | Sundry Debtors | 90000 |
|  |  | Bills Receivable | 15000 |
|  |  | Profit and Loss A/c | 820000 |
|  |  | Preliminary Expenses | 45000 |
|  | **2375000** |  | **2375000** |

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

1. The preference shares are to be reduced to Rs.50 each and equity shares to Rs.2 each both being fully paid.
2. Of the preference dividend in arrears three fourth to be waived and remaining to be paid in cash.
3. The debenture holders to take over plant & machinery at Rs.650000 in part satisfaction of their claim. The remaining claim should be converted into 14% debentures.
4. Creditors agreed to reduce their claim by Rs.20000. Bills payable to be paid immediately.
5. Goodwill, Patents, Profit and Loss A/c and Preliminary Expenses are to be written off entirely.
6. The following assets are to be revalued as under Furniture Rs.25000, Stock in Trade Rs.68000, Land and Building Rs.580000, Sundry Debtors Rs.80000.
7. A Secured loan of Rs.150000 at 12% p.a. is to be obtained by mortgaging Land and Building for repayment of bank overdraft and reconstruction expenses Rs.15000.

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

**Problem-4**

Following is the Balance Sheet of Delta Ltd. as on 31/03/2009:

|  |  |  |  |
| --- | --- | --- | --- |
| **Liabilities** | **(Rs.)** | **Assets** | **(Rs.)** |
| 15000,11.5% Preference shares of Rs.10 each fully paid up. | 150000 | Goodwill | 80000 |
| 13000 10% Preference Shares of Rs.10 each, Rs.5 per share paid up | 65000 | Patents | 54000 |
| 20000 Equity Shares of Rs.10 each fully paid up | 200000 | Land & Building | 175000 |
| 12% Debentures of Rs.100 each | 150000 | Plant & Machinery | 325000 |
| 11% Debentures of Rs.100 each | 300000 | Furniture | 15000 |
| Interest due on debentures | 19500 | Investment | 75000 |
| Sundry Creditors | 450000 | Sundry Debtors | 315000 |
|  |  | Bills Receivable | 100000 |
|  |  | Bank | 20000 |
|  |  | Profit & Loss Account | 175500 |
|  | **1334500** |  | **1334500** |

The following scheme of reconstruction was submitted and approved by the court:

1. 11.5% preference shares of Rs.10 each fully paid were reduced to 14% preference shares of Rs.10 each, Rs.6 per share paid up.
2. 10% preference shares of Rs.10 each, Rs.5 per share paid up, were reduced to 13% preference shares of Rs.10 each Rs.3 per share paid up.
3. Equity shares of Rs.10 each fully paid were reduced to the denomination of Rs.5 each fully paid.
4. 11% Debenture holders agreed to accept 50000 equity shares of Rs.5 each in full settlement of their claims.
5. Debenture holders agreed forego the interest due on debentures.
6. Sundry Creditors agreed to forego 10% of their claims.
7. The company recovered as damages a sum of Rs.50000 which was not recorded in the books.
8. Cost of reconstruction was paid Rs.2250.
9. Asset are to be revalued as under
10. Land and Building Rs.250000
11. Plant and Machinery Rs.275000
12. Furniture Rs. 10000
13. Investments Rs. 90000
14. Sundry Debtors Rs.300000
15. All intangible assets and accumulated losses are to be written off.

**You are required to:**

1. **Pass journal entries in the books of Delta Ltd.**
2. **Prepare Capital Reduction A/c & Balance Sheet after reconstruction.**

**Problem-5**

Following is the Balance Sheet of Paramount Ltd as on 31/03/2009.

|  |  |  |  |
| --- | --- | --- | --- |
| **Liabilities** | **(Rs.)** | **Assets** | **(Rs.)** |
| 6000-8% Preference  Shares of Rs.100 each | 600000 | Goodwill | 60000 |
| 50000 Equity Shares of Rs.10 each | 500000 | Patents & Trade Marks | 40000 |
| Capital Reserves | 50000 | Building | 300000 |
| 5%Debentures of Rs.100 each | 300000 | Plant & Machinery | 300000 |
| Debenture Interest due | 50000 | Furniture | 100000 |
| Sundry Creditors | 180000 | Stock | 150000 |
|  |  | Sundry Debtors | 75000 |
|  |  | Bank | 100000 |
|  |  | Cash | 25000 |
|  |  | Discount on Debentures | 30000 |
|  |  | Profit & Loss A/c | 500000 |
|  | **1680000** |  | **1680000** |

Note: Preference dividend is in arrears for three years.

The following scheme of reconstruction was prepared and duly approved by the court.

1. The Preference Shares shall be converted into equal number of 9% Preference Shares of Rs.50 each.
2. The equity shares shall be reduced to Rs.3 each. However the face value will remain the same.
3. 5% Debentures shall be converted into equal number of 6% Debentures of Rs.75 each. The debenture holders also agreed to waive 50% of the accrued interest.
4. Arrears of preference dividend is to be reduced to one year’s dividend which is paid in cash.
5. The sundry creditors agreed to waive 30% of their claims and to accept equity shares for Rs.30000 in part settlement of their renewed claims.
6. The assets are to be revalued as under:
7. Building Rs.350000
8. Plant & Machinery Rs.250000
9. Furniture Rs. 80000
10. Stock Rs.100000
11. Sundry Debtors Rs. 70000
12. Intangible assets and fictitious assets are to be written off.

Pass journal entries; prepare Capital Reduction Account and Balance Sheet after reconstruction in the books for Paramount Ltd.

**Problem-6**

Following is the Balance Sheet of Paradise Ltd. as on 31/03/2009

|  |  |  |  |
| --- | --- | --- | --- |
| **Liabilities** | **(Rs.)** | **Assets** | **(Rs.)** |
| 10% Pref. Shares of Rs.10 each | 240000 | Premises | 320000 |
| Eq. Shares of Rs.10 each | 400000 | Plant and Equipments | 520000 |
| 15% Deb. Of Rs.100 each | 480000 | Investment | 120000 |
| Sundry Creditors | 200000 | Stock | 144000 |
| Bank Overdrafts | 120000 | Debtors | 96000 |
| Other Current Liabilities | 160000 | Deposits & Advances | 40000 |
|  |  | Publicity Campaign Expenses | 160000 |
|  |  | Profit & Loss Account | 200000 |
|  | **1600000** |  | **1600000** |

It is observed that new product launched by the company has not succeeded even after three years of marketing. The management is of the opinion that the assets and liabilities are not valued correctly and also finds it difficult to raise finance. To overcome the situation a scheme of reconstruction is prepared by the directors and approved by all. The salient features of the scheme are:

1. Plant and Equipment having book value of Rs.80000 is obsolete. This is sold as scrap for Rs.16000.
2. The auditors have pointed out that depreciation on plant is not provided to the extent of Rs.40000.
3. Stock includes items valued at Rs.48000 which is sold at a loss of 50%.
4. The present realisable value of investment is 56000.
5. Dividend on preference shares is in arrears for three years. This amount is not payable.
6. All losses and fictitious assets are to be written off.
7. The expenses paid for forming and implementing scheme is Rs.8000.
8. The paid up value of equity share is to be reduced to Rs.2 per share and preference shares to Rs.5 per share. However, the face value remains unchanged.
9. The creditors due are settled as: (i) 20% immediate payment in cash. (ii) 40% amount is cancelled. (iii) 40% paid by issue of 16% Debentures.
10. Other current liabilities include Rs.40000 payable to directors towards remuneration. This liability is to be cancelled.
11. A call of Rs.3 per share on equity share is made and received.
12. Bank overdraft is paid off to the extent possible.

You are required to show: (i) Journal Entries for above scheme of reconstruction and (ii) Balance Sheet after reconstruction.

**Problem-7**

The summarised Balance Sheet of M/s Ketan Ltd. as on 31/12/2008 is as under:

|  |  |  |  |
| --- | --- | --- | --- |
| **Liabilities** | **(Rs.)** | **Assets** | **(Rs.)** |
| 10% Pref. Shares of Rs.10 each | 500000 | Goodwill | 200000 |
| Eq. Shares of Rs.10 each | 1000000 | Land & Building | 1000000 |
| 10% Conv. Debentures of Rs.100 each | 400000 | Furniture | 125000 |
| Bank Overdraft | 320000 | Investment | 400000 |
| Sundry Creditors | 300000 | Stock | 280000 |
| Bills Payable | 50000 | Debtors | 220000 |
| Provision for Tax | 100000 | Bills Receivable | 25000 |
|  |  | Profit & Loss A/c | 420000 |
|  | **2670000** |  | **2670000** |

The scheme of reconstruction as approved by the court was as under:

1. Each existing Equity Share will be written down from Rs.10 to Rs.4.
2. Each existing 10% Preference Share is to be written down from Rs.10 to Rs.8 of which Rs.4 will be represented by 12% Preference Share and Rs.4 by Equity Share.
3. Each convertible debenture is to be exchanged for Rs.50 of non-convertible 10% debentures, Rs.35 of 12% Preference Shares and Rs.15 of Equity Shares.
4. The IDBI has agreed to apply for Rs.500000 of Equity Shares paying cash in full on application.
5. The reduction of capital and reserves are to be applied in eliminating fictitious assets and balance to be used in writing down the Land and Building and Investment in the ratio of 3:1.

Give journal entries regarding reduction, prepare Capital reduction Account and resulting summarized Balance Sheet as on 1/1/2009.