



इंटरनल रिकंस्ट्रक्शन

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## Internal Reconstruction

### #1 meaning

when a co. has been making losses for no. of years, the financial position does not represent true & fair view of state of affairs of co.

During this phase co. adopts a reconstruction scheme, a process by which affairs of co. are reorganised by

- ↳ Revaluation of Assets.
- ↳ Reassessment of liability
- ↳ Reducing sh. capital.
- ↳ write off losses.

### #2 Calcng.

a) Reduce Capital & liability & generate profits



and with that profit write off overvalued assets & losses.



↓  
means liability are reduced to reduce assets.

↓  
Liability Dr  
To Assets.

Liability Dr  
To Reconstruction  
(being liability reduced)

Reconstruction Dr  
To Assets.

① increase

② decrease.

Assets Dr  
To Rec.

Rec Dr  
To Assets

S.C.

BIS	
1000 E.sh.	
of ₹10	
each	10000

R.S.  
If Q. states  
Utilise R.S.  
R.S Dr xx  
To Rec. xx

liability  
↓  
T appearing in BIS.

③ sale.

④ used to set off liability.

Case-1 → E.sh. are reduced  
Q.R.S. to ₹8 fully paid.  
up.  
(Here N.v. is changed)

old → ESC (₹10) Dr 10000  
New → To ESC (₹8) 8000  
Rec → To Recon. (Bif) 2000

① paid off  
Liability Dr  
To mop  
To Rec.

CIB Dr  
To Assets.

Liab. Dr  
To Assets.

(Any PIL toy to)  
Recons.

(Any PIL toy to)  
Recons.

② waive off.

Liability Dr  
To Recon.

Case-2: E.sh. are reduced  
to ₹8 paid up.  
(No change in face value)

T not appearing in BIS.  
↳ contingent liability.

D → ESC Dr 2000  
R → To Rec. 2000

i) Paid off  
Recon. Dr  
To mop.

ii) waive off.  
No entry.

b) J.E. for exps. on Reconstruction or any payment of any penalty.



Recom. Dr  
To CRB

c) J.E. for increase in authorised s.c. or change in Bank O.D. facility.

No entry.

d) Sub division of shares (Share split)

eg → 10000 E sh. of ₹100 each is subdivided into 100000 eq. sh. of ₹10 each

Esc (₹100) Dr	100000
To Esc (₹10)	1000000

e) Consolidation of shares (Reverse split)

eg → Esc (₹10) Dr	100000
To Esc (₹100)	1000000

f) 2<sup>nd</sup> last entry



↳ write off

↳ P/L (Dr)

↳ goodwill

↳ misc exps.

↳ Dis. on iss of sh/Deb

↳ Preliminary exp

↳ Ad. suspense etc.



entry →

Reconstruction Dr

To P/L

To glw

To misc exps.

g) last entry

transfer for bal. of Recon. acc to Cap. Res.

Rec. Dr

To C.R.

⚡ Important points (Exam POV) (HD gift)

i) if Q. states that a particular asset is



Revalued but amount of Revaluation is not given,

then Bal. of Reconstruction acc represents Revaluation amount & Bal. of Reconstruction is  $\text{ref.}$  to particular asset which is revalued.



ii) if Q. states Esth. suffer reduction in their rights upto amount specifically stated.

it means Esth will not reduce by a specific amount but will reduce (sacrifice) as much as required by scheme.

iii) BIS after reconstruction should contain words "and Reduced"

iv) Steps to solve.

Step 1	Journal	→ ①	Reconstruction (if)
Step 2	Ledgers	→ ②	Bank.
Step 3	BIS (if)	→ ③	Esc
		→ ④	PSC.

The Balance Sheet of Neptune Ltd., as on 31.3.2011 is given below:

Liabilities	₹	₹	Assets	₹
80,000 Equity shares of ₹ 10 each fully paid		8,00,000	Freehold Property	5,00,000
5,000, 6% Cumulative preference shares of ₹100 each fully paid		5,00,000	Plant & Machinery	1,80,000
6% Debentures (secured by freehold property)	3,75,000		Trade investment (at cost)	1,70,000
Arrear interest	22,500	3,97,500	Sundry debtors	4,50,000
Sundry creditors		17,500	Stock in trade	2,00,000
Directors Loan		3,00,000	Deferred advertisement expenditure	1,50,000
			Profit and Loss A/c	3,65,000
		20,15,000		20,15,000



The Court approved a scheme of re-organisation to take effect on 1.4.2011 and the terms are given below :

- (i) Preference shares are to be written down to ₹ 75 each and equity shares to ₹ 2 each.
- (ii) Preference dividend in arrear for 4 years to be waived by 75% and for the balance equity shares of ₹ 2 each to be allotted. *↳ No entry!*
- (iii) Arrear of debenture interest to be paid in cash.
- (iv) Debentureholders agreed to take one freehold property (Book value ₹ 3,50,000) at a valuation of ₹ 3,00,000 in part payment of their holding. Balance debentures to remain as liability of the company.
- (v) Deferred advertisement expenditure to be written off.
- (vi) Stock value to be written off fully in the books.
- (vii) 50% of the Sundry Debtors to be written off as bad debt.
- (viii) Remaining freehold property (after takeover by debentureholders) to be valued at ₹ 3,50,000.
- (ix) Investment sold out for ₹ 2,00,000.
- (x) 80% of the Director's loan to be waived and for the balance, equity shares of ₹ 2 each to be issued.
- (xi) Company's contractual commitments amounting to ₹ 5,00,000 to be cancelled by paying penalty at 3% of contract value.
- (xii) Cost of reconstruction scheme is ₹ 20,000

Show the Journal entries to be passed for giving effect to the above transactions and draw Balance Sheet of the company after effecting the scheme.

# Sol<sup>n</sup> :- Step 1 Journal



⑩ CIB Dr 20000

To Rec. + 3000  
To Investment 17000

① 6% P.S.C. Dr (₹100) 50000  
To 6% PSC (₹75) 37500  
To Reconstruction 12500 +

⑪ Direct loan Dr 30000  
To ESC (₹2) 6000  
To Rec. + 24000

② ESC (₹10) Dr 80000  
To ESC (₹2) 16000  
To Reconstruction 64000 +

⑫ Reconstruction Dr 2000 -  
To bank 2000

③ Reconstruction Dr 3000 -  
To ESC (₹2) 3000

⑬ Reconstr. Dr 15000 -  
To Bank 15000  
(3L x 3%)

(50000 x 6% x 4 yrs x 25%)

⑭ Recon. Dr 36500 -  
To PIL 36500

④ accrual of Int. Dr 22500  
To CIB 22500

⑮ Recon. Dr 18000  
To C.R. 18000

⑤ 8% Deb Dr 30000  
Recon. (By) Dr 5000 -  
To FHP 35000

## Step 2 Bank a/c

⑥ Recon. Dr 15000 -  
To Def. Ad. Exp. 15000

To bal. b/d	—	By am. of Int.	22500
To investm.	20000	By penalty	15000
		By Cost of Rec	2000
		By Bal. c/d.	142500
		(By)	

⑦ Recon. Dr 20000 -  
To stock 20000

⑧ Recon. Dr 22500 -  
To Debtors 22500  
(45000 x 50%)

## ESC

⑨ FHP Dr 2000  
To Recon. 2000 +

To Rec.	80000	By Bal. b/d	80000
To bal. c/d	25000	By Rec	16000



# Breakup:-

(Bif)

By Distr. 60000  
By Rec 30000

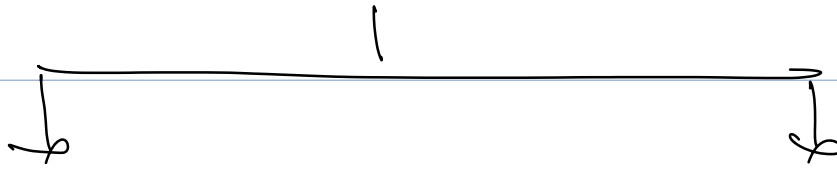


ESC (₹10) Dr 80000

To ESC (₹2) 16000

To Reconstruction 64000 +

Understanding purpose!



ESC Dr BL

To Rec BL

Rec. Dr 16000

To ESC 16000

6% Psc

To Rec 50000

By Bal Bld 50000

To Bal Cl

37500

By Rec. 37500

(Bif)

## Step 3 :-

## Balance Sheet of Neptune Ltd.

as at 1-4-11 (Reduced)

Particulars.	Note	Amount	Note-1	S.C.
Equity & liabilities:			ESC (step 2)	25000
1) SHF			6% Psc (11)	37500
a) S.C.	1	62500		<u>62500</u>
b) R.S. (C.R.)		18000	Note-2	TIP.
2) N.C.L.			Sund. Creditors	17500
a) L.T.B.				



6% Deb.

75000

Note-3.

PPE

C.L.

FHP

35000

a) TIP.

2

17500

PJM

18000

Total

897500

53000

Assets

1) NCA.

Note-4

TIR.

a) PPE

3

53000

S. Des.

45000

2) C.A.

- Rec.

(22500)

a) TIR

4

22500

22500

b) C.S.C.F.

Step 2

142500

897500

The following was the Balance Sheet of Ever Hopeful Ltd. as on 31<sup>st</sup> March, 2011.

Liabilities	₹	Assets	₹
Equity share capital in ₹100 each shares	5,00,000	Land & Building	2,00,000
10% Preference Capital in ₹ 100 each shares	3,00,000	Plant & Machinery	2,00,000
12% convertible debentures	90,000	Invention & Promotion Expenses	1,00,000
Loan from Bankers (secured)	1,10,000	Discount & Issue Expenses on shares & Debentures	30,000
Capital Reserve	40,000	Profit & Loss A/c	2,80,000
Creditors	1,60,000	Stock in hand	3,00,000
Securities premium	10,000	Debtors	1,00,000
	<b>12,10,000</b>		<b>12,10,000</b>

It was believed that worst was now over and Company's New Invention was certain to bring sizeable profit in future. But at present the Additional working capital was badly required. The dividend on Preference Shares was in arrears for the last three years. The company had a very valuable property which stood highly understated in the Balance Sheet and which it could not afford to sell, the said being required for the business.

In view of these shareholders and the creditors agreed upon the following scheme of reconstruction.

- All fictitious assets including invention and promotion expenses were to be written off.
  - ₹ 30,000 from Debtors, ₹ 2,00,000 from stock and ₹ 1,50,000 from plant and machinery were to be written off.
  - The convertible debentureholders were given the option of subscribing Equity shares of ₹ 30 each upto 50% of their face value and subscribing preference shares of ₹ 50/- each upto 25% of their face value and the remaining 25% was to be paid to them in cash. All debenture holders exercised the option.
  - All reserves were to be utilised.
  - The creditors being unsecured agreed to reduce their claim by 25% on the condition that they will be paid off before 31<sup>st</sup> March, 2013. They also agreed not to charge any interest till the date of payment.
  - Preference shares were reduced to ₹ 50 per share and equity shares were reduced to 30 per share.
  - Land & Building were revalued at such a figure so as to put through the entire scheme.
  - Bankers were to be paid off fully. For this purpose the company was to issue 6,000 equity shares of ₹ 30 each for cash.
  - The arrears of dividend on preference shares is cancelled.
- Assuming that the scheme had been duly sanctioned by the Court, prepare the Capital Reduction Account and Balance sheet after Reconstruction.

## Sol<sup>n</sup> :- Step 1 Journal

① Reconstruction Dr ₹ 7,00,000 —

To int & P Exps.	1,00,000
To D.O. in. of shd	30,000
To P/L.	2,80,000
To stock	2,00,000
To Debtors	30,000
To P/M	1,50,000

② 12% Deb. Dr 9,00,000

To Esc (₹30)	4,50,000
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## Step 2

### ① Reconstruction acc.

To Int & P.	1,00,000	By S.P.	1,00,000
To D.O.I.	30,000	By C.R.	4,00,000
To P/L	2,80,000	By Cr.	4,00,000
To stock	2,00,000	By P.S.C.	3,00,000
To Debt.	30,000	By E.S.C.	5,00,000
To P/M	1,50,000	By L & B	2,00,000
			By



To PSC (₹50) 22500  
To CIB 22500

② Bank acc

To ESC 180000	By 12% Deb. 21500
	By loan 11000
	By Bal. Id. <u>47500</u> (B/f)

③ J.P. Dr 10000  
C.R. Dr 40000  
To Recon. 5000 +

④ Gas Dr 40000  
To Recon. 40000 +

⑤ PSC (₹100) Dr 300000  
To PSC (₹50) 150000  
To Recon. 150000 +

⑥ ESC (₹100) Dr 500000  
To ESC (₹30) 150000  
To Reconst. 350000 +

⑦ Bank loan Dr 110000  
To CIB 110000

⑧ CIB Dr 180000  
To ESC (₹30) 180000

⑨ LIB Dr 200000  
To Reconst. 200000

(B/f. of Recon.)

③ ESC

To Rec. 500000	By Bal. Bld 500000
To Bal. Id. <u>375000</u> (B/f)	By Rec. 150000
	By Deb. 45000
	By CIB 180000

④ PSC

To Rec 300000	By Bal. Bld 300000
To Bal. Id. <u>172500</u> (B/f)	By Recon. 150000
	By Deb. 22500

Step 3 BLS of Ever hopeful Ltd.  
as at 31-3-2011 (Contd.)

Particulars	Notes	Amount	Note-1 S.C.
Eq. & Liability.			ESC (step 2) 375000
① SHF.			PSC (step 4) <u>172500</u>

Q1 S.C.

1

547500

547500



CL.

3) CL.

TIP.

Note-2

LSB

PJM

PPF  
400000  
HARSHIT DWIVEDI  
CA FOUNDATION | CA INTERMEDIATE | CA FINAL

50000

To total.

667500

450000

Assets.

1) Non C.A.

a) PPE

2

450000

2) Current

a) invent.

100000

b) T/R.

70000

c) C.A.C.R.

Step 2 (2)

47500

Total

667500

**QUESTION 7**

(STUDY MATERIAL)

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

Liabilities

Rs.

Assets

Rs.

6,000 shares of Rs. 60 each,

Rs. 30 paid up

First debentures

Second debentures

Unsecured creditors

Property, machinery and plant etc. (Cost

Rs. 3,90,000)

Estimated at

Cash in hand of

the receiver

1,50,000

2,70,000

30

3,00,000

6,00,000

4,50,000

1350000

525000  
75000

Charged under debentures	4,20,000
Uncalled capital	<u>1,80,000</u>
	<u>6,00,000</u>
Deficiency	<u>7,50,000</u>
<b>13,50,000</b>	<b>13,50,000</b>

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

The following scheme of reconstruction is proposed:

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

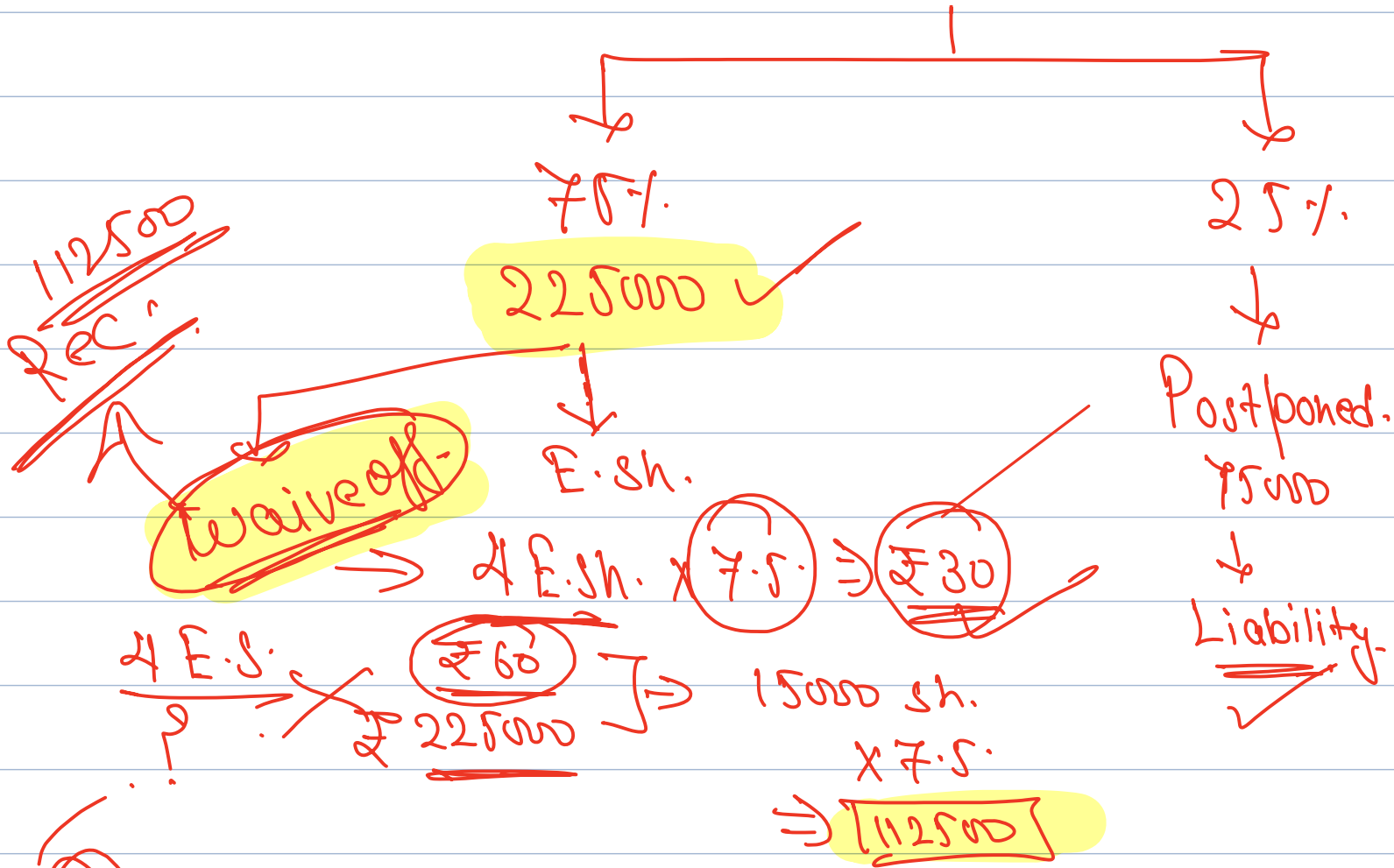
Assuming that the scheme is duly approved by all parties interested and by the Court, give necessary journal entries.

A.	B
①	②
69000. → old debt.	39000
+ <u>30000</u> → bring cash.	- <u>90000</u>
72000	<u>300000</u>
- <u>51000</u> → full satisfaction	
<u>21000</u> waive off.	



3

Unse cur.	₹50000
- A	(₹10000)
- B	(₹60000)
	<hr/>
	300000



4

60000 × 30 ⇒

60000 × 60 ⇒ 7.5

52.50 → Recon.

Sol<sup>n</sup>:- WN-1 Balance sheet.



## Liability

60000 sh. of  
₹ 60 each  
(₹ 30 paid up)  
First deb  
Second deb.  
TIP.

₹

180000  
300000  
600000  
450000  
1530000

## Asset

PPE  
Cash  
PIL (Dr)

₹

390000  
270000  
870000  
(B/F)  
1530000

### WN-2 :-

## Liability of Creditors.

	A	B	Others
1st deb.	300000	-	-
Sec. deb	300000	300000	-
TIP.	900000	600000	300000
	<u>690000</u>	<u>360000</u>	<u>300000</u>

### WN-3 :-

## Trade payables claim (other than A & B)

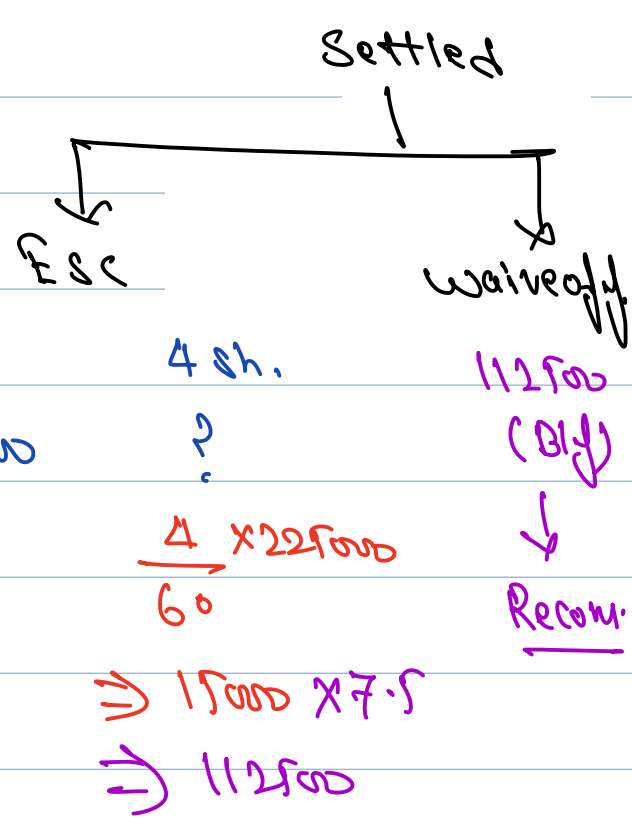
T.P. 450000  
- A's claim (900000)  
- B's claim (600000)  
300000

↓  
25%

↓  
75%



↓  
 Liability/loan  
 ₹ 5000



## Journal

- ① First deb. Dr 30000  
 Second deb Dr 30000  
 TIP Dr 90000  
 Cash Dr 30000  
     To first deb. 510000  
     To Recon. 210000
- ② Second deb Dr 300000  
 TIP Dr 60000  
     To Cash 90000  
     To Recon. 270000
- ③ Trade Pay. Dr 300000  
     To uns. Cr. ₹ 5000  
     To Esc (₹ 7.5) 112500  
     To Recon. 112500
- ④ Sh. final. Dr 180000  
     To Esc 180000  
     (6000 sh × ₹ 30)
- ⑤ Bank Dr 180000  
     To sh. final. 180000
- ⑥ Esc (₹ 60) Dr 360000  
     To Esc (₹ 7.5) 45000  
     To Recon. 315000
- ⑦ Reconstruction Dr 870000  
     To P1L 870000
- ⑧ Recon. Dr 37500  
     To C.R. 37500



{ Not done by ICAI but it should be done. }

{ I recommend don't do it. }



### # 3 Share Surrender

Till now we had seen that Esh sacrifice in terms of money from paid up value of shares.

But what if Esh surrenders in terms of shareholding??

When Esh surrenders in terms of their shareholding then this concept of Share Surrender (S.S) applied.

eg →

10 sh	x 100	}	→ 20 x 10 sh.	}	→ Normal Stedin Paid up Capital.
10 sh	x 80				
			<u>₹ 200</u>		

10 sh. x 100.  
8 sh x 100  
2 sh. x ₹ 100 ⇒ ₹ 200 → S.S.



Suppose

10 Esh of ₹100 = ₹1000



Esh. are reduced to ₹80 each paid up.

Esh are subdivided into Esh of ₹10 each

∴ Esh surrender 20% of their shareholding.

Esc Dr 200  
To Recon. 200

1) Esc (₹100) Dr 1000  
To Esc (₹10) 1000

2) Esc (20%) Dr 200  
To S.S. 200

Suppose → Crs. = ₹100  
are issued Esh.  
60%.

Crs Dr 100  
To Esc 60  
To Rec. 40

i) S.S. would be used to issue Esh to other liabilities

ii) S.S. not issued / unutilised will be cancelled by trf. to Reconciliation.

Crs Dr 100  
To Rec 100  
Rec. Dr 60  
To Esc 60

Suppose → Crs. are issued Esh.  
Crs = ₹100 out of S.S. to



60%

i) Crs Dr 100  
To Rec. 100



ii) S.S. Dr 60  
To ESC 60

(being E.sh. are involved  
of SS)

$$\text{S.S. not used} = 200 - 60 \\ = 140.$$

↓  
trf. to Recon.

iii) S.S. Dr 140  
To Recon. 140.

Steps of scheme of SS for J.E.

a) sub division

b) share surrender

c) Red<sup>n</sup> in Liab. & issue of sh.

d) trf. bal. of SS. to Rec. (if any)

e) Rest same entries as done previously

## Illustration 7

The Balance Sheet of Revise Limited as at 31st March, 20X1 was as follows :

		<b>Particulars</b>	<b>Notes</b>	<b>₹</b>
		<b>Equity and Liabilities</b>		
<b>1</b>		<b>Shareholders' funds</b>		
	A	Share capital	1	10,00,000
	B	Reserves and surplus	2	(6,00,000)
<b>2</b>		<b>Non-current liabilities</b>		
	A	Long-term borrowings	3	2,00,000
<b>3</b>		<b>Current liabilities</b>		
	A	Trade Payables		72,000
	B	Other current liabilities	4	24,000
	C	Short term provisions	5	<u>24,000</u>
		<i>Total</i>		<u>7,20,000</u>

		<b>Assets</b>		
<b>1</b>		<b>Non-current assets</b>		
	A	Property, Plant and Equipment	6	1,00,000
<b>2</b>		<b>Current assets</b>		
	A	Inventory		3,20,000
	B	Trade receivables		2,70,000
	C	Cash and cash equivalents		<u>30,000</u>
		<i>Total</i>		<u>7,20,000</u>

### Notes to accounts

			<b>₹</b>
<b>1</b>	<b>Share Capital</b>		
	<b>Equity share capital</b>		
	<u>10,000 Equity Shares of ₹ 100 each</u>		<u>10,00,000</u>
			<u>10,00,000</u>
<b>2</b>	<b>Reserves and Surplus</b>		
	Debit balance of Profit and loss Account		<u>(6,00,000)</u>
			<u>(6,00,000)</u>

<b>3</b>	<b>Long-term borrowings</b> 12% debentures		2,00,000 <u>2,00,000</u>
<b>4</b>	<b>Other current liabilities</b> Interest payable on debentures		24,000 <u>24,000</u>
<b>5</b>	<b>Short term provisions</b> Provision for taxation		24,000 <u>24,000</u>
<b>6</b>	<b>Property, Plant and Equipment</b> 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 is sub-divided into ten fully paid up equity shares of ₹ 10 each.
- After sub-division, each shareholder shall surrender to the company 50% of his holding, for the purpose of re-issue to debenture holders and trade payables as necessary.
- Out of shares 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 per cent. In consideration of the reduction, the debenture holders shall receive preference shares of ₹ 1,00,000 which are converted 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.
- Balance of profit and loss account to be written off.
- The shares 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

Sol<sup>n</sup> :- Step 1 Journal

Step 2 Esc

① Esc (₹10) Dr 100000

To Esc (₹10) 100000

To Rec.	100000	By Bal. B/d	100000
To S.S.	50000	By Rec.	100000
To bal. (d)	536000	By S.S.	36000
	(B/d)		

2) Esc (₹07) Dr 50000

To S.S. 50000

3) 12% Deb. Dr 150000

Deb. Int Dr 18000

To Rec. 168000

4) S.S. Dr 100000

To P.S.C (₹10) 100000

5) T.P. Dr 72000

To Recons. 72000

6) S.S. Dr 36000

To Esc 36000

7) Recons. Dr 60000

To P12 60000

8) S.S. Dr 364000



To Recon. 364 000

364 000

(being bal. of S.S. trf. to Rec.)



g) Rec. Dr 4000  
 To C.R. 4000

Step 3

B/S of Revise Ltd  
(As reduced)

Particulars	Note	Amount	Note   S.C.
Equity & liability			ESC (step 2) 536 000
1) SHF.			PSC <u>100000</u>
a) S.C.	1	636 000	<u>636 000</u>
b) R.S.S (C.R.)		4000	
2) NCL.			
a) L.T.B.			
12% Deb.		50000	
3) C.L.			
a) O.C.L			
O/S int.		6000	
b) STP		24000	
To tal		<u>720000</u>	
Assets.			
1) NCA.			



PPE.

100000

e.A.

Inventory

32000

TIR.

27000

CSE

3000

Total

72000