

Internal Reconstruction

1) Reconstruction means making changes in Business Assets/Liabilities to avoid the situation of Liquidation.

These changes consist of :-

- a) Changing the Capital Structure of a Company
- b) Making compromise arrangements with outside liabilities
- c) Writing off the Accumulated Losses ^{P&L ac Dr. Bal.} (अचर)
- d) Remeasuring the Overvalued Assets & Writing off of Irrelevant Assets/Fictitious Assets.

Conclusion :- Internal Reconstruction means to change the Finance position of a Company.

2) Adjustments relating to Share Capital

- a) Sub-division of Capital :- It will not reduce or Increase the amount of Share Capital. Only No. of Shares and Face Value will be changed. (Share Split)

Ex:-1 Equity Shares Capital (100/-) = 10,00,000

It was decided to sub-divide 100/- share into 10 shares of 10/- each. (earlier 10,000 no.)

$$\text{New No. of Shares} = \frac{10,00,000}{10} = 1,00,000 \text{ no.}$$

Esc (100) a/c Dr. 10,00,000
To Esc (10) a/c 10,00,000
(Being 10,000 no. of 100/- are sub-divided into 1,00,000 of 10/-)

b) Shares Consolidation :- Total Capital amt. will not be changed. Only no. of shares will get reduced & FV will be increased.

c) Reduction of Face Value & Paid up Value
Here, Face value & paid value will be reduced without change in No. of shares.

Ex:-2 Esc of 10/- each \Rightarrow ₹5,00,000

It was decided to reduce the FV to 3/- per share

Reduction will result into Gain, such gain shall be transfer to a special a/c "Reconstruction a/c" or "Capital Reduction a/c"

Esc (10) a/c Dr. 5,00,000
To Esc (3) a/c 22,50,00
To Capital Reduction a/c 2,50,000

(Being FV reduced to 3/- for 75,000 no. of shares)

d) Shares Surrender :- Here, some portion of shares are surrendered by existing shareholders without any payment.

Such surrendered shares can be re-issued to settle the liabilities.

Ex:-3 Esc (10/-) of 10,00,000

It was decided that shareholder shall surrender their 40% holding.

Esc a/c Dr. 4,00,000

To Shares Surrender a/c 4,00,000
(Being 40,000 no. of shares are surrendered)

6% Debentures are payable of 5,00,000
Surrendered shares shall be re-issued to all debenture holders in full settlement.

Shares Surrender a/c Dr. 4,00,000

To Share Capital 4,00,000

6% Debentures a/c Dr. 5,00,000

To Capital Reduction a/c 5,00,000

3) Compromise arrangement with Liabilities

a) Debentureholders

Ex:-4 6% Debentures (100/-) = 8,00,000
Freehold property = 7,00,000

Debn Holders agreed to take over freehold property in full settlement.

6% Debentureholders Dr. 8,00,000
 To property a/c 7,00,000
 To Capital Reduct. a/c 1,00,000

(Being Debn settled against property)

Ex:-5 Debentures = 8,00,000
Property = 7,00,000 (Bv)

Debentureholders agreed to take over property at a valuation of 12 lacs & they will pay remaining balance in cash.

Debentures a/c Dr. 8,00,000
Bank a/c Dr. 4,00,000

 To property a/c 7,00,000
 To Capital Reduction 5,00,000

b) Creditors :-

Ex:-6 One Creditor of a Company to whom Company owes of 400000/-. He decided to Forgo 40% of his Claim against receipt of equity Shares of Company for remaining 60% of his Claim.

Creditors a/c Dr. 400000
 To Esc a/c 240000 (60%)
 To Capital Red. 160000

c) Debentures & Creditors mix

Ex:-7 Mr. Kunal who holds 6% Debentures of Company of 300000/-. He is also a Creditor of a Company of 200000/-
Interest is not paid to Kunal since last 6 months. It was decided that Kunal will Forgo 60% of his Claim. He will also bring 100000 Cash & Company will issue him New Debentures for the Balance amt.

Payable to Kunal :-
Debt = 300000
Creditors = 200000
Interest = 9000

— Total payable = 509000
(-) 60% Waiver = (305400)

Still Payable = 203600

(+) received = 100000

New Debt = 303600

Debt a/c Dr. 300000
Creditor Dr. 200000
Int. Payable Dr. 4000
To Mr. Kunal a/c 509000

Bank 100000
To Kunal 100000

Kunal a/c Dr. 609000
To New Debt 303600
To Capital Red. 305400

d) Directors

Ex:-8 Director has given a loan to Company 2 years ago of 250000. It was decided that 80% shall be waived & remaining shall be settled against issue of equity share of 12.5 each (FV 10)

No. of Shares to be issued = $\frac{50000}{12.5} = 4000$ no.

Director's loan a/c Dr. 250000

To ESC a/c 40000

To SP a/c 10000

To Capital Red. a/c 200000

(Bring Director Loan Settled)

Ex:-9

A contingent liability of ₹ 1,00,000/- is payable, which has arisen due to the wrong action of one of the Directors. He has agreed to compensate this loss out of the loan given by him to the company. For the remaining loan of ₹ 3,00,000/-, the Directors have agreed to accept a cash payment of ₹ 20,000/- and allotment of 1,30,000 Equity Shares of ₹ 2/- each in full settlement. Director's Loan Liab (B/s) = 4,00,000

Director's Loan a/c Dr. 4,00,000

 To Bank a/c 20,000
 To Esc a/c 260,000
 To Capital Red. a/c 120,000

e) Preference Dividend :- Arrears of preference Dividend is waived :-

Ex:-10

B/s (extract)

9% Pref. Sh. Cap.	10,00,000
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Cont. Liab. :-

Pref. Dividend is in arrears for last 3 years

It was decided to waive entire 3 years Dividend

NO Entry

Ex:-11

B/s (extract)

91. PSC (3 yrs. arrears of Divd)	10,00,000
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1 year arrears shall be waived & remaining two years shall be settled in form of Equity Shares.

Record 2 yrs Dividend
First

Capital Red. Dr. 1.8
To Esc 1.8

~~P&A Dr. 1.8
To Divd. Payable 1.8~~

~~Dividend Payable Dr. 1.8
To PSC 1.8~~

~~Cap. Reduction Dr. 1.8
To P&A 1.8~~

F) Other Important adjustments

(i) The Balance of Securities premium A/c (Rs. 50,000) shall be utilized and transfer to Capital Reduction A/c

Security premium a/c Dr 50000
To Capital Reduction 50000

(ii) A Contingent Liability of which NO provision has been made was settled at Rs 9500/- and out of which 6100 was recovered from third party.

Capital Reduction Dr. 9500	Bank a/c Dr. 6100
To Bank 9500	To Cap. Red. 6100

(iii) Overvalued Assets shall be w/off and Fictitious Assets shall be removed :-

Misc exp. not yet w/off
Underwriting Commission
Pre-operating expense

B/S Asset side

Capital Reduction A/c Dr.
To Assets a/c
To Fictitious Asset a/c

(iv) If Goodwill is appearing in B/S and nothing is specified, then it shall also be w/off.

Capital Reduction Dr.
To Goodwill a/c

(V) Treatment of Shares Surrender

When SH Surrender a part of their Holding, then Such amt. is transfer to a temporary a/c Called "Shares Surrender A/c"

"Use of Shares Surrender A/c"

This account shall be utilized to re-issue New preference or Equity Shares.

Such New pref./equity Shares shall be given to Settle Liabilities

Any Balance amount (un-utilized) in "Shares Surrender A/c" shall be transfer to Capital Reduction A/c.

<u>Ex:-12</u>	Esc of 10/- each	50,00,000
	Creditors	14,00,000
	Debentures	12,00,000

All SH agreed to Surrender 40% of their Holding Out of Surrendered Shares, 2500 re-issued no.

as 10% Pref. Shares of 5/- each, and these Pref. Shares were allotted to Creditors in Full Settlement.

Out of Surrendered Shares, 100000 no. are issued as equity shares of 10/- each & allotted to Debentureholders in full settlement.

Solution :-

Step 1 :- Surrender of Shares :-

Equity Share Capital a/c Dr. 20,00,000
 To Shares Surrender a/c 20,00,000

Step 2 :- Re-issue out of Surrendered Shares

Shares Surrender a/c Dr. 125000
 To 10% Pref. Share Capital 125000

Shares Surrender a/c Dr. 10,00,000
 To Equity Share Capital 10,00,000

Step 3 :- Settlement with Creditors / Debentureholders

When above re-issued share are allotted to Creditors & Debentureholders, then again share issue entry not required.

Their Dues will now be Cancelled :-

Creditors a/c Dr. 140000

Debentures a/c Dr. 1200000

Step 4:- Any Balance remaining in Shares Surrender a/c shall be closed to Capital Reduction A/c

Share Surrender a/c Dr. 875000
To Capital Reduction a/c 875000

$$\left(20,00,000 - 125,000 - 10,00,000 = 875,000 \right)$$

Step 2 Step 2'

Final Balance of Capital Reduction A/c

After writing off all Assets, P&L Dr. Balance if Capital Reduction Balance still remains positive, then it is transferred to "Capital Reserve A/c"

If there is Insufficient Balance in "Capital Reduction A/c" to W/OFF P&L Dr. Balance, then check if there is any GR Balance available

Yes
available

GR Balance shall also be utilized to W/OFF remaining losses

Not
available

↓
Remaining Loss
not yet W/OFF
shall be
Continued.

Important Questions Adjustments

1) Q103(A) → (i)

2) Q202(A) → (3) & (9)

3) Q203(A) → (ii)

4) Q204(A) → (iii), (vii), (viii)

5) Q205(A) → (ii) → Disputed, (v)

6) Q206(A) → (iv)

7) Q207(A) → (4), (6), (10)

8) Q208(A) → (i) & (vii)

9) Q209(A) → B/S preparation is Important & Adjustment (1), (4)

10) Q210(A) → (iii)

11) Q211(A) → Full Question (all adjustments)

12) Q212(A) → (5) Disputed and (11)

13) Q213(A) → 6, 7, 9, 10



V'Smart Academy