CHAPTER-4 INTERNAL RECONSTRUCTION

Q. 1. Green Limited had decided to reconstruct the Balance Sheet since it has accumulated huge losses. The following is the summarized Balance Sheet of the Company on 31.3.2012 before reconstruction :

Liabilities	₹	Assets	₹
Share Capital:		Fixed Assets:	
Authorised:		Goodwill	20,00,000
1,50,000 Equity Shares of ₹50 each	75,00,000	Building	10,00,000
Subscribed and Paid up Capital:		Plant	10,00,000
50,000 Equity Shares of ₹ 50 each	25,00,000	Computers	25,00,000
1,00,000 Equity Shares of ₹50 each		Investments	Nil
40 per share paid up	40,00,000	Current Assets	Nil
Secured Loans:		Profit and Loss A/c-Loss	20,00,000
12% First Debentures	5,00,000		
12% Second Debentures	10,00,000		
Current Liabilities:			
Trade payables	5,00,000		
	85,00,000		**85,00,000**

The following is the interest of Mr. X and Mr. Y in Green Limited:

	Mr. X	Mr. Y
	₹	₹
12% First Debentures	3,00,000	2,00,000
12% Second Debentures	7,00,000	3,00,000
Trade Payables	2,00,000	1,00,000
	12,00,000	6,00,000
Fully paid up ₹ 50 shares	3,00,000	2,00,000
Parly paid up shares (₹ 40 paid up)	5,00,000	5,00,000

The following Scheme of Reconstruction is approved by all parties interested and also by the Court:

(a) Uncalled capital is to be called up in full and such shares and the other fully paid up shares be converted into equity shares of ₹ 20 each.

(b) Mr. X is to cancel ₹ 7,00,000 of his total debt (other than share amount) and to pay ₹ 2 lakhs to the company and to receive new 14% First Debentures for the balance amount

(c) Mr. Y is to cancel ₹ 3,00,000 of his total debt (other than equity shares) and to accept new 14% First Debentures for the balance.

(d) The amount thus rendered available by the scheme shall be utilised in writing off of Goodwill, Profit and Loss A/c Loss and the balance to write off the value of computers.

You are required to draw the Journal Entries to record the same and also show the Balance Sheet of the reconstructed company.

Q. 2. Following is the Balance Sheet of M Ltd. as at 31st March, 2013:

Liabilities	₹	Assets	₹
15,000, 10% Preference shares of		Goodwill	3,50,000
₹ 100 each	15,00,000	Land & Buildings	15,00,000
35,000 Equity shares of ₹100 each	35,00,000	Plant & Machinery	10,00,000
Securities Premium account	1,00,000	Inventory	6,00,000
7% Debentures of ₹100 each	5,00,000	Trade Receivables	15,00,000
Trade Payables	12,50,000	Cash at bank	1,00,000
Loan from Director	1,50,000	Profit & Loss A/c	19,50,000
	70,00,000		**70,00,000**

No dividend on Preference shares has been paid for the last 5 years.

The following scheme of reorganization was duly approved by the Tribunal:

(i) Each Equity share to be reduced to ₹ 25.

(ii) Each existing Preference share to be reduced to ₹ 75 and then exchanged for 1 new 13% Preference share of ₹ 50 each and 1 Equity share of ₹ 25 each.

(iii) Preference shareholders have forgone their right for dividend for four years. One year's dividend at the old rate is however, payable to them in fully paid equity Shares of ₹ 25.

(iv) The Debentureholders be given the option to either accept 90% of their claims in cash or to convert their claims in full into new 13% Preference shares of ₹ 50 each issued at par. One half (in value) of the debentureholders accepted Preference shares for their claims. The rest were paid cash.

(v) Contingent liability of ₹ 1,50,000 is payable, which has been created by wrong action of one Director. He has agreed to compensate this loss out of the loan given by the Director to the company.

(vi) Goodwill does not have any value in the present. Decrease the value of Plant and Machinery, Inventory and Trade receivables by ₹ 4,00,000, ₹ 1,00,000 and ₹ 1,50,000 respectively. Increase the value of Land and Buildings to ₹ 18,00,000.

(vii) 40,000 new Equity shares of ₹ 25 each are to be issued at par, payable in full on application. The issue was underwritten for a commission of 4%. Shares were fully taken up.

(viii) The total expenses incurred by the company in connection with the scheme excluding underwriting commission amounted to ₹ 15,000.

Pass necessary Journal Entries to record the above transactions.

Q. 3. The Balance Sheet of A Co. Ltd. as on 31.03.2011 is as follows :

Assets	₹	₹
Fixed Assets :		
Freehold property	4,25,000	
Plant	50,000	
Patents	37,500	
Goodwill	1,30,000	6,42,500
Traded investments (at cost)		55,000
Current Assets :		
Debtors	4,85,000	
Stock	4,25,000	
Deferred Advertising	1,00,000	10,10,000
Profit and Loss Account		4,35,000
Total		21,42,500
Liabilities	₹	₹
Share Capital		
4,000 6% Cumulative Preference Shares of ₹ 100 each	4,00,000	
75,000 Equity Shares of ₹ 10 each	7,50,000	11,50,000
6% Debentures (Secured on Freehold Property)	3,75,000	
Accrued interest	22,500	3,97,500
Current Liabilities :		
Bank Overdraft	1,95,000	
Creditors	3,00,000	
Directors Loans	1,00,000	5,95,000
		21,42,500

The court approved a scheme of re-organisation to take effect on 1.4.2011 whereby :

(i) The preference shares to be written down to ₹ 75 each and equity shares to ₹ 2 each.

(ii) Of the preference shares 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) Accrued interest 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) Patent, Goodwill and Deferred Advertising to be written off.

(vi) Stock to be written off by ₹ 65,000.

(vii) Remaining freeholds property to be re-valued at ₹ 3,87,500.

(viii) Amount of ₹ 68,500 to be provided for doubtful debts.

(ix) Trade investments to 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 totalling ₹ 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.

Q. 4. The draft Balance Sheet of Y Limited as on 31st March, 2013was as follows:

Liabilities	Amount (₹)	Assets	Amount (₹)
5,00,000 Equity shares of ₹10 each fully paid	50,00,000	Goodwill	10,00,000
9% 20,000 Preference shares of ₹ 100 each fully paid	20,00,000	Patent	5,00,000
10% First debentures	6,00,000	Land and Building	30,00,000
10% Second debentures	10,00,000	Plant and Machinery	10,00,000
Debentures interest outstanding	1,60,000	Furniture and Fixtures	2,00,000
Trade payables	5,00,000	Computers	3,00,000
Directors' loan	1,00,000	Trade Investment	5,00,000
Bank Overdraft	1,00,000	Trade receivables	5,00,000
Outstanding liabilities	40,000	Inventory	10,00,000
Provision for tax	1,00,000	Discount on issue of debentures	1,00,000
		Profit and Loss Account (Loss)	15,00,000
	96,00,000		**96,00,000**

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

A holds 10% first debentures for ₹ 4,00,000 and 10% second debentures for ₹ 6,00,000. He is also trade payables for ₹ 1,00,000. B holds 10% first debentures for ₹ 2,00,000 and 10% second debentures for ₹ 4,00,000 and is also trade payables for ₹ 50,000.

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

(i) All the equity shares be converted into fully paid equity shares of ₹ 5 each.

(ii) The preference shares be reduced to ₹ 50 each and the preference shareholders agree to forego their arrears of preference dividends in consideration of which 9% preference shares are to be converted into 10% preference shares.

(iii) Mr. 'A' is to cancel ₹ 6,00,000 of his total debt including interest on debentures and to pay ₹ 1 lakh to the company and to receive new 12% debentures for the Balance amount.

(iv) Mr. 'B' is to cancel ₹ 3,00,000 of his total debt including interest on debentures and to accept new 12% debentures for the balance amount.

(v) Trade payables (other than A and B) agreed to forego 50% of their claim.

(vi) Directors to accept settlement of their loans as to 60% thereof by allotment of equity shares and balance being waived.

(vii) There were capital commitments totalling ₹ 3,00,000. These contracts are to be cancelled on payment of 5% of the contract price as a penalty.

(viii) The Directors refund ₹ 1,10,000 of the fees previously received by them.

(ix) Reconstruction expenses paid ₹ 10,000.

(x) The taxation liability of the company is settled at ₹ 80,000 and the same is paid immediately.

(xi) The assets are revalued as under :

	₹
Land and Building	28,00,000
Plant and Machinery	4,00,000
Inventory	7,00,000
Trade receivables	3,00,000
Computers	1,80,000
Furniture and Fixtures	1,00,000
Trade Investment	4,00,000

Pass Journal entries for all the above mentioned transactions including amounts to be written off of Goodwill, Patents, Loss in Profit & Loss Account and Discount on issue of debentures.

Prepare :

Bank Account and working of allocation of Interest on Debentures between A and B.

Q. 5. S.P. Construction Co. finds itself in financial difficulty. The following is the summarized balance sheet on 31st December 2012:

Liabilities	₹	**Assets**	₹
Share Capital		Land	1,56,000
20,000 Equity Shares of		Building (net)	27,246
₹ 10 each fully paid	2,00,000	Equipment	10,754
5% Cum. Pref. Shares of		Goodwill	60,000
₹ 10 each fully paid	70,000	Investments (Quoted) in shares	27,000
8% Debentures	80,000	Inventory	1,20,247
Loan from Directors	16,000	Trade receivables	70,692
Trade Payables	96,247	Profit & Loss Account	39,821
Bank Overdrafts	36,713		
Interest Payable on Debentures	12,800		
	5,11,760		**5,11,760**

The authorised capital of the company is 20,000 Equity Shares of ₹ 10 each and 10,000 5% Cum. Preference Shares of ₹ 10 each.

During a meeting of shareholders and directors, it was decided to carry out a scheme of internal reconstruction. The following scheme has been agreed :

(1) The equity shareholders are to accept reduction of ₹ 7.50 per share. And each equity share is to be redesignated as a share of ₹ 2.50 each.

(2) The equity shareholders are to subscribe for a new share on the basis of 1 for 1 at a price of ₹ 3 per share.

(3) The existing 7,000 Preference Shares are to be exchanged for a new issue of 3,500 8% Cumulative Preference Shares of ₹ 10 each and 14,000 Equity Shares of ₹ 2.50 each.

(4) The Debenture holders are to accept 2,000 Equity Shares of ₹ 2.50 each in lieu of interest payable.

The interest rate is to be increased to 9½%. Further ₹ 9,000 of this 9½% Debentures are to be issued and taken up by the existing holders at ₹ 90 for ₹ 100.

(5) ₹ 6,000 of directors' loan is to be credited. The balance is to be settled by issue of 1,000 Equity Shares of ₹ 2.50 each.

(6) Goodwill and the profit and loss account balance are to be written off.

(7) The investment in shares is to be sold at current market value of ₹ 60,000.

(8) The bank overdraft is to be repaid.

(9) ₹ 46,000 is to be paid to trade payables now and balance at quarterly intervals.

(10) 10% of the trade receivables are to be written off.

(11) The remaining assets were professionally valued and should be included in the books of account as follows :

	₹
Land	90,000
Building	80,000
Equipment	10,000
Inventory	50,000

(12) It is expected that due to changed condition and new management operating profit will be earned at the rate of ₹ 50,000 p.a. after depreciation but before interest and tax.

Due to losses brought forward it is unlikely that any tax liability will arise until 2014.

You are required to show the necessary journal entries to affect the reconstruction scheme; prepare the balance sheet of the company immediately after the reconstruction.

Q. 6. M/s. Bhansali Ltd. Whose Balance Sheet as at 31st March, 2011 is as given below :

	₹	₹
Sources of Funds :		
1,00,000 Equity shares of ₹ 20 each ₹ 10 Paid up		10,00,000
8% Preference Share Capital :		
8,000 shares of ₹ 100 each, ₹ 75 paid up		6,00,000
Secured Loans 9% Debentures	6,00,000	
Outstanding Interest	1,08,000	7,08,000
Loan from ICICI Ltd.	1,50,000	
Outstanding interest	15,000	1,65,000
Total ₹		**24,73,000**
Application of Funds :		
Fixed Assets	11,20,000	
Goodwill	80,000	12,00,000
Investment at cost (Market value 55,000)		65,000
Current assets and loans and advances :		
Current assets :		
Stock		6,80,000
Debtors	1,20,000	
Bills Receivable	49,000	
	8,49,000	
Less : Current Liabilities :		
Sundry Creditors	69,000	
		7,80,000
Profit and Loss Account		4,28,000
Total ₹		**24,73,000**

Preference dividend is in arrears for one year.

Following Scheme of reconstruction is approved and agreed upon.

(i) Preference shareholders to give up their claims, inclusive of dividends to the extent of 30% and balance to be paid off.

(ii) Debenture holders agree to give up their claims to receive interest in consideration of their rate of interest being enhanced to 10% henceforth.

(iii) ICICI Ltd. agree to give up 50% of their interest outstanding in consideration of their claim paid off at once.

(iv) Sundry creditors would like to grant a discount of 5% if they were to be paid off immediately.

(v) Balance of profit and loss account, Goodwill and 25% of the total sundry debtors to be written off.

(vi) Fixed assets to be written down by ₹ 14,000.

(vii) Investment to be reflected at their market value.

(viii) Cost of reconstruction is ₹ 3,350.

(ix) To the extent required, Equity shareholders suffers on reduction of their rights.

(x) The Equity shareholders bring in necessary cash against their partly paid shares to leave working capital at ₹ 20,000. Pass necessary Journal entries in the books of the company assuming that scheme has been put through fully and prepare the Balance Sheet after reconstruction.

Q. 7. Following is the Balance Sheet of Delta Ltd. as on 31st March, 2011.

Trial Balance as on 31-03-2011

Liabilities	₹	Assets	₹
15,000 11.5% Preference Shares of		Goodwill	80,000
₹ 10 each fully paid up	1,50,000	Patents	54,000
13,000 10% Preference Shares of		Land and Buildings	1,75,000
₹ 10 each, ₹ 5 per share paid up	65,000	Plant and Machinery	3,25,000
20,000 Equity Shares of ₹ 10 each full paid up	2,00,000	Furniture	15,000
12% Debenture of ₹ 100 each	1,50,000	Investments	75,000
11% debentures of ₹ 100 each	3,00,000	Sundry debtors	3,15,000
Interest due to debentures holders	19,500	Bills Receivables	1,00,000
Sundry Creditors	4,50,000	Bank	20,000
		Profit & loss A/c	1,75,500
	13,34,500		13,34,500

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

(1) 11.5% Preference Shares of ₹10 each fully paid were reduced to 14% Preference Share of ₹ 10 each, ₹ 6 per share paid up.

(2) 10% Preference Shares of ₹ 10 each, ₹ 5 per share paid up, were reduced to 13% Preference Shares of ₹ 10 each, ₹ 3 per share paid up.

(3) Equity Shares of ₹ 10 each, fully paid were reduced to the denomination of ₹ 5 each fully paid.

(4) 11% debenture holders agreed to accept 50,000 equity shares of ₹ 5 each in full settlement of their claims.

(5) Debenture holders agree to 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 ₹ 50,000 which was not recorded in the books.

(8) Cost of Reconstruction was paid ₹ 2,250.

(9) Assets are to be revalued as under :

	₹
Land and Buildings	2,50,000
Plant and Machinery	2,75,000
Furniture	10,000
Investments	90,000
Sundry Debtors	3,00,000

(10) All intangible assets and accumulated losses are to be written off.

You are required to :

(i) Pass Journal Entries in the Books of Delta Ltd.

(ii) Prepare Capital Reduction A/c and Balance Sheet after reconstruction.

Q. 8. The shareholders of Maitri Ltd. decided on a corporate restructuring exercise necessitated because of economic recession. From the given summarised balance sheet as on 31-3-2012 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 Maitri Ltd.

Summarised Balance Sheet of Maitri Ltd. as on 31.3.2012

Liabilities		₹	Assets		₹
Share Capital			Fixed Assets		
30,000 Equity shares of ₹ 10 each		3,00,000	Trademarks and Patents		1,10,000
40,000 8% Cumulative Preference			Goodwill at cost		36,100
shares ₹ 10 each		4,00,000	Freehold Land		1,20,000
Reserves and Surplus			Freehold Premises		2,44,000
Securities Premium Account		10,000	Plant and Equipment		3,20,000
Profit and Loss Account		(1,38,400)	Investment (marked to market)		64,000
9% Debentures (₹ 100)	1,20,000		Current Assets		
Accrued Interest	5,400	1,25,400	Inventories:		
Current liabilities			Raw materials and packing		
Trade payables		1,20,000	materials	60,000	
Vat 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 ₹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.