

Chapter 6
Accounts of
External
Reconstruction

INTRODUCTION

- When a company is in financial difficulties and is unable to make profit, it may either be closed down or it may be reconstructed and reorganized. Many times, a new company is formed to wipe out the past losses and to get rid of the shortage of working capital.

MEANING OF RECONSTRUCTION

- When a company has gone through financial difficulties, when there are huge accumulated losses and the management feels that the time has come when it can run business profitably, it has two alternatives: (i) It can either resort to reduction of capital and wipe off accumulated losses. This is termed as internal reconstruction. (ii) The other way is to wind up the old company and to form a new one to take over the business of the old company. This is termed as external reconstruction.

1. Following was the Balance Sheet of Navjyot Ltd. as on 31st March, 2021 :

Particulars	Note	Rs.
I. EQUITY AND LIABILITIES :		
(1) Shareholders' Funds :		
(a) Share Capital :		
Equity Shares of Rs. 100 each fully paid		4,00,000
(2) Non-Current Liabilities :		
(a) Long Term Borrowings : 6% Debentures		2,00,000
(3) Current Liabilities :		
(a) Trade Payables : Creditors		1,10,000
Total		<u>7,10,000</u>
II. ASSETS :		
(1) Non-Current Assets :		
(a) Fixed Assets :		
(i) Tangible Assets :		
Factory Building		1,30,000
Machinery		2,50,000
(b) Other Non-Current Assets : Profit & Loss A/c		2,00,000
(2) Current Assets :		
(a) Inventories : Stock		15,000
(b) Trade Receivables : Debtors		1,00,000
(c) Cash and Cash Equivalents : Bank balance		15,000
Total		<u>7,10,000</u>

Though capital reduction scheme was implemented earlier, financial difficulties continued. Hence the following properly approved reconstruction scheme was formed and implemented :

- (1) Divyajyot Ltd. with authorised share capital of Rs.10,00,000 divided into Shares of Rs.100 each to be incorporated.
- (2) Divyajyot Ltd. purchased the business of Navjyot Ltd. for Rs. 3,10,000 for which Rs. 10,000 were paid in cash and remaining amount in shares.
- (3) Divyajyot Ltd. to take over 6% Debentures and Creditors. Debentures are to be paid by giving them Equity Shares of the same amount.
- (4) Liquidation expenses of Navjyot Ltd. amounted to Rs. 10,000.

Prepare Realisation A/c and draft necessary Journal Entries in the books of Navjyot Ltd. Also draft necessary Journal Entries in books of Divyajyot Ltd.

• **Solution: Step – 1: Net Assets = Total Assets – Total Liabilities**

Total Assets		₹
Factory Building		1,30,000
Machinery		2,50,000
Stock		15,000
Debtors		1,00,000
Bank Balance		<u>15,000</u>
	Total Assets	5,10,000
Less: Total Liabilities		
6% Debentures	2,00,000	
Creditors	<u>1,10,000</u> →	
		<u>3,10,000</u>
	Net Assets	<u>2,00,000</u>

Step – 2: Calculation of Purchase Consideration.

Particulars	₹
Equity Share Capital	3,00,000
Cash	10,000
Total Purchase Consideration	<u>3,10,000</u>

Step – 3: Goodwill or Capital Reserve:

$$\begin{aligned}\text{Goodwill} &= \text{Purchase Consideration} - \text{Net Assets} \\ &= ₹ 3,10,000 - ₹ 2,00,000 \\ &= ₹ \mathbf{1,10,000}\end{aligned}$$