<u>Capital Reduction</u>

This section deals with the process of reducing the Ordinary Share Capital balance so that the true value of shares are shown on the Balance Sheet.
This is for companies who are experiencing net losses over a few years.

The Companies Act 1985 allows companies to reduce their <u>value of the share capital</u> if, in doing so, the interests of the creditors are protected.

The Directors will decide to reduce the Share Capital balance if:
LOSSES IN THE PROFIT AND LOSS ACCOUNT ARE SEEN TO BE <u>PERMANENT</u> AND WILL LEAD TO THE CAPITAL BEING ERODED.

A **<u>CAPITAL REDUCTION</u>** account is used for this purpose.
IMPORTANT – this account must have a *zero balance* after the exercise is completed.

<u>JOURNAL ENTRIES:</u>

1. **DEBIT** Capital Reduction

   CREDIT Profit and loss (to write off the loss)

   Any other assets reducing in value Eg
   Goodwill
   Vehicles
   Land and Buildings
   Debtors (any bad debts written off)
   Stock

2. **DEBIT** Ordinary Share Capital

   CREDIT Capital Reduction (to close the capital reduction account)

An important skill in this section is to know how to calculate the value of a companies' share:

FORMULA: $$\frac{\textbf{Ordinary Share capital + Reserves}}{\textbf{Number of ordinary shares issued}}$$

NOTE – Preference share capital is NOT included.