

INTERNAL RECONSTRUCTION

Meaning:

It refers to the reconstruct the business without its liquidation. It does not require the binding of the existing company. It necessarily involves the reduction of share capital. There is no transfer of assets and liabilities, because there is not a formation of new company.

It is of 3 types

Through alteration of capital
Through reduction of capital
Through scheme of reconstruction

Significance of internal reconstruction

- (a) When there is an overvaluation of assets and undervaluation of liabilities.
- (b) When there is a difficulty to meet the financial crisis and there are continuous losses.

Accounting Entries on Internal Re-Construction

Entry for share capital reduced without changing the face value of the shares

Share Capital A/c
 To Capital Reduction/Reconstruction A/c

Entry if face value of the shares is also changed on reduction of capital a new category of share capital is created :

Share Capital A/c (Old)
 To Share capital A/c (New)
 To Capital reduction A/c

Entry where rate of dividend on preference shares is changed under the scheme of reconstruction:

Preference Share Capital A/c (OLD)
 To Preference Share Capital A/c (New)

Entry When debenture holder and creditors are also ready to reduce their claim against company:

Debenture A/c
Creditors A/c
 To Capital reduction A/c

Entry in case of appreciation in the value of any asset:

Assets A/c

To Capital reduction A/c

Entry if any contingent liability matures and is to be paid immediately the following entry is passed:

Capital reduction A/c

To Liability payable A/c

Liability Payable A/c

To Bank A/c

Entry for utilising the amount of capital reduction to w/o accumulated losses.

Capital Reduction A/c

To Profit & Loss A/c

To Preliminary Expenses A/c

To Discount on Shares /Debentures A/c

To Goodwill A/c

To Trade Assets A/c

To Patents/Copy rights

To Assets A/c

For transferring any balance left in the capital reduction account to capital reserve account

Capital reduction a/c

dr. (with the balance left)

To capital reserve a/c

External reconstruction is effected by liquidating the company. It is just like absorption. In it a new company is formed to acquire the business of an existing company are transferred to the newly formed company. But it is not done in the internal reconstruction.

Capital Reduction

Capital reduction refers to the cancellation of that part of paid up capital which is lost in operations or which is not represented by existing assets. It is generally resorted to write off the past accumulated losses of the company. It is unlawful except when sanctioned by the court because conservation of capital is one of the main principles of the company law. The issued share capital of a company represents the security on which the creditors rely. Companies usually do not call the full value of shares at one time. The uncalled capital act as a future security for the company's creditors. Therefore, any reduction of capital reduces the security of creditor.

A company is permitted to reduce its share capital by section 100 through following ways:

By reducing the uncalled liability of the members

By writing off the part of paid up capital which is lost in operations or which is not represented by available assets.

By returning that part of paid up capital which is in the excess of the need of the company

Accounting procedure for Capital Reduction:

For extinguishing or reducing the uncalled liability of the member:

Equity Share Capital A/c

To Equity share Capital A/c

For writing off the part of paid up capital which is lost in operation or which is not representing by available assets:

Equity Share Capital A/c

To Equity Share Capital A/c

To Capital Reduction A/c

If the face value of shares remain unchanged

Equity Share Capital A/c

To Capital Reduction A/c

For reducing the capital by returning the excess capital:

Equity Share Capital A/c

To Equity Share Capital A/c

To Equity Shareholders A/c

For payment to Shareholders

Equity Shareholders A/c

To Bank A/c

For uses of Capital reduction A/c

Capital Reduction A/c

To Accumulated Losses A/c

To Goodwill A/c

To Fictitious Assets A/c

To Other Assets A/c

To Capital Reserve A/c(Balancing Figure)

Capital Reduction

It refers to the cancellation of that part of paid up capital which is lost in operations or which is not represented by existing assets. It is generally resorted to write up the past accumulated loss of the company. It is unlawful except when sanctioned by the court because conservation of capital is one of the main principles of the company law. The issued share capital of a company represents the security on which the creditors rely. Companies usually do not call the full value of shares at one time. The uncalled capital act as a future security of creditor.

A company is permitted to reduce its share capital by section 100 through following ways:

- (i) By reducing the uncalled liability of the members.
- (ii) By writing off the part of paid up capital which is lost in the operations or which is not represented by available assets.
- (iii) By returning that part of capital which is in the excess of the need of the company.

A company may reduce its share capital if all of the following conditions are satisfied:

- (a) If a company is authorised by its articles to do so.
- (b) If special resolution is passed at a general meeting.
- (c) If the court's order in confirming the reduction of share capital is obtained.

Reduction of share capital can be done in the following three ways:

- (i) By extinguishing or reducing the liability on any of its shares in respect of uncalled amount of shares.
- (ii) By cancelling the paid up share capital which is lost or is not represented by available assets.
- (iii) By paying off any paid up share capital which is in excess of the requirements of the company.

Procedure for reducing share capital

The following procedure is to be followed for reducing share capital:

The company cannot reduce its share capital unless it is authorised by its articles.

However, if the particles do not permit capital reduction, they may be altered by special resolution to enable the company to reduce its share capital.

The company must pass a special resolution for reduction of capital.

The company must apply to the court for an order confirming the capital reduction. The court must look after the interests of creditors and shareholders before giving an order confirming the capital reduction.

The court may make an order confirming the capital reduction. The court may make an order confirming the capital reduction on such terms and conditions as it thinks proper, if it is satisfied that every creditor of the company entitled to object capital reduction has consented to the reduction or that his debt has been discharged or secured by the company. The court may also order the company to add the words “and reduced” to the name of the company for such period as it deems fit. The court may also order the company to publish reasons for reduction and all other information in regard there to for public information.

The order of the court confirming the reduction must be produced before the registrar and a certified copy of the order and of the minutes of reduction should be filed with the registrar for registration.

Note: in the following cases, procedure of reduction of capital is not called for:

Where redeemable preference shares are redeemed in accordance with the provisions of section 80.

Where any shares are forfeited for non-payment of calls.

Where there is surrender of shares or a gift is made to a company of its own shares.

Where the nominal share capital of a company is reduced by cancelling any shares which have not been taken or agreed to be taken by any person.

Alteration of share capital

- (a) Increase in share capital by issue of new shares
- (b) Consolidation of all as part of its existing shares
- (c) Sub division of its existing shares
- (d) Conversion of fully paid up into stock or vice-versa

In case of consolidation shares of smaller amount converted into shares of larger amount but the value of share capital remain same.

In case of sub division shares of larger amounts converted into shares of smaller amounts but the value of share capital remain same.;

In case of internal reconstruction a capital reduction account is to be opened, which is credited with the amount sacrificed by the shareholders, debenture holders and creditors and also due to increase in the value of any assets.

Then the amount of capital reduction is utilised for writing off fictitious assets, past losses and excess value of other assets. If there is any balance of capital reduction account left after writing off the above losses, then it is to be transferred to capital reserve account. The amount to be written off cannot exceed the amount credited to the capital reduction amount. But if any reserve appears on the liabilities side of the balance sheet, the same way be utilised in writing off the accumulated losses and assets.

If there is any contingent liability (like arrears of preference dividend etc.) and if the same is forgone for the claimant, then no entry will be passed.

If any contingent liability or unrecorded liability (like reconstruction expenses) is to be paid, then the following entry will be passed.

Capital reduction a/c	dr.
To cash /bank/share capital a/c	

In case there is any profits or gain occur during the process of internal reconstruction then such profits or gains must be credited to capital reduction account. The case of surrender of shares, shareholders surrender part of their holdings to the company, which are utilised to repay debenture holders, preference shareholders and other creditors of the company. Balance of unused shares surrendered is to be cancelled by transferred to capital reduction account.

Concept of alteration of share capital: according to sec 94 of companies act, a ltd company, if authorised by its articles can be made by passing an ordinary resolutions in general meeting without the approval of court.

The company can increase its share capital by making fresh issue of shares. accounting entries are the same as are made at the time of issue of shares.

Consolidation of shares refers to the conversion of existing shares of small amount into shares of large amount. Consolidation does not bring any change in the amount of share capital. It only reduces the no. of shares.

Sub-division of shares defines as the conversion of shares of larger denomination into shares of smaller denomination is called sub-division of shares. sub division also does not bring any change in the amount of share capital. It only increases the no. Of shares.

The company can convert its fully paid up shares into stock and vice versa. Partly paid up shares can never be converted into stock.

The company can cancel only those shares which are not so far taken by public. Since cancellation of unissued capital does not affect the paid up capital in any way, no entry is required at the time of cancellation.

Accounting entries in alteration of capital

Examples		Dr. (Rs)	Cr. (Rs.)
(A)	For increase in share capital Bank account dr. To equity share capital a/c (being the amount received on shares of Rs. each)		
(B)	for consolidation of shares Equity share capital A/c dr. To equity share capital A/c (being conversion of Shares of Rs. each intoshares of Rs. each)		
(c)	for sub-division of shares Equity share capital A/c dr. To equity share capital (being conversion of shares of Rs. Each into shares of Rs. each)		
(d)	For conversion of share into stock or vice versa Equity share capital A/c dr. To equity stock a/c (being conversion of fully paid Equity shares of Rs. each into equity stock) Equity stock A/c dr. To equity share capital A/c (being conversion of equity stock into Equity shares of Rs. each)		
(e)	For cancellation of unissued capital No entry is passed for cancellation of capital		