



***“Accounts is an account of
the account to keep an
account”***

- The Presenter himself

A hand in a white shirt is shown reaching towards a row of dominoes. The dominoes are arranged in a line, and the hand is positioned as if about to tip one of them. The background is a soft, out-of-focus white.

Internal Reconstruction of Companies

By
Krishnan R
SIES College of Arts,
Science and Commerce,
Sion (W)

What is it all about?

- **A form of capital re-organization.**
- **Governed by Sec 61 to 66 of Companies Act, 2013.**
- **A step to revive a company from getting knocked out due to losses.**
- **A scheme in which all interested parties volunteer to sacrifice.**
- **The sacrificers can be shareholders, debenture holders, creditors, etc.**
- **Technically, it involves writing down certain assets to an extent which can be balanced by capital reduction, thereby eliminating capital losses.**

Internal Reconstruction/Capital Reduction

- **Internal Reconstruction means the reduction of capital to cancel any paid up share capital which is lost or unrepresented by available assets. This is generally resorted to write off the past accumulated losses of the company.**
- **Reduction of capital is unlawful except when sanctioned by the court. The issued share capital of a company represents the security on which the creditors rely. The uncalled capital acts as a future security for the company's creditors. Therefore any reduction of capital reduces the security of the creditors.**

Methods

1. **Alteration of Share Capital** - A scheme where quantum of equity share capital is altered by issue, consolidation, sub-division, conversion of shares into stock or cancellation of unissued shares.
2. **Variation of Shareholders's Rights** - A scheme where existing rights enjoyed by shareholders are altered. Perhaps, by way of dividend or participative rights, etc.
3. **Reduction of Share Capital** - A scheme where share capital is reduced by way of sacrifice, contributing to Capital Reduction.
4. **Compromise/Arrangement** - A scheme where claims pertaining to reserves and surpluses, preference shares, debentures, creditors are partly sacrificed.

Reduction Procedure

1. Identifying overall losses (by adding accumulated losses, fictitious assets, overvaluation of assets, under-provision of liabilities, preliminary expenses, etc.) to be written-off.
2. Determining the parties who can bear the sacrifice (like Creditors, Debenture holders, Preference and Equity Share holders)
3. Use the sacrificed amount (Point 2) to write off the losses (Point 3)

Journal Entries

I. Alteration of Share Capital

a. Increase by issue of share

Bank A/c.... Dr

To Share Capital A/c (E/P)

b. Consolidation of Shares

Share Capital A/c.... Dr	(Rs. 10 X 1000 shares)	Old
To Share Capital A/c	(Rs. 100 X 100 shares)	New

c. Sub-division of Shares

Share Capital A/c.... Dr	(Rs.100 X 100 shares)	Old
To Share Capital A/c	(Rs. 10 X 1000 shares)	New

d. Conversion of Shares into Stock

Equity Share Capital A/c.... Dr
To Equity Stock A/c

e. Conversion of Equity Stock into Shares

Equity Stock A/c.... Dr
To Equity Share Capital A/c

Note: No entry need to be passed for cancelling unissued shares

II. Variation of Shareholder's Rights

a. Reduction in Dividend Rate

10% Pref Share Capital A/c.... Dr (Old)

To 8% Pref Share Capital A/c (New)

b. From Cumulative to Non-Cumulative Pref Share Capital

10% Cumulative Pref Share Capital A/c.... Dr (Old)

To 10% Non-Cumulative Pref Share Capital A/c (New)

III. Capital Reduction

a. Reduction in Face Value

Share Capital A/c.... Dr (FV: Rs. 100; PDV: Rs. 90)
To Share Capital A/c (FV: Rs. 90; PDV: Rs. 90)

b. Reduction in Paid Up Value (From Rs. 100 to Rs. 10)

Share Capital A/c.... Dr (PDV: Rs. 100) (Rs. 90 X no. of shares)
To Capital Reduction A/c (PDV: Rs. 90) (Rs. 90 X no. of shares)

c. Reduction in both Face Value and Paid Up value (From Rs. 100 to Rs. 10)

Share Capital A/c.... Dr (Rs. 100)
To Share Capital A/c (Rs. 10)
To Capital Reduction A/c (Rs. 90)

d. Surrender of Shares

i. On surrender of shares

Share Capital A/c.... Dr

To Shares Surrendered A/c

ii. Re-issue of surrendered shares

Shares Surrendered A/c.... Dr

To Share Capital A/c

iii. Cancellation of surrendered shares

Shares Surrendered A/c.... Dr

To Capital Reduction A/c

IV. Compromise / Arrangement

a. Sacrifice of Reserves

Reserves A/c.... Dr

To Capital Reduction

b. Revaluation of Assets (Increased Value)

Assets A/c.... Dr

To Capital Reduction A/c

c. Sale of Assets at Profit

Bank A/c.... Dr

To Assets A/c

To Capital Reduction A/c (Profit Amount)

d. Third Party Liability Sacrificed

Liability/Provision A/c.... Dr

To Capital Reduction A/c

e. Payment to Third Party Creditors (Liabilities)

Liability A/c.... Dr

To Bank A/c

To Share Capital A/c

To Assets A/c

f. Arrears of Pref Dividend Paid

Capital Reduction A/c.... Dr

To Pref Shareholders A/c

Pref Shareholders A/c.... Dr

To Bank A/c

V. Utilization of Capital Redcution

a. For writing-off Intangible Assets/Fict Assets

Capital Reduction A/c.... Dr

To P & L A/c

To Misc Expenses not written-off A/c

To Goodwill A/c

b. For writing down Fixed and Current Assets

Capital Reduction A/c.... Dr

To Fixed/Current Assets A/c

c. For recording new Liability/Provision

Capital Reduction A/c.... Dr

To Liability/Provision A/c

d. For Reconstruction Expenses

Capital Reduction A/c.... Dr

To Bank A/c

e. Transfer of Balance amount to Capital Reserve A/c

Capital Reduction A/c.... Dr

To Capital Reserve A/c

Chalo, ek example hojaye



The following is the Balance Sheet of Hopeful Ltd. as on 31st December, 2006:

Balance Sheet

<i>Liabilities</i>	<i>Rs.</i>	<i>Assets</i>	<i>Rs.</i>
13% Cumulative Preference Shares of Rs. 100 each	1,00,000	Fixed Assets	15,00,000
Equity shares of Rs. 10 each, fully paid-up	7,00,000	Current Assets	35,00,000
8% Debentures	3,00,000	Profit and Loss Account	3,00,000
Current liabilities	39,00,000		
Provision for Taxation	3,00,000		
	53,00,000		53,00,000

- (i) Fixed assets are to be written down by 33.33%.
- (ii) Current assets are to be revalued at Rs. 27, 00,000.
- (iii) Preference shareholders to forego their right to arrears of dividend, which are in arrears for three years.
- (iv) The taxation liability of the company is settled at Rs. 4, 00,000.
- (v) One of the creditors of the company, to whom the company owes Rs. 25, 00,000, decides to forego 50% of his claim. Others for Rs. 5, 00,000 were allotted 1, 00,000 equity shares of Rs. 5 each in satisfaction of balance of their claims.

(vi) The rate of interest on debentures is increased to 11%. The debenture holders surrender their existing debentures of Rs. 100 each and exchange the same for fresh debentures of Rs. 75 each.

(vii) All existing equity shares are reduced to Rs. 5 each.

(viii) All preference shares are reduced to Rs. 75 each.

Pass journal entries and show the Balance Sheet of the company after giving effect to the above.

Solution:

Journal Entries of Hopefull LTD.

Date	Particulars	L.F.	Amount Dr. Rs.	Amount Cr. Rs.
31st Dec. 2006	Equity Share Capital Account (Rs. 10) Dr. To Capital Reduction Account To Equity Share Capital Account (Rs. 5 each) (Being equity capital reduced from Rs. 10 Per share to Rs. 5 Per share)		7,00,000	3,50,000 3,50,000
"	13% Cumulative Preference Share Capital Account Dr. To Capital Reduction Account (Being reduction of preference shares to Rs. 75 each)		25,000	25,000
"	Sundry Creditors Account (Current liabilities) Dr. To Equity Share Capital A/c (Rs. 5 each) To Capital Reduction Account (Being claim ceded by creditors and allotment of shares in partial settlement of balance of claim)		17,50,000	5,00,000 12,50,000
"	8% Debentures Account Dr. To 11% Debentures Account To Capital Reduction Account (Being conversion of 8% debentures of Rs. 100 each to 11% debentures of Rs. 75 each)		3,00,000	2,25,000 75,000
"	Capital Reduction Account Dr. To Profit and Loss Account To Fixed Assets Account To Current Assets Account To Provision for Taxation Account (Being the loss written-off, assets depreciated and provision for taxation increased)		17,00,000	3,00,000 5,00,000 8,00,000 1,00,000

Balance Sheet of Hopefull LTD. (and reduced)
as on 31st December, 2006

<i>Liabilities</i>	<i>Rs.</i>	<i>Assets</i>	<i>Rs.</i>
13% Cumulative preference Shares of Rs. 75 each fully paid-up	75,000	Fixed Assets	10,00,000
Equity Share Capital	8,50,000	Current Assets	27,00,000
11% Debentures	2,25,000		
Current Liabilities	21,50,000		
Provision for Taxation	4,00,000		
	37,00,000		37,00,000

GRACIAS

