

Internal Reconstruction

Meaning of Internal Reconstruction:

Internal Reconstruction is an arrangement made by companies where by the claims of shareholders, Debenture holders, creditors and other liabilities are altered/reduced so that the accumulated losses are written off, assets are valued at its fair value and the balance sheet shows the true and fair view of the financial position.

Forms of Internal Reconstruction:

- Re-organization or Alteration of share capital
- Reduction of Share Capital and other liabilities

1. Reorganization or Alteration of Share Capital:

- a. Increasing the share capital by making fresh issue of shares
- b. Decreasing the share capital by canceling the un issued shares
- c. Conversion of shares into stock and vice versa
- d. Consolidation of shares of smaller amounts into shares of larger amounts
- e. Sub-division of shares of larger amounts into share of smaller amounts.

A company can alter its share capital if it is authorized by its Articles of association

2. Reduction of Share Capital:

Reduction of share capital is an arrangement under which the capital of the shareholder and sometime even the claims of debenture holders and the creditors are reduced. The amount made available by capital reduction is utilized in writing off the accumulated losses, fictitious assets and the overvalued portion of the other assets.

A Company can reduce its paid-up capital if

- It is authorized by its articles
- A special resolution is passed
- A sanction of the court is obtained

Internal Reconstruction

Difference between internal Reconstruction and External Reconstruction

Difference	Internal Reconstruction	External Reconstruction
New Company	No new company is formed	New Company is formed
Liquidation	No company is liquidated	One company is liquidated
Court confirmation	Court's confirmation is required	No court's confirmed is required
	Internal Reconstruction is slow and tedious	External Reconstruction can be carried easily
Loss set off	In this case the company is able to setoff its past losses against future profit	In this case the company is not able to setoff its past losses against future profit

Accounting Entries:

1. For reduction of Equity Share Capital

(Old) Equity Share Capital A/c Dr
To (New) Equity Share Capital A/c
To Capital Reduction A/c

2. For reduction of Preference Share Capital

(Old) Preference Share Capital A/c Dr
To (New) Preference Share Capital A/c
To Capital Reduction A/c

3. For reduction of the amount due to debenture holders:

Debenture holder's A/c
To Capital Reduction A/c

4. For reduction of the amount due to creditors

Creditors A/c Dr
To Capital Reduction A/c

5. For appreciation in the value of assets

Assets A/c Dr
To Capital Reduction

Internal Reconstruction

6. For the payment of reconstruction expenses A/c

Reconstruction Expenses A/c

To Bank

7. For utilization of capital reduction account in writing off accumulated losses and various fictitious assets.

Capital Reduction A/c Dr

To Profit & Loss A/c (Loss)

To Preliminary Expenses A/c

To Discount on issue of shares or debentures A/c

To Underwriting Commission A/c

To Advertising Expenses A/c

To Reconstruction Expenses A/c

To Good will A/c

To Patents or Trade Marks A/c

To Fixed Assets A/c (Over valued assets)

To Other Assets A/c

To Capital Reserve A/c (is some balance is left)

KLe Society's S Hjalingsappa College