

Reconstruction Of Company

Reconstruction is a process of the company's reorganization, concerning legal, operational, ownership and other structures, by revaluing assets and reassessing the liabilities. It refers to the transfer of company or several companies' business to a new company. This, therefore, means that the old company will get put into liquidation, and shareholders will therefore agree to take shares of equivalent value in the new company.

Reconstruction is required when the company is incurring losses for many years, and the statement of account does not reflect the true and fair position of the business, as a higher net worth is depicted, than that of the real one.

In other words, "Reconstruction" involves the winding up of an existing company and the transfer of its assets and liabilities to a new company formed for the purpose of taking over the business and undertaking of the existing company. Shareholders in the existing company become shareholders in the new company. The business undertaking and shareholders of the new company are substantially the same as those of the old company.

Objectives of Reconstruction

The major objectives of reconstruction are as follows-

1. To resolve the problem of over-capitalization/huge accumulated losses/over valuation of assets.
2. When the capital structure of a company is complex and is required to make it simple
3. When change is required in the face value of shares of the company
4. To generate surplus for writing off accumulated losses & writing down overstated assets.
5. Raising the fresh capital by issuing new shares.
6. Changing altogether the memorandum of association of the company.
7. To generate cash for working capital needs, replacement of assets, to add balancing equipment's, modernise plant & machinery etc.

Types of Reconstruction

A company can be reconstructed in any of the two ways. These are:

1. External Reconstruction and
2. Internal Reconstruction.

Internal Reconstruction: Internal reconstruction refers to the internal re-organization of the financial structure of a company. It is also termed as re-organization which permits the existing company to be continued. Generally, share capital is reduced to write off the past accumulated losses of the company.

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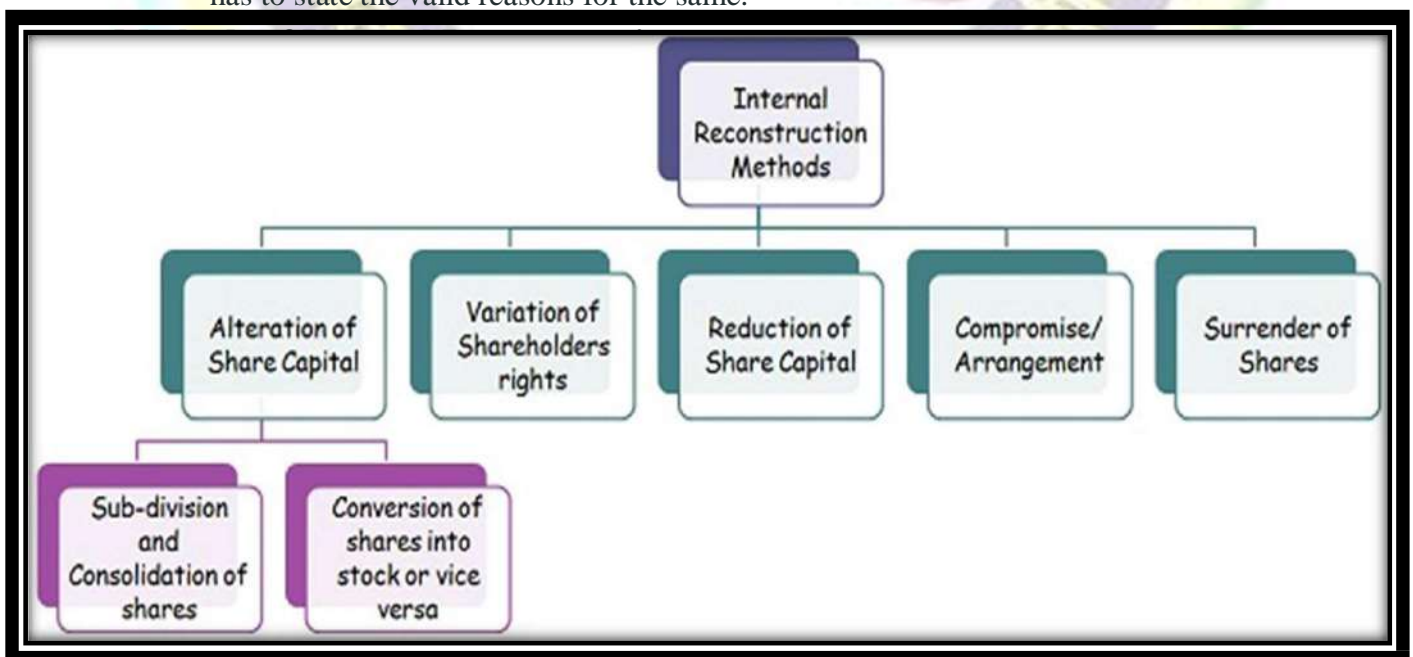
Significance of Internal Reconstruction

Internal reconstruction is done by the company when:

1. There is an overvaluation of assets and undervaluation of liabilities.
2. There is a difficulty to meet the financial crisis and there are continuous losses.

Conditions/Provisions regarding Internal Reconstruction

1. **Authorization by Articles of Association:** The company must be authorized by its articles of association to resort for capital reduction. Articles of association contains all the details regarding the internal affairs of the company and mention the clause containing manner of reduction of capital.
2. **Passing of Special Resolution:** The Company must pass the special resolution before resorting to capital reduction. The special resolution can be passed only if the majority of the stakeholders are assenting to the internal reconstruction. This special resolution must be get signed by the tribunal and deposited to the registrar appointed under the Companies Act, 2013.
3. **Permission of Tribunal:** The Company must get the due permission of the court or tribunal before starting the process of the capital reduction. The tribunal grants permission only it feels satisfied with the point that the company is going fair and there is positive consent of every stakeholder.
4. **Payment of borrowings:** As per Section 66 of the Companies Act, 2013, the company has to repay all the amounts it gets deposited and also the interest due thereon before going for capital reduction.
5. **Consent of Creditors:** The written consent of the creditors is required for the company which is going for capital reduction. The court requires the company to secure the interest of the dissenting creditors. The company gets the permission of the court after the court thinks fit that reduction of capital will not harm the interest of the creditors.
6. **Public Notice:** The Company has to make a public notice as per the directions of the tribunal stating that the company is resorting to capital reduction. Also, the company has to state the valid reasons for the same.



2. (Ds-3 opp Doctors' colony P.N.B building kankarbagh patna)

Accounts by Nitesh Sir

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External Reconstruction: When a company is suffering losses for the past several years and facing financial crisis, the company can sell its business to another newly formed company. Actually, the new company is formed to take over the assets and liabilities of the old company. This process is called external reconstruction. In other words, external reconstruction refers to the sale of the business of existing company to another company formed for the purpose. In external reconstruction, one company is liquidated and another new company is formed. The liquidated company is called "Vendor Company" and the new company is called "Purchasing Company". Shareholders of Vendor Company become the shareholders of purchasing company.

Differentiate between Internal and External reconstruction

Basis of Distinction	Internal Reconstruction	External Reconstruction
1. Meaning	Internal reconstruction refers to the method of corporate restructuring wherein existing company is not liquidated to form a new one.	External reconstruction is one in which the company undergoing reconstruction is liquidated to take over the business of existing company.
2. New company	No new company is formed.	New company is formed.
3. Capital Reduction	Capital is reduced and the external liability holders waive their claims.	No reduction in the capital
4. Transfer of Assets and Liabilities	No such transfer takes place.	Assets and liabilities of existing company are transferred to the new company.
5. Application	It is done to ensure an inner re-arrangement of financial structure.	It is done to form a new company.
6. Approval of Tribunal	Required.	Not required.
7. Liquidation	Liquidation of company is not done.	Liquidation of company is must
8. losses against profits	It can set off past losses against future profits.	Since a new company is established, losses of the old company can't be set off against the profits of the new company.

Conclusion

Company restructuring is a process in which a company changes the organizational structure and processes of the business. Therefore, in the process of internal reconstruction, only the rights of the shareholders and creditors are changed with certain reduction of capital and the rights/claims of the debenture-holders are kept outside the purview of the procedure of internal reconstruction. The process of external reconstruction is governed by the process of 'amalgamation in the nature of merger' under the Companies Act, 2013. In the process of external reconstruction, a new company is formed to take over the liquidated company and the newly formed company gets a fresh share capital without any reduction in the share capital.

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Accounting Treatment (for internal reconstruction)

Case 1: When Alteration of Share Capital:

Accounting Entries

1.	For increase in share capital Bank account To equity share capital a/c (Being the amount received on shares of ₹ each)	Dr.
2.	For consolidation of shares Equity share capital A/c To equity share capital A/c (Being conversion of shares of ₹ each intoshares of ₹ each)	Dr.
3.	For sub-division of shares Equity share capital A/c To equity share capital (Being conversion of shares of ₹ each into shares of ₹ each)	Dr.
4.	For conversion of share into stock or vice versa Equity share capital A/c To equity stock a/c (Being conversion of fully paid equity shares of ₹ each into equity stock) Equity stock A/c To equity share capital A/c (Being conversion of equity stock into equity shares of ₹ each)	Dr. Dr.
5.	For cancellation of unissued capital No entry is passed for cancellation of capital	

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Case 2: When Variation of Shareholders right:

As Per Section 48 of the Companies Act 2013 states that where a share capital of the company is divided into different classes of shares, the rights attached to the shares of any class may be varied with the consent in writing of the holders of not less than three-fourths of the issued shares of that class or by means of a special resolution passed at a separate meeting of the holders of the issued shares of that class.

Accounting Entries

1.	For changing rate of dividend of preference shares (Old) % Cum preference share capital A/c Dr. To (New) % Cum preference share capital A/c (Being rate of dividend on preference shares changed)
2.	For converting cumulative preference shares into non cumulative preference shares without changing the amount of share capital Cum preference share capital A/c Dr. To Non Cum preference share capital A/c (Being cumulative preference converted into shares into non cumulative preference shares)

Case 3 When Reduction of Share Capital:

Section 66 of the Companies Act 2013 provides that subject to confirmation by the Tribunal on an application by the company, a company limited by shares or limited by guarantee and having a share capital may, by a special resolution, reduce the share capital in any manner and in particular, may—

- (a) extinguish or reduce the liability on any of its shares in respect of the share capital not paid-up; or
- (b) either with or without extinguishing or reducing liability on any of its shares, —
 - (i) cancel any paid-up share capital which is lost or is unrepresented by available assets; or
 - (ii) pay off any paid-up share capital which is in excess of the wants of the company

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Accounting Entries

1.	Entry for share capital reduced without changing the face value of the shares	
	Share Capital A/c	Dr.
	To Capital Reduction/Reconstruction/ Reorganization Account) A/c	<i>(with the amount of the reduction made)</i>
2.	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)	Dr.
	To Share capital A/c (New)	<i>(with the amount treated as paid up)</i>
	To Capital reduction A/c	<i>(with the difference amount)</i>
3.	Entry When debenture holder and creditors are also ready to reduce their claim against company	
	Debenture A/c	Dr.
	Creditors A/c	Dr.
	To Capital reduction A/c	
4.	Entry in case of appreciation in the value of any asset	
	Assets A/c	Dr.
	To Capital reduction A/c	

5.	Entry if any contingent liability matures and is to be paid immediately the following entry is passed	
	Capital reduction A/c	Dr.
	To Liability payable A/c	
	Liability Payable A/c	Dr.
	To cash/ Bank/ share capital A/c	
6.	Entry for utilising the amount of capital reduction to write off accumulated losses.	
	Capital Reduction A/c	Dr.
	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	
7.	For transferring any balance left in the capital reduction account to capital reserve account	
	Capital reduction A/c	Dr.
	To capital reserve A/c	<i>(with the balance left)</i>

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Case 4 When Compromise/Arrangement: A scheme of compromise and arrangement is an agreement between a company and its members and outside liabilities when the company faces financial problems. Such an arrangement, therefore, also involves sacrifices by shareholders, or creditors and debenture holders or by all.

Accounting Entries

1.	When shareholders give up their claim to reserves and accumulated profits	
	Reserves A/c	Dr.
	To Reconstruction A/c	
2.	When outside liabilities is settled at lesser amount	
	Outside liabilities A/c	Dr.
	To Reconstruction A/c	