

Reconstruction

* When a company suffered heavy losses in the past and it is considered that company has bright future, such company should not be liquidated. It should be reconstructed or reorganized through a scheme of reconstruction which is also called "Capital reduction scheme".

* The term "Reconstruction" means reorganizing the capital structure of a company including the reduction of the claims of both the shareholders and creditors against the company. Such a reconstruction becomes necessary when the financial condition of the company is not good due to past accumulated losses, overvaluation of Assets, etc. The objective of reconstruction is to reorganize the company so that it may run efficiently and profitably in the near future. It involves reducing the claims of various stakeholders of the company on the one hand and writing off the past accumulated losses and other unrepresented Assets on another head.

The scheme of reconstruction may involve the following

(1) Surrender of shares:

As per the scheme of reconstruction company may be asked its shareholders to surrender some of the share holding. Before asking to surrender the shares the company may alter its share capital either by subdivision of shares (or) by consolidation of shares.

A. Subdivision of shares

In this case, shares of larger denominations are converted into shares of smaller denomination. In such a case the paid up share capital remains

the same, but the no. of shares is increased. The following entry is recorded

Equity Share cap. (₹100) a/c Dr. XXY

TO Equity Share cap. (₹10) a/c XXX

[20,000 shares @ ₹100 each = 20l]
[2,00,000 shares @ ₹10 each = 20l]

(b)

Consolidation of Shares :

In this case, the shares of smaller denominations are converted into the shares of larger denominations.

In this case also the paid up capital remains the same but no. of shares will be decreased.

After such alteration, the share holders may surrender some of their shares holdings either for reissue (or) otherwise for cancellation. When shares are surrendered by share holders the following entry is

Equity Share capital a/c Dr. XXX

TO Shares Surrender a/c XXX

When surrendered shares are reissued/cancellation

Share Surrendered a/c Dr. XXX

(Reissue) TO Equity Share cap. a/c XXX

(Cancelled) TO cap. reduction a/c XXX

(2) Reduction of capital

The Company can reduce the face value of the share (or) paid up amt. of the shares.

(a) when the face value of share is reduced

Equity share capital (old face value) alc Dr. XXX

TO Equity share cap. (New face value) alc XXX

TO Capital reduction/reconstruction alc

In this case no further call to be made from the existing share holders.

(b) when the paid amt. of share is reduced

Equity share cap. alc Dr. XXX

TO cap. reduction/reconstruction alc XXX

In this case, further call to be made from existing sh. holders if required.

(3) Sacrifice made by debenture holders & creditors

In this scheme of reconstruction, the debenture holders (or) creditors may waive certain amount due to them.

XXX Debenture holders alc Dr. XXX

XXX creditors alc Dr. XXX

XXX TO cap. reduction alc XXX

(4) Revaluation of Assets

In the scheme of reconstruction, the assets may be revalued. If any asset is revalued upward the entry is

Asset alc Dr.

TO cap. reduction alc

If any Asset is revalued downward, the loss is to be written off against cap. reduction alc.

(5) For the utilization of unutilized reserves if any of there are any unutilized reserves at the time of Reconstruction they may be utilized for reconstruction purpose.

Security premium alc Dr. XXX

Capital reserve alc Dr. XXX

General reserve alc Dr. XXX

To cap. reduction alc XXX

(6) Utilization of balance in cap. reduction/Reconstruction

The balance of Reconstruction alc is used to write off profit & loss alc debit balance, fictitious Assets, and other unrepresented Assets, and for making necessary provisions as per the scheme. If there is any balance still left in the Reconstruction alc, such balance is transferred to capital reserve alc

cap. reduction/Reconstruction alc Dr. XXX

To Profit & loss alc (debit bal.) XXX

To Goodwill alc XXX

To Fictitious Assets alc XXX

To Unrepresented Assets alc XXX

To provisions (if necessary) alc XXX

To Capital reserve alc XXX

Treatment of contingent liabilities

Contingent liab. are not present obligations.

For example arrears of preference dividend.

(a) As per reconstruction scheme, if the contingent liab. like arrears of dividend, is required to be paid, then the following entries are to be recorded

(i) For the payment of arrears

Preference dividend a/c Dr.

TO Bank a/c

(ii) For writing off pref. dividend

Cap. reduction a/c Dr.

TO pref. dividend

(b) As per reconstruction scheme, if the contingent liab. is not req. to be paid

NO Entry is required