

# Internal Reconstruction Class Notes

## Internal Reconstruction

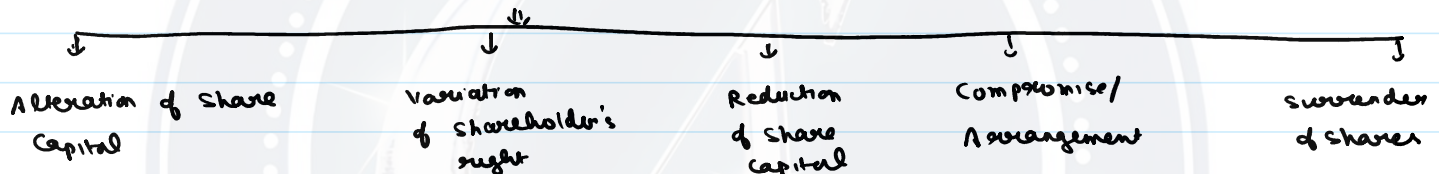
1] How to identify it is a question of internal reconstruction?

- \* New company is not formed
- \* Financial statements after reconstruction is asked
- \* Capital Reconstruction A/c is asked

2] while making Balance sheet, use words

Balance sheet of \_\_\_\_\_ (and Reduced)

3] Methods of Internal Reconstruction



- Increase in share capital
- Consolidation of shares
- Subdivision of shares
- Conversion of shares into stock & vice-versa
- Cancellation of shares

A] Alteration of share capital

- Increase in share capital  $\Rightarrow$  Increase in Authorized share capital

• Consolidation of shares

Consolidate existing shares of smaller denomination to shares of bigger denomination

e.g. A company share capital is ₹ 50000 divided into 5000 shares of ₹ 10 each resolve to consolidate shares into shares of ₹ 100 each.

50000 shares of £10 each resolve to consolidate shares into shares of £100 each.

Share Capital A/c (£10) Dr. 500000  
 to Share Capital A/c (£100) 500000

Share Capital (old denomination) Dr. xxx  
 to Share Capital (new denomination) xxx

Subdivision of shares

subdivide shares of higher denomination to shares of smaller denomination

e.g. if 5000 shares of £100 each are subdivided into shares of £10 each

Share Capital A/c (£100) Dr. 500000  
 to Share Capital A/c (£10) 500000

e.g. 5000 shares of £100 each, £80 Paid up divided into 50000 shares of £10 each

no. of shares	FV	Paid up	Share capital (£100)	Dr	400000
5000	100	80	to Share Capital (£10)		400000
50000	10	8			

Conversion of shares into stock

Equity share capital Dr.  
 to Equity stock

Conversion of stock into shares

Equity stock Dr.  
 to Equity share capital

Cancellation of shares

which have not been taken up

which have not been taken up  
↓  
no entry will be passed

### c) Variation of shareholder right

where different types of shares with different rights are issued  
in respect to Dividend, Voting rights, Company can change such rights  
e.g. change in rate of dividend on preference shares  
convert cumulative preference into non cumulative preference shares

(old) % Cumulative preference share capital a/c      ₹ 21.

to (new) % Cumulative preference share capital a/c

Cumulative preference share capital a/c      ₹ 21.

to Non cumulative preference share capital

### c] Reduction of share capital

Reduction of capital to cancel any paid up share capital  
which is lost or unrepresented by available assets

Reduction of capital reduces security of creditors.

\* By extinguishing or reducing liability on any of shares in respect of  
capital not paid up

e.g. Capital      20000      equity shares  
Face value      10  
Paid up value      8  
Reduced ↓ fully paid shares of ₹ 8

Equity share capital (₹ 10)      ₹ 160000

to Equity share capital (₹ 8)      160000

\* Paid up capital reduced without reducing face value

eg.	<u>old</u>	<u>new</u>		
Fv	100	100	Share Capital	nm. 40
Paid up	100	60	to Capital Reduction	40

eg.	<u>old</u>	<u>new</u>		
Face value	10	10	Share Capital	nm. 2
Paid up	8	6	to Capital Reduction	2

\* when Paid up value and face value both are reduced

eg	<u>old</u>	<u>new</u>		
Fv	10	6	Share Capital (£10)	nm. 8
Paid up	8	6	to Share Capital (£6)	6
			to Capital Reduction	2

eg	<u>old</u>	<u>new</u>		
Fv	100	50	Share Capital (£100)	nm. 60
Paid up	60	40	to Share Capital (£50)	40
			to Capital Reduction	20

### D] Compromise / Arrangement

↓  
 Agreement between company and its members and outside liabilities when company faces financial problems.

↓  
 Involves sacrifice — By —> Share holders  
 Creditors  
 Preference holders

### E] Share Surrender

① Share Capital Nc nm. [ only fully paid up shares can be surrendered ]  
 to Share Surrender

Reissue of surrendered shares to discharge liabilities

share surrender Dr.  
to share capital

trade payables / liability Dr.  
to Capital Reduction

Cancellation of share surrender  
share surrender  
to Capital Reduction

Other Aspects of Internal Reconstruction

- \* Revaluation of Assets
- \* Reassessment of liabilities
- \* writing off fictitious assets and losses

Revaluation

Asset ↑ ⇒ Asset A/c Dr.  
to Capital Reduction / Reconstruction

Assets ↓ ⇒ Capital Reduction / Reconstruction Dr.  
to Assets

Liability ↑ ⇒ Capital Reduction / Reconstruction Dr.  
to liability

liability ↓ liability Dr.  
to Capital Reconstruction

unrecorded liability paid ⇒ Capital Reconstruction Dr.  
to Bank

Recorded liability paid ⇒ liability Dr.  
to Bank

Expenses on Reconstruction  $\Rightarrow$  Capital Reconstruction  $\text{Rs.}$   
 to Bank

debentureholder

sacrifice by debentureholder

Interest @ 10%.

FV = ₹ 100

$\Rightarrow$

Interest @ 12%

FV = ₹ 90

10% debenture  $\text{Rs.}$  100  
 to 12% debenture 90  
 to Capital Reduction 10

creditors sacrifice

creditors  $\text{Rs.}$

to Capital Reconstruction

Arise of preference dividend [which does not appear in balance sheet]

!!

↓

Paid

↓

Not Paid

Capital Reconstruction  $\text{Rs.}$   
 to Bank

no entry

Settlement of tax liability

Provision for tax  $\text{Rs.}$

to Bank

to Capital Reconstruction

writing off Fictitious assets, Reserves and Surplus to be tied to Capital  
reduction

Capital Reconstruction  $\text{Rs.}$

to Prel. expenses

to discount on debentures

to Fictitious assets

to Profit & loss (debit balance)

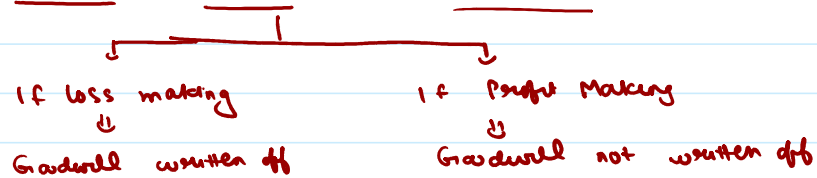
to asset [tangible/intangible] [basis: facts of question]

to Goodwill [only if specified in question]

to Capital Reserve \*

to Goodwill [only if specified in question]  
to Capital Reserve \*

Whether Goodwill should be written off?



In Exam

↓

do as stated in question

↓

wrote off Goodwill if specified

\* After all transactions, prepare Capital Reconstruction A/c

↓

check if any specific use of same given

↓

follow the same

if nothing specified ⇒ transfer to Capital Reserve