Hello, students are welcome to this module on Unit 2 Internal reconstruction.

In this module you will be studying the concept treatment of special items and the legal aspects in

relation to internal reconstruction.

What we will be studying is the meaning of reconstruction, Types, the legal aspects and treatment of certain items.

After studying this module, understand what internal reconstruction is, the difference between internal and external reconstruction and the treatment of special items starting

Before we learn this concept, we must know the concept `of reconstruction.

Reconstruction is a process by which the affairs of a company are reorganized. This reorganization can take the form of revaluation of assets, ‘reassessment of liabilities, writing off of losses suffered, reducing the paid value of shares, and varying the rights of shareholders of different classes of shares.

Some of the reasons why a firm would undertake reconstruction is that it has been suffering losses for consecutive period number of years because the assets may be overvalued. There may be intangible assets that are unrepresented and there may be debit balances in the profit and loss account or debit balance. There are losses that have accumulated over a long period of time.

When we talk about reconstruction, there are two types of reconstruction. We have internal reconstruction, and we have external reconstruction. Internal reconstruction is also known as capital reduction, and in such reconstruction the internal capital of the company is reorganized and sometimes even losses are written off. When we talk about external reconstruction, the existing company is closed, and a completely new company is formed. The shareholders of the old company automatically become the shareholders of the new company.

So to understand the concept better of reconstruction, let us differentiate between what is internal reconstruction and what is external reconstruction. When we are talking about liquidation, In case of the internal reconstruction, the existing company is not liquidated, just the company share capital and other liabilities and Losses may be reorganized. but in case of the external reconstruction the company is liquidated and a new company is formed.

Coming to the next point of difference and that is capital reduction now in case of capital reduction in internal reconstruction, shareholders debenture holders and creditors may have to reduce their claims in a scheme of compromise or An arrangement. But in case of external reconstructions, there is no variation of shareholder rights.

Internal reconstruction is governed by section 61 and 66 of the Companies Act of 2013 and requires the approval of the court before undertaking the same. However, in case of external reconstruction, this happens under Section 232 of the Companies Act of 2013, and no quote approval is required for such a scheme of reconstruction.

Coming to internal reconstruction, there are four legal aspects when we talk about internal reconstruction.

- First one is alteration of share capital under Section 61.
- Reduction of share capital under Section 66.
- The variation of shareholder rights under Section 48 and the scheme of compromise.
- An arrangement under sections 2:30 and 2:31.

Now we will have a look at each of these legal aspects separately and what types of Journal entries would come under such aspects.
First thing we talk about is the alteration of share capital or alteration of share capital must be authorized by the Articles of Association after passing an ordinary resolution in the Annual General Meeting, and only then can you alter the memorandum of Association with the new share capital. A notice of alteration of this share capital must be given to the registrar of companies within 30 days of such alteration.

How can a company alter its share capital?
It can do so by increasing the share capital, dividing share capital into shares of larger amounts, converting share capital into stock, dividing shares into smaller amounts, and canceling of shares that have not been taken up.

Now we look at the Journal entries for the alteration of share capital.

Firstly, for increase of share capital, there are two entries that come. The first entry is the record of the application money received. So we debit the bank account and we credit equity share application, an allotment account and the second entry would be the equity share application and allotment being transferred to equity share capital account.

The second mode of alteration would be the consolidation of shares that means conversion Of shares having a smaller face value to shares having a larger face value. So again here you would the shares having the smaller face value would be debited to the shares having the larger face value.

For subdivision of shares, that means conversion of shares having a larger face value to a smaller face value. You would take this similar kind of entry, but you would debit the share with the with the larger face value. So equity share capital larger face value debited to equity share capital with a smaller face value.

But the next way we can alter share capital is to convert or shares into equity stock. Now a whole block of shares can be converted into equity stock by passing the following Journal entry Share Capital debited to equity stock account. Converting a block of shares or a block of equity stock back into individual shares. You have to pass a reverse entry that is equity stock account debited to equity share capital account.

The next manner or in which we can reduce or in which we can undertake of share capital under Section 66. Again, such a reduction must be authorized by the Articles of Association.
However, in case of reduction of share capital, a special resolution needs to be passed in the annual General meeting. An auditor is appointed to process this reduction of share capital, and he must certify that the proposed treatment of the reduction of share capital is in line with the accounting standard. Such documents as prepared by the auditor must be submitted to the National Company Law Tribunal within 15 days and the tribunal passes an order confirming the reduction of shares. The tribunal's order, along with the minutes of the meeting, must be filed with the Registrar of Companies.

How can we reduce shares? What are the different ways in which a reduction of share capital can take place?

First is you can reduce the liability of uncalled capital. You can return a paid-up share capital write off, paid up capital record. Unrecorded liabilities write of accumulated losses and Annual reserves that have that are on the books of accounts for the purpose of reduction.

Let's have a look at some of the Journal entries.

Firstly, we have reducing liabilities in respect of the uncalled amount here in the example, we will only make the share capital worth. To that extent. In case of reducing liabilities in respect of the old uncalled amount, the equity share capital will be adjusted to the amount of money that has been paid up.

In this example, Rupees 30 is paid up. Therefore we have changed the value per share to from ₹ 50 to ₹ 30. And we make the shares fully paid up. So as usual you would debit the old Share capital and you will credit the share capital with the new face value.

Return of paid up capital. Sometimes the company may want to only have a surplus amount of capital on its books, which it wants to return to the shareholders. So in that particular case again you will have two Journal entries. One entry are showing how much is the balance due to members and the other General Journal entries showing the amount that is that you will pay to the Members. in this example we have reduced Paid Up capital to ₹ 30 per share and the balancing figure of rupees 20 per share is returned to the shareholders. In the next entry, we pay our shareholders the amount that is due to them. That is, the amount of rupees two lacs.

The next way in which we can reduce our share capital is writing-off the share capital. Due to huge losses the company decides to reduce the value of the share to rupees 20 per share. So the balance rupees 80 per share is transferred to the capital reduction account. Now, in this particular problem, you have two types of situations. One where there is a change in face value and one where there is no change in face value. If there is a change in face value, that means you are going to now a classified equity share capital as rupees 20. In that case the balancing figure would be shown in the capital reduction account.

If you are talking about no change in face value, then the amount that is being written off, that is the amount of rupees. One lakh will be transferred directly to the capital reduction account.

The next Where in which we can reduce our share capital is the payment of unrecorded liabilities and areas of dividends. So whatever liabilities or arrears of dividend, maybe you can pass this particular entry as capital reduction account to bank account.

Writing of accumulated losses, intangible assets, an overvalued asset. So normally we want to remove such items from our books of accounts, so we must adjust it with the balance in the capital reduction account so all these accumulated losses over valued assets. Intangible assets will be written off by debiting the capital reduction account.

Utilization of reserves to write off assets.

Now, sometimes you have reserves on your balance sheet, such as you have general reserve, or you may have provision for taxation. Such items can be transferred to the credit of the capital reduction account in order to make the process of this internal reconstruction easier OK. The next scheme under which internal reconstruction can take place is the variation of shareholder rights in a company. There are different classes of shares among those classes of shares. You may have different rates of dividends that are paid on them under this scheme rights two dividend voting and repayment of capital can be altered if it is authorized by the Articles of Association. Now the consent of $3/4^{th}$ of the shareholders is required, and a separate meeting needs to be held for that class of shares whose rights are going to be altered.
For example, you are, you have, say, 10% preference shares. Now you are going to reduce the rate of dividend to 9%, so that would be called variation of shareholders rights. Again, you would debit the old preference shares and you would credit to the 9% preference shares. As shown in this example.

The next scheme under which you can. Undertake internal reconstruction is a scheme of compromise.
An arrangement here an amicable settlement is arrived between the debenture holders preference, shareholders and creditors and you are going to probably give them some part of their claim. You are probably going to pay that in cash or you may issue new shares or new debentures in lieu of all their claims so you can so you can come across any of these three situations. Where the debenture holders or creditors may forgo their claims. In part they will be given new debentures or shares in full or partial settlement of their claim and sometimes they can. Shareholders may for both your dividend and accept a reduced rate of dividend.

For example, you are reducing the liability of your creditors and you are saying that in full satisfaction of 50% of your claim debentures are going to be issued. So 10% debentures will be issued for half of the creditors claim, or five lacks, which is to like 50,000 and balancing figure that is to like 50,000 will be taken to the capital reduction account.

These are my references.

Thank you.