RIZVI COLLEGE OF ARTS, SCIENCE AND COMMERCE

Subject: Financial Accounting V

Topic: Internal Reconstruction

Class: T.Y.B.A.F

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Outline

- Meaning of Internal Reconstruction
- Objectives of Internal Reconstruction
- Conditions/Provisions regarding Internal reconstruction
- Method of Internal Reconstruction
- Alteration to Share Capital
- Reduction in Share Capital
- Variation in Shareholder Rights
- Compromise/ Arrangements

Meaning of Internal Reconstruction

- Reconstruction is a process by which affairs of a company are reorganized by revaluation of assets, reassessment of liabilities and by writing off the losses already suffered by reducing the paid up value of shares and/or varying the rights attached to different classes of shares.
- Internal Reconstruction is the process in which the financial structure of a company is reorganised without dissolving the existing company and forming a new company.

Objectives of Internal Reconstruction

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

Conditions/Provisions regarding Internal reconstruction

- Authorization by Articles of Association
- Passing of Special Resolution
- Permission of Tribunal
- Payment of borrowings
- Consent of Creditors
- Public Notice

Method of Internal Reconstruction

Methods

- **Alteration of Share Capital**
  - Increase in Share Capital
  - Subdivision & Consolidation
  - Conversion of share into stock and vice versa
- **Reduction of Share Capital**
  - Reduction in Nominal Value
  - Reduction in Paid up Capital
  - Reduction in both
  - Surrender of share
- **Variation in Shareholder Rights**
  - Rate of Dividend
  - Conversion from Cumulative to Non Cumulative
- **Scheme of Compromise**
  - Creditors
  - Members
  - Others

Alteration to Share Capital

- Section 61 to 64 of Companies Act, 2013 deals with alteration of share capital. It may take the form of fresh issue of new shares, conversion of fully paid shares with stock, cancellation of unissued capital, consolidation of existing shares and subdivision of existing shares.
- Memorandum of Association contains capital clause of a company. A company, limited by shares, can alter this capital clause, if is permitted by.

  i. the Articles of Association of the company; and

  ii. if a resolution to this effect is passed by the company in the general meeting.
- A company can alter share capital in any of the following ways:

  A) The company may increase its capital by issuing new shares.

  B) It may consolidate the whole or any part of its share capital into shares of larger amount.

  C) It may convert shares into stock or vice versa.

  D) It may sub-divide the whole or any part of its share capital into shares of smaller amount.

  E) It may cancel those shares which have not been taken up and reduce its capital accordingly.

Reduction in Share Capital

- Reduction of share capital is an arrangement under which the capital of the shareholders and sometimes even the claims of the creditors and debenture holders are reduced.
- The amount made available by way of capital reduction is utilized in writing off the fictitious assets, accumulated losses, and the overvalued portion of the other assets.
- A corporate sector unit can reduce its paid-up capital if

  (a) It is authorized by its articles

  (b) A special resolution is passed and

  (c) A sanction of the court is obtained

- Following are the methods of reductions of capital:

Reduction in nominal value only – here the face value of the shares is reduced only.

Reduction in paid up value only - Here the nominal value of shares remains same only
paid up is reduced.

Reduction in both Nominal and Paid up value - In this case both the paid up capital and nominal value are reduced.

Surrender of Shares: In this method, shares are divided into shares of smaller denominations and then the shareholders are made to surrender their shares to the company. These shares are then allotted to debenture holders and creditors so that their liabilities are reduced.

Variation in Shareholder Rights

- 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.
- When a company has issued different types of shares with different types of rights regarding voting and right of dividend etc. such right may be changed in any manner and considered as part of internal reconstruction. For example, company may change rate of dividend on preference shares and convert cumulative preference shares into non cumulative preference shares without changing amount of share capital.

Compromise/ Arrangements

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.

Thank You