

Internal Reconstruction (Section 66 of the Companies Act, 2013)1. Introduction

- **Meaning of the term Reconstruction:** The term “Reconstruction” means to rebuild or rearrange.
- **Types of Reconstruction:**
 - **Internal Reconstruction:** Re-organisation within the same entity (Covered in this chapter).
 - **External Reconstruction:** Covered by Accounting Standard 14 (AS 14).
- **Internal Reconstruction:** Internal Reconstruction means restructuring the Balance Sheet position of the company without liquidating the company.
- **Implementing the Scheme:** In order to implement the scheme, a special account is created called the **Capital Reduction Account** or **Reconstruction Account**.
- **Nature of Capital Reduction Account:** This account is a **nominal account** which is created to transfer the:
 - Sacrifice made by shareholders or outside parties.
 - Losses from the reduction of assets.

2. Journal Entries (J.E.)

The Capital Reduction Account is the central account for recording all sacrifices and writing off all accumulated losses and overvalued assets.

2.1 For Increase / Decrease in Value of Assets

Action	Journal Entry (J.E.)
a) For Increase in Asset	Asset Account Debit → To Capital Reduction Account
b) For Decrease in Asset	Capital Reduction Account Debit → To Asset Account

2.2 For Claims Waived off by Creditors / Debenture holders / Outside Parties

- **Journal Entry (J.E.):** Creditor / Debenture / Liability Account Debit → To Capital Reduction Account

2.3 For Contingent Liabilities Cancelled

- **Rule: No entry.**
- **Reason:** Because in the Balance Sheet (B/S), such a liability was **NOT** recorded. Therefore, there is **No entry** on the waiver of this liability.
- **Examples of Contingent Liabilities:**
 1. Arrears of Preference Dividend (Pref. Div).
 2. Capital Expenditure commitment.
 3. Any other contingent liability specified in the question.

2.4 Contingent Liability Paid Off

- **Option 1 (Liability Recognized and Paid):**
 - Capital Reduction Account Debit (for the liability amount) → To Liability Account (for recognizing the liability)
 - Liability Account Debit (for the liability amount) → To Cash in Bank Account (for payment)
- **Option 2 (Paid Directly from Reconstruction Fund):**
 - Capital Reduction Account Debit (for the payment amount) → To Cash in Bank Account

2.5 For Reconstruction Expenses

- **Journal Entry (J.E.):** Capital Reduction Account Debit → To Cash in Bank Account

2.6 For Intangible Assets Appearing in the Balance Sheet

- **a) In case of Goodwill (GW):**
 - **Rule:** Write off, if nothing is mentioned.
 - **Journal Entry (J.E.):** Capital Reduction Account Debit → To Goodwill Account
- **b) For other Intangibles** (Patents, Copyrights, etc.): Do as per the information given in the question.

2.7 For Reduction of Share Capital

- **a) When Face Value of shares is reduced:**
 - **Journal Entry (J.E.):** Equity Share Capital Account Debit (Old Face Value) → To Equity Share Capital Account (New Face Value) → To Capital Reduction Account (Difference/Sacrifice)
- **b) When only Paid Up Value is reduced (Face Value remains the same):**
 - **Journal Entry (J.E.):** Equity Share Capital Account Debit (Reduction amount per share) → To Capital Reduction Account (Total reduction amount)
 - **Reason:** The net entry is passed because the face value of shares is still the original amount (e.g., ₹10).
- **Important Note:** If in the question, no specific information is given as to whether the paid-up value is reduced or the face value is reduced, it is **assumed that the face value is reduced**, and the entry should be passed as per the rule for 2.7(a).

2.8 Write off Debit Balance of Profit and Loss Account (P&L) or Miscellaneous Expenditure or Accumulated Losses

- **Rule:** This is to be done **ALWAYS** whether mentioned or not in the question.
- **Journal Entry (J.E.):** Capital Reduction Account Debit → To Profit and Loss / Miscellaneous Expenditure / Accumulated Losses

2.9 For Any Credit Balance left in Capital Reduction Account (if any)

- **Journal Entry (J.E.):** Capital Reduction Account Debit → To Capital Reserve

3. Other Provisions

3.1 Words "AND REDUCED"

- **Note:** When the Balance Sheet (B/S) is prepared after the Internal Reconstruction scheme, the words **"AND REDUCED"** should be added with the name of the company.

3.2 Subdivision and Consolidation of Shares

- **a) Subdivision of Shares (e.g., ₹10 share divided into 2 shares of ₹5 each):**
 - **Journal Entry (J.E.):** Equity Share Capital Account Debit (Old Face Value) → To Equity Share Capital Account (New Face Value)
- **b) Consolidation of Shares (e.g., 2 shares of ₹10 each consolidated into 1 share of ₹20 each):**
 - **Journal Entry (J.E.):** Equity Share Capital Account Debit (Old Face Value) → To Equity Share Capital Account (New Face Value)
- **Note:** In the case of sub-division/consolidation of shares, the Equity Share Capital **Amount remains the same**, only the number of shares and face value change. Therefore, there is **No Capital Reduction** involved.
- **c) Conversion of Equity Shares to Equity Stock:** This is similar to the consolidation of shares.
 - **Journal Entry (J.E.):** Equity Share Capital Account Debit (Share Capital) → To Equity Stock (Stock Value)

4. Surrender of Shares

- **Concept:** Under this scheme, the shareholders are expected to return a part of their holdings back to the company. The company can either **cancel** or **reissue** these surrendered shares to the creditors / debenture holders to settle their dues.
- **Note:** The amount of sacrifice by shareholders is temporarily held in the Share Surrender Account and is transferred to Capital Reduction only when cancelled or if the balance remains unutilized.

4.1 Journal Entries for Surrender of Shares

- **1) Entry for Surrender of Shares:**
 - Equity Share Capital Account Debit → To Share Surrender Account
- **2) Entry for Reissue:**
 - **a) For Reissue of shares surrendered to creditors or debenture holders:**
 - Shares Surrendered Account Debit → To Equity Share Capital Account
 - **b) Entry for cancellation of liability so settled (The amount of liability settled is the sacrifice):**

- Creditor / Debenture Account Debit → To Capital Reduction Account
- **3) Balance in the Shares Surrendered Account NOT utilized (i.e., shares to be cancelled):**
 - Shares Surrendered Account Debit → To Capital Reduction Account