

Tutorial Notes

Class: B.Com (Prog.) Semester III (CC9)

Subject: Corporate Accounting.

Topic: Re Construction, Objective, Type and difference between Internal and External.

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### **Reconstruction**

Reconstruction is a process of the company's reorganization, concerning legal, operational, ownership and other structures, by revaluing assets and reassessing the liabilities. It refers to the transfer of company or several companies' business to a new company. This, therefore, means that the old company will get put into liquidation, and shareholders will therefore agree to take shares of equivalent value in the new company. Reconstruction is required when the company is incurring losses for many years, and the statement of account does not reflect the true and fair position of the business, as a higher net worth is depicted, than that of the real one.

In other words, "Reconstruction" involves the winding up of an existing company and the transfer of its assets and liabilities to a new company formed for the purpose of taking over the business and undertaking of the existing company. Shareholders in the existing company become shareholders in the new company. The business undertaking and shareholders of the new company are substantially the same as those of the old company.

### **Objectives of Reconstruction**

The major objectives of reconstruction are as follows-

1. To resolve the problem of over-capitalization/huge accumulated losses/over valuation of assets.
2. When the capital structure of a company is complex and is required to make it simple
3. When change is required in the face value of shares of the company
4. To generate surplus for writing off accumulated losses & writing down overstated assets.
5. Raising the fresh capital by issuing new shares.

6. Changing altogether the memorandum of association of the company.
7. To generate cash for working capital needs, replacement of assets, to add balancing equipment's, modernise plant & machinery etc.

### **Types of Reconstruction**

A company can be reconstructed in any of the two ways. These are:

1. External Reconstruction and
2. Internal Reconstruction.

**External Reconstruction:** When a company is suffering losses for the past several years and facing financial crisis, the company can sell its business to another newly formed company. Actually, the new company is formed to take over the assets and liabilities of the old company. This process is called external reconstruction. In other words, external reconstruction refers to the sale of the business of existing company to another company formed for the purposed. In external reconstruction, one company is liquidated and another new company is formed. The liquidated company is called "Vendor Company" and the new company is called "Purchasing Company". Shareholders of vendor Company become the shareholders of purchasing company.

**Internal Reconstruction:** Internal reconstruction refers to the internal re-organization of the financial structure of a company. It is also termed as re-organization which permits the existing company to be continued. Generally, share capital is reduced to write off the past accumulated losses of the company.

### **Significance of Internal Reconstruction**

Internal reconstruction is done by the company when:

1. There is an overvaluation of assets and undervaluation of liabilities.
2. There is a difficulty to meet the financial crisis and there are continuous losses.

### **Differentiate between Internal and External reconstruction**

Basis of Distinction		Internal Reconstruction	External Reconstruction
1.	Meaning	Internal reconstruction refers to the method of corporate restructuring wherein existing	External reconstruction is one in which the company undergoing reconstruction is liquidated to

		company is not liquidated to form a new one.	take over the business of existing company.
<b>2.</b>	<b>New company</b>	No new company is formed.	New company is formed.
<b>3.</b>	<b>Capital reduction</b>	Capital is reduced and the external liability holders waive their claims.	No reduction in the capital
<b>4.</b>	<b>Transfer of Assets and Liabilities</b>	No such transfer takes place.	Assets and liabilities of existing company are transferred to the new company.
<b>5.</b>	<b>Application</b>	It is done to ensure an inner re-arrangement of financial structure.	It is done company. To form a new
<b>6.</b>	<b>Approval of Tribunal</b>	Required.	Not required.
<b>7.</b>	<b>Liquidation</b>	Liquidation of company is not done.	Liquidation of company is must
<b>8.</b>	<b>losses against profits</b>	It can set off past losses against future profits.	Since a new company is established, losses of the old company can't be set off against the profits of the new company.