Lesson 4

Accounting for Debentures

Key Concepts One Should Know

- Issue of Debentures
- Redemption of debentures
- Collateral security
- Debenture Interest
- Conversion of Debenture

Learning Objectives

To understand the:

- Meaning of debentures
- Methods for the issue of debentures
- Methods of the redemption of debentures
- Open market operations
- Working of cum-interest and ex-interest

Lesson Outline

- Introduction
- Kinds of Debentures
- Issue of Debentures at
 - Par
 - Premium
 - Discount
- Issue of Debentures for Consideration Other than Cash
- Issue of Debentures as Collateral Security
- Debenture Interest
- Treatment of Discount/loss on Issue of Debentures
- Redemption of Debentures
 - Par
 - Premium
 - Discount
- Conversion of Debentures
- Purchase of Debentures in the open market
- LESSON ROUND UP
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INTRODUCTION

In addition to raising funds by the issue of different kinds of shares, a company may supplement its capital by arranging money in the form of both short-term and long-term borrowings. Short-term borrowings are carried out by way of promissory notes, bills of exchange, bank overdrafts, cash credits, public deposits, etc. while long-term borrowings include by loan on mortgage of property, term loans from financial institutions, public deposits for a long period, issue of debentures, etc.

DEBENTURES

Debentures are part of loan capital and the company is liable to pay interest thereon whether it earns profit or not. Debentures include debenture stock, bonds or any other instrument of a company evidencing a debt whether constituting a charge on the assets of the company or not.

KINDS OF DEBENTURES

Debentures may be of different kinds depending upon the conditions of their issue



(a) Secured or Mortgage

When debentures are secured by a mortgage or charge on the property of the company, they are called secured or mortgage debentures.

(b) Unsecured or Naked

When debentures are issued without any security, they are termed as unsecured or naked debentures.

(c) Bearer

These debentures are payable to bearer and are transferable by mere delivery. Interest coupons are attached to each individual debenture. The interest and principal amount on such debentures is payable upon presentation and delivery of coupons and debentures.

(d) Registered

Interest and principal amount is paid only to the person whose name is registered in the debenture ledger. Such debentures are transferable through a transfer deed.

(e) Convertible

Debentures may be convertible into preference or equity shares of the company on certain specified dates on the basis of an agreement between the company and the debenture holders.

(f) Non-Convertible

Such debentures are paid into cash.

(g) Redeemable

Such debentures are paid either at par or at a premium after the expiry of a particular period or under a system of periodical drawings.

(h) Irredeemable or Perpetual

Such debentures are payable either on a happening of the contingency, or when the company winds its business up, or when the company decides to redeem, itself.

(i) First Mortgage Debentures

Such debentures are paid on the basis of priority as compared to other debentures.

(j) Second Mortgage Debentures

Such debentures are paid after the redemption of first mortgage debentures.

ISSUE OF DEBENTURES

Subject to the restrictions imposed by Section 71 of the Companies Act, 2013, a company can issue debentures. Applications for debentures are invited from the public through a prospectus and the applicants are asked to pay the application money along with the applications. The company may ask for payment of the whole of the amount along with the application or by installments.



(a) For Cash

- (i) At Par
- (ii) At a Premium
- (iii) At a Discount
- (b) For Consideration Other than Cash
- (c) As Collateral Security

Conditions for issue of debentures as per Companies Act, 2013

1. Issue of Debentures by Special Resolution

A company can issue partly or fully convertible debentures by passing special resolution at a general body meeting.

2. No Voting Rights

No company can issue any debentures carrying any voting rights.

3. Terms for the Issue of Secured Debentures

Secured debentures may be issued according to prescribed terms and conditions.

4. Creation and Utilization of Debenture Redemption Reserve

The company shall create Debenture Redemption Reserve out of its divisible profits and the amount credited to such an account shall not be utilized for any purpose other than the redemption of debentures.

5. Debenture Trustee(s)

A company cannot issue a prospectus or make an offer or invitation to more than 500 persons for subscribing to debentures unless the company has before issuing such a prospectus, appointed one or more debenture trustees.

A debenture trustee shall take steps to protect the interest of the debenture holders and redress the grievances in accordance with the rules as may be prescribed.

Points	Debentures	Shares
Capital	Debenture is a part of loan capital or borrowing	Share capital is an ownership capital.
Status	Debenture holder is creditor of company	Shareholder is the owner of the company
Income	Interest is the income on the investment in debentures	Dividend is the income on investment in shares
Charges or Appropriation	Payment of interest is charge against and is payable even if there is no profit	Payment of dividend is an appropriation of profit and not payable if there is no profit.
Voting rights	Debenture holders do not have any voting rights.	Shareholders generally enjoy the voting rights
Issue at discount	No restriction is imposed on the issue of debentures at discount	Section 53 prohibits the issue of shares at discount
Rate	Rate of interest is fixed	Rate of dividend may vary from year to year for equity shares
Convertibility	Debentures can be convertible	Equity shares can never be convertible

Difference between debentures and shares:

Issue of debentures for cash

Debentures may be issued for cash on a par, a premium or discount. When the debentures are issued for cash, the entire issue price may be received on application itself or the amount may be payable in installments, such as on application, on allotment and balance in calls.

Any premium or discount on the issue of debentures is generally recorded at the time of making allotment. Accounting treatment when the debentures are issued at par:

(a) When the full issue price is payable in lumpsum along with application

	(1)	On receipt of application money:				
		Bank A/c	Dr.	(with the money received on		
		To Debentures Application and Allotment A/c		application)		
	(2)	On allotment:				
		Debentures Application and Allotment A/c	Dr.	(with the money received on		
		To Debentures A/c		debentures allotment)		
(b)	When	n the amount is payable in instalments				
	(1)	On receipt of application money:				
		Bank A/c	Dr.	(with the money received on		
		To Debenture Application A/c		application)		
	(2)	On Allotment of debentures:				
		Debenture Application A/c	Dr.	(with the application money on		
		To Debentures A/c	debentures allotted)			
	(3)) On allotment money due				
		Debenture allotment A/c	Dr.	(with the allotment money due)		
		To Debenture A/c				
	(4)	On receipt of allotment money:				
		Bank A/c	Dr.	(with the money received on		
		To Debenture Allotment A/c		allotment		
	(5)	On making calls:				
		Debenture Calls A/c	Dr.	(with the money due on respective		
		To Debenture A/c		calls)		
	(6)	On receipt of call money:				
		Bank A/c	Dr.	(with the money received on		
		To Debenture Calls A/c		respective calls		

Over subscription: The excess application money may be retained for adjustment towards allotment and particular calls similar to share application money.

But money received from applicants to whom no debenture has been allotted will be refunded to them. The following journal entry is made in this regard:

Debenture Application A/c Dr

To Bank A/c

Illustration 1.

ABC Ltd. made an issue of 50,000 12% Debentures of Rs 100 each, payable as follows: Rs. 25 on Application Rs. 50 on Allotment

Rs. 25 on First and Final Call.

Applications were received for 52,000 debentures and the directors allotted 50,000 debentures rejecting applications for 2,000 debentures. The application money received for 2,000 rejected debentures was duly refunded. All the calls were made and the moneys duly received.

Show the Journal Entries to record the above transactions and prepare the Balance Sheet of the company. ABC Ltd.

Solution:

S.No	Particulars	Debit (Rs)	Credit (Rs)
(i)	Bank A/c Dr	13,00,000	
	To 12% Debenture Application A/c		13,00,000
	(Being application money of Rs 25 each on 52,000 debentures received)		
(ii)	12% Debenture Application A/c Dr	13,00,000	
	To 12% Debentures A/c To Bank A/c		12,50,000 50,000
	(Being allotment of 50,000 debentures as per board's resolution dated and 2,000 debentures rejected and refunded)		
(iii)	12% Debenture Allotment A/c Dr	25,00,000	
	To 12% Debentures A/c		25,00,000
	(Being allotment money due on 50,000 debentures @ Rs 50 each)		
(iv)	Bank A/c Dr	25,00,000	
	To 12% Debenture Allotment A/c		25,00,000
	(Being allotment money received)		
(v)	12% Debenture First and Final call A/c Dr	12,50,000	
	To 12% Debentures A/c		12,50,000
	(Being call money due on 50,000 debentures @ Rs 25 each)		
(vi)	Bank A/c Dr	12,50,000	
	To 12% Debenture First and Final call A/c		12,50,000
	(Being the call money received)		

Journal Entries

ABC Ltd.

Balance Sheet as on

Particulars	Note	Rs
EQUITY AND LIABILITIES		
Non Current Liabilities Long Term Borrowings	1	50,00,000
ASSETS		
Cash and cash equivalent		50,00,000

Notes to Account

	Particulars	Note	Rs
1.	Long Term Borrowings		
	12% Debentures	1	50,00,000
2	Cash and Cash Equivalent		
	Cash at Bank		50,00,000

Issue of Debentures at Premium

When the debentures are issued for cash at premium, the amount of premium is recorded at the time of making entries for allotment money.

The entries for receipt of application money and transfer of application money to debenture account are same as issue at par.

Dr

The entries for allotment are

(i) When allotment money becomes due

Debenture Allotment A/c To Debenture A/c To Securities Premium A/c When allotment money is received

Bank A/c Dr

To Debenture Allotment A/c

And for calls the entries are same as for issue at par.

Illustration 2.

(ii)

Z Ltd. issued 2,500, 10% Debentures of Rs.100 each, a premium of 10% payable as Rs. 20 on application, Rs.50 on allotment (including the premium) and the balance on first & final call. The public applied for 3,500 debentures. Applications for 2,250 debentures were accepted in full, applicants for 500 were allotted 250 debentures, and remaining applications were rejected. All money was duly received.

Journalize these transactions.

Solution:

Z Ltd. Journal Entries

	Particulars	Debit (Rs)	Credit (Rs)
(i)	Bank A/c Dr.	70,000	
	To Debenture Application A/c		70,000
	(Being application money received on 3,500 debentures)		
(ii)	Debentures Application A/c Dr.	70,000	
	To 10% Debentures A/c		50,000
	To Debentures Allotment A/c		5,000
	To Bank A/c		15,000
	(Being the application money adjusted and the surplus refunded)		

(iii)	Debenture Allotment A/c Dr.	1,25,000	
	To 10% Debentures A/c		1,00,000
	To Securities Premium A/c		25,000
	(Being the Amount due on allotment @ Rs. 50 on 2,500 debentures)		
(iv)	Bank A/c Dr.	1,20,000	
	To Debentures Allotment A/c		1,20,000
	(Being the Balance of the amount due on allotment received)		
(v)	Debentures Call A/c Dr.	1,00,000	
	To 10% Debentures A/c		1,00,000
	(Being the Amount due on Call @ Rs. 40 on 2,500 debentures)		
(vi)	Bank A/c Dr.	1,00,000	
	To Debentures Call A/c		1,00,000
	(Being the Amount due on call received)		

Issue of debentures at discount

If the debentures are issued at a price lower than the nominal value of the debentures, the debentures are said to be issued at a discount. The difference between the nominal value and the issue price is regarded as the discount.

Such a discount on the issue of debentures may either be written off against revenue profit or capital profits of the company. When debentures are issued at a discount the Debentures Account should be credited with the nominal value of the debentures and the discount allowed on issue of debentures. It being a capital loss should be debited to "Discount on Issue of Debentures Account". Thus, the accounting entry will be as follows:

Debentures Allotment A/c Dr (with the amount due on allotment)

Discount on issue of Debentures A/c Dr (with the amount of discount)

To Debentures A/c (with the total)

Illustration 3.

Z Ltd. issued 5,000, 14% debentures of Rs 100 each at a discount of 5%, the discount being adjustable on allotment.

The debentures were payable as follows: On Application - Rs. 20

On Allotment - Rs. 25

On First and Final Call - Rs. 50

The debentures were fully subscribed and the money was duly received.

Show the cash book and journal entries and prepare the balance sheet of the company.

Dr.	Cash Book (Ba	ank Column)	Cr.
Particulars	Amount (Rs)	Particulars	Amount (Rs)
To 14% Debenture Application A/c	1,00,000	By Balance c/d	4,75,000
(Application money on 5,000 debentures @ Rs 20 per debenture)			
To 14% Debenture Allotment A/c	1 25 000		
(Allotment money on 5,000 debentures @ Rs.25 per debenture)	1,20,000		
To 14% Debenture First and Final Call A/c			
(First and final call money on 5,000 debentures @ Rs.50 per debenture)	2,50,000		4,75,000

Solution:

Z Ltd.

Journal Entries

S. No	Particulars	Debit (Rs)	Credit (Rs)
(i)	14% Debenture Application A/c Dr.	1,00,000	
	14% Debenture Allotment A/c Dr.	1,25,000	
	Discount on Issue of Debentures A/c Dr.	25,000	
	To 14% Debentures A/c		2,50,000
	(Allotment of 5,000 14% debentures of Rs. 100 each issued at a discount of 5% and allotment money due on 5,000 debentures @ Rs 25 per debenture as per Board's resolution dated)		
(ii)	14% Debenture First and Final Call A/c Dr.	2,50,000	
	To 14% Debentures A/c		2,50,000
	(First and final call money due on 5,000 debentures @ Rs 50 per debentures as per Board's resolution dated)		

Z Ltd.

Balance Sheet as on

Particulars	Note	Rs.
EQUITY AND LIABILITIES		
Non-Current Liabilities		
Long-Term Borrowings	1	5,00,000
ASSETS	2	
Non-current assets Other non-current assets Current Assets		25,000
Cash and cash equivalent		4,75,000

Notes to Account

1	Long-Term Borrowings	1	
	14% Debentures		5,00,000
2	Other non-current assets	2	
	Discount on the issue of debentures		25,000

ISSUE OF DEBENTURES FOR CONSIDERATION OTHER THAN CASH

Sometimes a company may allot debentures (on a par, premium or discount) to vendors as a payment for the purchase price of the assets. The issue of debentures is then for consideration other than cash. In such a case, the following journal entries are made:

(1) For acquisition of assets:

Sundry Assets (Individually) A/c

Dr. (with the value of assets)

To Vendors A/c(with the purchase price)

Notes: (i) If the value of debentures allotted is more than the agreed purchase price, the difference is debited to Goodwill Account.

(ii) Similarly, if the value of debentures allotted is less than the agreed purchase price, it is credited to Capital Reserve Account.

2.	(a) On allotment of debentures (at par)		
	Vendors A/c	Dr.	(with the value of debentures)
	To Debentures A/c		
	(b) On allotment of debentures (at premium)		
	Vendors A/c	Dr.	(with the purchase price)
	To Debentures A/c (with the nominal value)		
	To Securities Premium A/c		(with the amount of premium)
	(c) On allotment of debentures (at a discount)		
	Vendors A/c	Dr.	(with the amount of purchase)
	Discount on Issue of Debentures A/c	Dr.	(with the amount of discount)
	To Debentures A/c (with the nominal value)		

Illustration 4.

Radha Ltd. purchased machinery worth Rs.1,20,000 and building worth Rs. 2,00,000 from Deepa Ltd. for an agreed purchase consideration of Rs. 3,00,000 to be satisfied by the issue of 3,000, 12% debentures of Rs. 100 each.

Show the necessary journal entries in the books of Radha Ltd.

Solution:

Radha Ltd. Journal Entries

S.No	Particulars	Debit (Rs)	Credit (Rs)
1	Building A/c Dr.	2,00,000	
	Plant and Machinery A/c Dr.	1,20,000	
	To Deepa Ltd.		3,00,000
	To Capital Reserve A/c		20,000
	(Purchase of sundry assets and transfer of capital profits as per agreement with the vendor dated)		
2	Deepa Ltd. Dr.	3,00,000	
	To 12% Debentures A/c		3,00,000
	(Being 3,000, 12% Debentures of Rs 100 each allotted to vendors for consideration other than cash as per Board's resolution dated)		

DEBENTURES ISSUED AS A COLLATERAL SECURITY

The term 'Collateral Security' may be defined as additional security given for a loan. Where a company obtains a secured loan from a bank or insurance company, it may mortgage some of its assets as a security against the said loan. But the lending institution may insist on some more assets as a collateral security so that the amount of loan can be realized in full with the help of collateral security, in case the amount realized from the sale of first security falls short of the loan money. In such a situation, the company may issue its own debentures to the lender as collateral security against the loan in addition to any other security that may be offered. Such an issue of debentures is known as "Debentures issued as Collateral Security".

In such a case, the lender has the absolute right over the debentures until and unless the loan is repaid. On repayment of the loan, however, the lender is legally bound to release the debentures forthwith. But in case the loan is not repaid by the company on the due date or in the event of any other breach of agreement, the lender has the right to retain these debentures and to realize them.

The holder of such debentures is entitled to interest only on the amount of loan, but not on the debentures.

Accounting Treatment of Collateral Security

FIRST METHOD

No accounting entry is required to be shown in the books of account at the time of issue of such debentures because there is no immediate liability created by the company.

But the existence of such debentures issued as collateral security has to be mentioned by way of a note on the Balance Sheet under the specific loan account.

Illustration 5.

B Ltd. secured an overdraft of Rs. 80,000 from the bank by issuing 900, 12% Debentures of Rs. 100 each as collateral security. Prepare the Balance Sheet of the Company.

Solution

Balance Sheet of Z Ltd. as at....

Particulars	Note	Amount (Rs.)
EQUITY AND LIABILITIES	1	
Current liability		
Short-term borrowings		80,000

Notes to Account

	Particulars	Amount
1	Short-term borrowings	
	Bank Overdraft (Secured by the issue of 900, 12% Debentures of Rs.100 each as collateral security)	80,000

SECOND METHOD

If it is desired that such an issue of debentures as collateral security is to be recorded in the books of account, the accounting entries will be as follows:

Dr.

(i) On issue of debentures as collateral security

Debentures Suspense A/c

(with the nominal value of the debentures issued)

To Debentures A/c

To Debentures A/c

In this case, Debentures Suspense Account will appear on the asset side of the balance sheet under the heading Miscellaneous Expenditure. Debentures Account will appear as a liability on the liabilities side of the Balance Sheet.

(ii) On repayment of the loan and release of debentures

Debentures A/c

(with the nominal value of the debentures released)

To Debentures Suspense A/c

Note: The net effect of the above two entries is nil. Both the Debentures Suspense Account and the Debentures Account are cancelled on repayment of the loan. As such, this method is rarely followed in practice.

Illustration 6.

B Ltd. secured an overdraft of Rs.80,000 from the bank by issuing 900,12% Debentures of Rs.100 each as collateral security. Prepare the Balance Sheet of the Company.

Solution

Journal Entries

Debentures Suspense A/c	Dr.	90,000
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Dr.

90.000

(Issue of 900, 12% Debentures of Rs.100 each as collateral security for a bank overdraft of Rs. 80,000 as per Board's resolution dated.....)

Balance Sheet of Z Ltd. as at.....

Particulars	Note	Amount (Rs.)
EQUITY AND LIABILITIES	1	90,000
Non-current liabilities		
Long-term borrowings	2	90.000
Current liability		
Short-term borrowings		
ASSETS		
Non-Current Assets	3	90,000
Other non-current assets		

Notes to Account

	Particulars	Amount
1	Long-term borrowings	
	900, 12% Debentures of Rs.100 each	
	(Issued as collateral security as per contra)	90,000
2	Short-term borrowings	
	Bank Overdraft	
	(Secured by the issue of 900, 12% Debentures of Rs.100 each as collateral security)	80,000
3	Other non-current assets	
	Debentures Suspense Account	90,000
	(Issued as collateral security as per contra)	

DEBENTURE INTEREST

Wherever a company issues debentures it undertakes to pay interest thereon at a fixed percentage. As the debentures acknowledge a debt, the payment of interest on the debt is obligatory on the part of the company issuing them irrespective of the fact whether the company earns profit or not. Thus, interest payable on debentures is a charge against the profits of the company. Interest on debentures is normally payable half-yearly and it is calculated at the fixed percentage on the nominal value of debentures issued and not on the issue price. Thus, the issue of debentures at par or at a premium or at a discount would not make any difference for the purpose of calculating interest on debentures.

In certain cases, the company must deduct income tax at the prescribed rate from the gross amount of interest payable on debentures and only net amount is paid to the debentureholder. It is called tax deducted at source and has to be deposited with the tax authorities.

(i) On interest becoming due

Debenture Interest A/c

Dr.

(with the gross interest due)

To Income-tax Payable A/c or

Tax Deducted at (with the amount of Income-tax to be Source A/c. deducted at source)

To Debenture holders' A/c (with the net amount payable after deduction of income-tax)

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(ii) On payment of interest to the debenture holders					
Debenture holders' A/c	Dr.	(with the net amount of paid interest)			
To Bank A/c					
(iii) On payment of income-tax to the Go	overnment				
Income-tax Payable A/c	Dr.	(with the amount of income-tax deducted at			
To Bank A/c		source and deposited with the Government)			
(iv) On transfer of Debenture Interest to Profit and Loss Account at the end of the year					
Profit and Loss A/c	Dr.	(with the gross amount of interest on debentures)			

To Debenture Interest A/c

Illustration 7.

M Ltd. had issued Rs. 5,00,000, 10% debentures on which interest was payable half-yearly on 30th September and 31st March. Show the necessary journal entries relating to debenture interest for the year ended 31st March, 2019 assuming that all moneys were duly paid by the company. Tax deducted at source is 10%.

Solution:

Date	Particulars	Debit (Rs)	Credit (Rs)
2018	Debenture Interest A/c Dr.	25,000	
Sep.30	To Income-tax Payable A/c		2.500
	To Debenture-holders A/c (Interest due on Rs 5,00,000, 10% debentures for 6 months and income-tax deducted at source thereon @ 10%)		22,500
Sep,30	Debenture-holders' A/c Dr. To Bank A/c	22,500	
	(Payment of interest to debenture-holders)		22,500

Sep,30	Income-tax Payable A/c Dr.	2,500	
	To Bank A/c		2,500
	(Deposit of income-tax deducted at source from Debenture Interest with the Government)		
March,31	Debenture Interest A/c Dr.	25,000	
	To Income-tax Payable A/c		2,500
	To Debenture-holders A/c		22,500
	(Interest due on Rs 5,00,000, 10% debentures for 6 months and income-tax deducted at source thereon @ 10%)		
2019	Debenture-holders' A/c Dr.	22,500	
March,31	To Bank A/c (Payment of interest to debenture-holders)		22,500

M Ltd. **Journal Entries**

March,31	Income-tax Payable A/c Dr.	2,500	
	To Bank A/c		2,500
	(Deposit of income-tax deducted at source from Debenture Interest with the Government)		
March,31	Profit and Loss A/c Dr.	50,000	
	To Debenture Interest A/c		50,000
	(Transfer of Debenture Interest to Profit and Loss A/c)		,

Interest accrued and due (outstanding interest)

Interest on debentures is paid periodically. Suppose a company pays interest on 30th September and 31st March on Rs. 5,00,000, 14% Debentures. The company will pay Rs. 35,000 in every six months. The debenture-holders cannot demand interest before these specified due dates. Assuming that the accounting period ends on 31st March and the interest from 1st October to 31st March remains unpaid. In that case the debenture interest is accrued and due and it is technically termed as outstanding interest and will be recorded as under:

Debenture Interest A/c Dr 35,000

To outstanding debenture interest A/c

The liability of outstanding debenture interest will be shown as "other current liability" in Balance sheet

Interest accrued but not due (accrued interest)

While preparing final accounts, interest upto closing date must be taken into account, though the same is simply accrued but not payable.

For example, if the debenture interest is paid on 30th June and 31st December and the company closes its books on 31st March. After the payment of interest on 31st December, the next payment will be made on 30th June in next accounting period. But for proper accounting, interest from 1st January to 31st March must be accounted for. It is called interest accrued but not due or simply accrued interest and will be recorded as:

Debenture interest A/c

(i)

Dr

To Accrued debenture interest A/c

Issued at par and redeemable at par:

Accrued debenture interest will be shown as "other current liability" in Balance sheet.

Accounting entries for issue of debentures (based on conditions of redemption)

A company may issue debentures on certain terms as to their issue price at par or a premium or discount and as to their redemption which can be either at par or at premium.

	Bank Account	Dr.	(with the nominal value of debentures)
	To Debentures Account		
(ii)	Issued at discount and redeemable at par:		
	Bank Account	Dr.	(with the amount received)
	Discount on Issue of Debentures Account	Dr.	(with the amount of discount)
	To Debentures Account (with the nominal	l value)	
(iii)	Issued at premium and redeemable at par:		
	Bank Account	Dr.	(with the amount received)

35,000

(with the premium on redemption)

	To Debentures Account		(with the nominal value)
	To Securities Premium Account		(with the amount of premium)
(iv)	Issued at par and redeemable at premium:		
	Bank Account	Dr.	(with the amount received)
	Loss on issue of Debentures Account	Dr.	(with the amount of premium on redemption)
	To Debentures Account		(with the nominal value)
	To Premium on Redemption of Debentures	s Account	(with the premium on redemption)
(v)	Issued at discount, and redeemable at premi	um	
	Bank Account	Dr.	(with the amount received)
	Discount on Issue of Debentures Account	Dr	(with the discount allowed on issue)
	Loss on Issue of Debentures Account	Dr.	(with the premium payable on redemption)
	To Debentures Account		(with the nominal value)

Note : (i) Premium on Redemption of Debentures Account is shown as liabilities side of the balance sheet.

Loss on Issue of Debentures Account is written off gradually every year during the life of the debentures. The unwritten off amount is shown in the balance sheet under 'Other Current or other Non-Current Asset'.

Premium on Redemption of Debentures Account is transferred to debenture holders account at the time of redemption.

Illustration 8.

Journalize the following transactions.

Issue of 12%, 1,00,000 debentures of Rs. 100 each

- 1. at par and redeemable at par.
- 2. at 10% discount and redeemable at par.
- 3. at 10% premium and redeemable at par.
- 4. at 10% premium and redeemable at a premium of 5%.

To Premium on Redemption of Debentures Account

- 5. at par and redeemable at a premium of 5%.
- 6. at 10% discount and redeemable at a premium of 5%.

Solution:

Journal Entries

(in '000)

S.No	Particulars		Debit (Rs.)	Credit (Rs.)
(i)	Bank Account	Dr.	10,000	
	To 12% Debentures Account			10,000
	(Being 12% Debentures issued at par)			
(ii)	Bank Account	Dr.	9,000	
	Discount on Issue of Debentures Account	Dr.	1,000	
	To 12% Debentures Account			10,000
	(Being 12%debentures issued at 10% discount)			

(iii)	Bank Account	Dr.	11,000	
	To 12% Debentures Account			10.000
	To Securities Premium Account			1.000
	(Being 12% debentures issued at 10% premium)			,
(iv)	Bank Account	Dr.	11,000	
	Loss on Issue of Debenture Account	Dr.	500	
	To 12% Debentures Account			10,000
	To Securities Premium Account			1,000
	To Premium on redemption of Debentures			500
	(Being 12% debentures issued at 10% premium and red at 5% premium)	leemed		
(v)	Bank Account	Dr.	10,000	
	Loss on issue of Debentures Account	Dr.	500	
	To 12% Debentures Account			10,000
	To Premium on Redemption of Debentures Account			500
	(Being 12% debentures issued at par and redeemed premium)	at 5%		
(vi)	Bank Account	Dr.	9,000	
	Loss on Issue of Debentures Account	Dr.	1,500	
	(1000+500)			
	To 12% Debentures Account			10,000
	To Premium on redemption of Debentures Account			500
	(Being 12% debentures issued at 10% discount and red at 5% premium)	leemed		

TREATMENT OF DISCOUNT/LOSS ON THE ISSUE OF DEBENTURES

The discount/loss on debentures is in the nature of capital loss and therefore the same must be written off over the life time of debentures. The entire amount of discount or loss on issue of debenture cannot be written off in the year of issue since the benefit of debenture capital will continue till the redemption of debentures takes place. However, the following alternatives are available to write off discount/loss on issue of debentures.

- 1. Discount on issue of debentures being a capital loss can be written off against capital profits.
- 2. Discount on issue of debentures can be treated as deferred revenue expenditure and written off against revenue over the period of life of the debentures.

In case there is no capital profit and it is decided to treat discount on the issue of debentures as deferred revenue expenditure, it is desirable to write it off against revenue over the period of life of the debentures on an equitable basis. The following are the two methods which are generally adopted for this purpose.

(a) Fixed Instalment Method

Where the debentures are redeemable at the end of specific period, the total amount of discount should be written off by equal instalments of fixed amount over that period.

(b) Fluctuating Instalment Method

If the debentures are to be repaid by annual drawings or instalments it would be equitable in such a case to write off discount in proportion to unpaid amount of debentures.

Illustration 9.

Bee Ltd. issued 2,000, 12% Debentures of Rs.100 each at a discount of 6% on 01.04.2016 repayable by equal annual drawings in four years.

You are required to show the discount on Issue of Debentures Account over the period.

Solution:

Total amount of discount on issue of debentures:

= Rs. 2,00,000 x 6/100 = Rs. 12,000

This total discount of Rs. 12,000 has to be written off in proportion to the debentures outstanding at the beginning of each year. Thus, outstanding balance ratio will be as follows:

1.4.2016 = Rs. 2,00,000

1.4.2017 = Rs. (2,00,000 - 50,000) = Rs.1,50,000

1.4.2018 = Rs. (1,50,000 - 50,000) = Rs. 1,00,000

1.4.2019 = Rs. (1,00,000 - 50,000) = Rs.50,000

Outstanding balance ratio = 2,00,000 : 1,50,000 : 1,00,000 : 50,000

= 4 : 3 : 2 : 1

Therefore, amount of discount to be written off every year will be as follows:

Rs.

31.3.2017 = 12,000 x 4/10 =		4,800
31.3.2018 = 12,000 x 3/10 =		3,600
31.3.2019 = 12,000 x 2/10 =		2,400
31.3.2020 = 12,000 x 1/10 =		1,200
Total	Rs.	12,000

REDEMPTION OF DEBENTURES

MEANING

Redemption of debentures means repayment of loan due on debentures to the debenture holders. The terms and conditions of redemption are generally given in the prospectus. But irredeemable debentures are perpetual in nature and are redeemable on the happening of a contingency and not otherwise.

METHODS OF REDEMPTION

Redeemable debentures are redeemed either at par or at a premium and following methods of redemption are available to the company to discharge its liability.



(1) Lumpsum

The redemption is made in one lumpsum at the expiry of a specified period promised as the redemption date when the debentures were issued.

(2) Annual Instalments or Draw by Lots

Under this method, a certain amount of debentures is redeemed at regular intervals, say yearly, during the life of debentures. The amount of annual drawings may or may not be equal.

(3) Conversion into Shares

A company may issue convertible debentures, giving options to the debenture holders to exchange their debentures for equity shares or preference shares in the company.

(4) Purchase of Its Own Debentures in Open Market

A company is entitled to purchase its own debentures in open market, i.e., through the stock exchange. When the company purchases its own debentures for immediate cancellation, it leads to automatic redemption. Own debentures may also be purchased by the company for its own investment and same may be reissued in future too.

Sources of Redemption

A company can arrange funds from the following sources

- (a) Out of capital
- (b) Out of profit
- (c) Through conversion

REDEMPTION OUT OF CAPITAL

When debentures are redeemed out of capital, no debenture redemption reserve is created out of profit of the company. Thus, the profit would not be reduced and the same can be utilized in future for the payment of dividend.

A. When debentures are redeemed at par

(i)	On debentures becoming due for payment		
	Debentures A/c	Dr	(with the nominal value of debentures)
	To Debenture holders A/c		
(ii)	On redemption		
	Debenture holders A/c	Dr	
	To Bank A/c		

B.	When debentures are redeemed at premium						
	(i)	On debentures becoming due for payment					
		Debentures A/c	Dr	(with the nominal value of debentures)			
		Premium on redemption of Debentures A/c To Debenture holders A/c	Dr	(with the amount of premium)			
	(ii)	On redemption					
		Debenture holders A/c	Dr				
		To Bank A/c					
	(iii)	On writing off premium on redemption since i	t was no	ot recorded at the time of issue of debentures			
		Securities Premium A/c	Dr				
		Free reserves A/c	Dr				
		To Premium on redemption of debentur	res A/c				
C.	Whe	n debentures are redeemed at discount					
	Altho	ough it's a very rare possibility, the accounting t	reatmer	nt would be			
	(i)	On debentures becoming due for payment					
		Debentures A/c	Dr	(with the nominal value of debentures)			
		To Debenture holders A/c		(with the mount payable)			
		To Capital Reserve A/c		(with the amount of discount) On redemption			
	(ii)	On redemption					
		Debenture holders A/c	Dr				
		To Bank A/c					

Illustration 10.

Amritsar Ltd. issued Rs 5 Crores, 10% debentures of Rs. 1000 each at Rs. 940. The debentures are redeemable in five annual instalments.

Pass appropriate entries in year 1 and 2

Solution:

Amritsar Ltd. Journal Entries

	Particulars		Debit (Rs.)	Credit (Rs.)
Year 1	Bank A/c	Dr	4,70,00,000	
(i)	Discount on issue of Debentures A/c	Dr	30.00.000	
	To 10% Debentures A/c		, ,	
	(Being issue of 50,000, 10% debentures of Rs 1 each at Rs. 940)	000		5,00,00,000
(ii)	Debenture interest A/c	Dr	50,00,000	
	To Bank A/c			50,00,000
	(Being payment of interest)			

(iii)	Profit & Loss A/c	Dr	60,00,000	
	To Debenture interest A/c			50,00,000
	To discount on issue of Debenture A/c			10,00,000
Year	10% Debenture A/c	Dr	1,00,00,000	
2	Debenture interest A/c	Dr	40,00,000	
(i)	To Bank A/c			1,40,00,000
(ii)	Profit & Loss A/c	Dr	48,00,000	
	To Debenture interest A/c			40,00,000
	To discount on issue of Debentures A/c			8,00,000

Debenture Redemption Reserve (DRR)

Section 71(4) of the companies Act, 2013 provides that the debentures shall be redeemed out of divisible profits of the company through the creation of Debenture Redemption Reserve in accordance with the conditions given below:

- (i) Debenture Redemption Reserve is created out of profits of the company available for payment of dividend. (ii) Every company is required to create DRR shall on or before the 30th day of April in each year invest or deposit, as the case may be, a sum which shall not be less than 15% of the amount of its debentures maturing during the year ending on 31st day of March of next year in any one or more of the following methods, namely;
 - (a) In deposits with any scheduled banks free of any charge or lieu.
 - (b) In unencumbered securities of the Central Government or of any State Government.
 - (c) In unencumbered securities mentioned in sub-clauses (a) to (d) and (e) of Section 20 of Indian Trusts Act, 1882.
 - (d) In unencumbered bonds issued by any other company which is notified under sub-clause (f) of Section 20 of Indian Trusts Act, 1882.
- (iii) The amount invested or deposited as stated above shall be used only for the redemption of the debentures maturing during the year.
- (iv) The amount remaining invested or deposited as the case may be, shall not, at any time, fall below 15% of the amount of debentures maturing during the year ending on 31st March of every year.
- (v) In case of partly convertible debentures, DRR shall be created in respect of non-convertible portion of debentures issue in accordance with subrule.
- (vi) The amount credited to DRR shall not be utilized by the company except for the purpose of redemption of debentures.
- (vii) No DRR is required for debentures issued by All India Financial Institutions (AIFIs) regulated by Reserve Bank of India (RBI) and Banking companies for both public as well as privately placed debentures.
- (viii) For other financial institutions within the meaning of Section 2(72) of the Companies Act, 2013, DRR will be applicable as applicable to NBFCs registered with RBI.
- (ix) For Non-Banking Financial Companies registered with the RBI under Section 45-IA of the RBI(Amendment) Act 1997, the adequacy of DRR will be 25% of the value of outstanding debentures issued through public issue as per SEBI (Issue and Listing of Debt Securities) Regulations, 2008 and no DRR is required in case of privately placed debentures.
- (x) For other companies including manufacturing and infrastructure companies, the adequacy of DRR will be 25% of the value of outstanding debentures issued through public issue as per present SEBI (Issue and Listing of Debt Securities), Regulations 2008 and also 25% DRR is required in the case of privately

placed debentures by listed companies. For unlisted companies issuing debentures on private placement basis, the DRR will be 25% of the value of outstanding debentures.

Further, where a company intends to redeem its debentures prematurely, it may provide for transfer of such amount in Debenture Redemption Reserve as is necessary for redemption of such debentures even if it exceeds the limits specified in this sub-rule.

Accounting Treatment

For appropriation of surplus or withholding of profits in the form of DRR

Surplus A/c

Dr

(with the amount appropriated)

To DRR A/c

DRR would be shown or disclosed as Shareholder's Funds on the Balance Sheet under the heading: Reserves and Surplus.

On transferring the balance of DRR when the debentures are redeemed

DRR A/c

Dr

To General Reserve A/c

Illustration 11.

Jai Bhagwan Ltd has a balance of Rs. 4,00,000 in the Profit & Loss Statement. The company decided to forego the payment of dividend and utilize the profits to repay 12%, Rs. 3,50,000 debentures on 30th June 2019 at a premium of 10%. Debenture interest is paid annually on 31st December every year when the accounts are closed. The company has a balance of Rs. 2,00,000 in DRR.

Journalize and ignore narration.

Solution:

Jai Bhagwan Ltd. Journal Entries

	Particulars		Debit (Rs.)	Credit (Rs.)
June	Debenture interest A/c	Dr	21,000	
30,2019	To Bank A/c			21,000
	12% Debentures A/c	Dr	3,50,000	
	Premium on redemption of Debentures A/c	Dr	35,000	
	To Debenture holders A/c			3,85,000
	Surplus A/c	Dr	1,50,000	
	To DRR A/c			1,50,000
	Debenture holders A/c	Dr	3,85,000	
	To Bank A/c			3,85,000
	Profit & Loss A/c	Dr	35,000	
	To Premium on redemption of Debentures A/c			35,000

Sinking Fund Method (Debenture Redemption Fund Method)

A sinking fund may be defined as a fund created by an appropriation of certain profits and investments of the

same for the redemption of debentures. The investment may be in the form of Government Bonds or other quickly saleable securities so that the same can be sold without much difficulty.

Types of Sinking Funds

- (i) Cumulative Sinking Fund
- (ii) Non- Cumulative Sinking Fund

Cumulative Sinking Fund

A cumulative sinking fund is maintained on the basis of annual appropriation of the profits plus the interest earned on the sinking fund investments.

The accounting entries for maintaining a cumulative sinking fund are as follows:

A.	At the	e end of First year		
	(i)	For appropriation of required amount for Sinking Fund		
		Surplus A/c	Dr	
		To Sinking Fund A/c		
	(ii)	For investing the surplus appropriated		
		Sinking fund investment A/c	Dr	
		To Bank A/c		
В.	At the	e end of second and subsequent years		
	(i)	For receiving interest on Sinking Fund Invest	tment	
		Bank A/c	Dr	
		To interest on Sinking Fund Investment	A/c	
	(ii)	For transferring interest to Sinking Fund Account		
		Interest on sinking fund investment A/c	Dr	
		To Sinking Fund A/c		
	(iii)	For annual appropriation		
		Surplus A/c	Dr	
		To Sinking Fund A/c		
	(iv)	For investing the surplus appropriated and the interest received		
		Sinking Fund Investment A/c	Dr	
		To Bank A/c		
C.	At the	e end of Last Year		
	(i)	For receiving interest on Sinking Fund Invest	tment	
		Bank A/c	Dr	
		To Sinking Fund A/c		
	(ii)	For annual appropriation		
		Surplus A/c	Dr	
		To Sinking Fund A/c		
(iii)	For s	ale of Sinking Fund Investment		
	(a)	In case of profit		
		Bank A/c	Dr	

		To Sinking Fund Investment A/c		(with the amount of profit)
		To Sinking Fund A/c		
	(b)	In case of loss		
		Bank A/c	Dr	
		Sinking Fund A/c	Dr	(with the amount of loss)
		To Sinking Fund Investment A/c		
(iv)	For r	edemption of debentures		
	(a)	At par		
		Debentures A/c	Dr	
		To Bank A/c		
	(b)	At premium		
		Debentures A/c	Dr	
		Premium on Redemption of Debentures A/c	Dr	
		To Bank A/c		
	(c)	For closing the Sinking Fund Account		
		Sinking Fund A/c	Dr	
		To General Reserve A/c		

Illustration 12.

Prakash Ltd. issued Rs. 10,00,000, 10% debentures on January 1, 2017. These were to be redeemed on 31st December, 2019. For this purpose the company established Sinking Fund. Investments were expected to earn 5% interest p.a. Sinking Fund table shows that 0.317208 invested annually at 5% amount to Rs. 1 in 3 years. On 31st December, 2019 the investment was sold for Rs. 6,56,000. Interest received and investments are made in multiples of Rs. 100. Journalize and ignore narration and debenture interest.

Solution:

Calculation of annual appropriation =Rs. 10,00,000 x 0.317208 = Rs. 3,17,208

Prakash	Ltd.

Journal Entries

	Particulars	Debit (Rs)	Credit (Rs)
2017	Bank A/c Dr	10,00,000	
Jan 1	To 10% Debentures A/c		10,00,000
Dec 31	Surplus A/c Dr	3,17,208	
	To Sinking Fund A/c		3,17,208
	Sinking Fund Investment A/c Dr	3,17,208	
	To Bank A/c		3,17,208
2018	Bank A/c Dr	15,860	15.0.00
Dec 31	To Sinking Fund A/c		15,860
	Surplus A/c Dr	3,17,208	
	To Sinking Fund A/c		3,17,208

	Sinking Fund Investment A/c	Dr	3,33,100	
	To Bank A/c			3,33,100
2019	Bank A/c	Dr	32,515	
Dec 31	To Sinking Fund A/c			32,515
	Surplus A/c	Dr	3,17,2018	
	To Sinking Fund A/c			3,17,208
	Bank A/c	Dr	6,56,000	
	To Sinking fund Investment A/c			6,50,300
	To Sinking Fund A/c			5700
	10% Debentures A/c	Dr	10,00,000	
	To Bank A/c			10,00,000
	Sinking Fund A/c	Dr	10,00,000	
	To General Reserve A/c			10,00,000

Non-Cumulative Sinking Fund

If the sinking fund is non-cumulative, the interest received on Sinking Fund Investment is not invested and not credited to Sinking Fund A/c. The amount of interest is credited to Profit & Loss statement.

Illustration 13.

The following balances appeared in the books of a company as on December 31, 2014:

6% Mortgage 10,000 debentures of Rs.100 each; Debenture Redemption Reserve (for redemption of debentures) Rs.10, 42,000;

Investment Rs.5,28,000, 4% Government Loan purchased at par and 5,60,000, 3-1/2% Government paper purchased for Rs. 5,42,000.

The interest on debentures had been paid up to December 31, 2010. On February 28, 2015, the investments were sold at Rs. 90 and Rs. 87 respectively, and the debentures were paid off at 101 together with accrued interest.

Write the ledger accounts concerned. The Debenture Redemption Reserve is non-cumulative.

Solution:

6% Mortgage Debentures Account

Feb 28	To Debenture holders	10,00,000	Jan 1	By Balance b/d	10,00,000
	A/C	10,00,000			10,00,000

Premium on Redemption of Debentures Account

To Debenture holders A/c	10,000	Jan 1	By Debenture Redemption Reserve. A/c	10,000
	10,000			10,000

To Balance B/d	10,70,000	By Bank (Rs. 5,28,000 Govt. Loan @ Rs. 90)	4,75,200
		By Bank (Rs. 5,60,000 Govt. Paper @ Rs.87)	4,87,200
		By D.R.R. (Loss)	1,07,600
	10,70,000		10,70,000

Debentures Redemption Fund Investment Account

Debentures Redemption Fund Account

To Premium on Redemption To DRR	10,000	By Balance b/d	10,42,000
investment A/c	1,07,600	By Profit & Loss Appropriation	75,600
To General Reserve	10,00,000	A/c	
	11,17,600		11,17,600

Insurance Policy Method

Under this method also, annual sum is appropriated out of surplus and credited to Debenture Redemption Fund A/c in the same manner as it is done in Sinking Fund method. However, the appropriate profit is not invested in marketable securities, instead an insurance policy is taken for the required amount and an amount equal to profit set aside is paid as premium to insurance company. At the end of policy period, the insurance company returns the total accumulated amount which is sufficient to pay the debenture holders.

Accounting Treatment

A.	From	ı year to year		
	(i)	On payment of premium		
		Debenture Redemption Fund Policy A/c	Dr.	(with the annual premium amount)
		To Bank A/c		
	(ii)	For appropriation of profit equivalent to am	ount of pr	emium paid during the year
		Surplus A/c	Dr	
		To Debenture Redemption Fund A/c		
B.	At th	e time of maturity and redemption		
	(i)	On realization of policy		
		Bank A/c	Dr	(with the amount of policy)
		To Debenture Redemption Fund Policy A	A/c	
	(ii)	On transfer of interest earned on premium		
		Debenture Redemption Fund Policy A/c	Dr	(with the difference between the amount of
		To Debenture Redemption Fund A/c		policy realized and the total premium paid)
	(iii)	On transfer of premium on redemption of de	ebentures	
		Debenture Redemption Fund A/c	Dr	
		To Premium on redemption		
	(iv)	For closing the Debenture Redemption Fund	d Account	
		Debenture Redemption Fund A/c	Dr	
		To General Reserve A/c		

Illustration 14.

Go Ltd. issued 500, 12% Debentures of Rs. 100 each at par on 1st April, 2015, repayable at par after 3 years on 31st March, 2018. The directors decided to take out an insurance policy to provide necessary cash for the redemption of the debentures. The annual premium for the policy payable on 1st April every year was Rs. 15,705.

You are required to show the journal entries in the books of the company.

Solution:

Go Ltd.

Journal Entries

	Particulars		Debit (Rs.)	Credit (Rs.)
2015	Bank A/c	Dr.	50,000	
April 1	To 12% Debentures A/c			50,000
	(Allotment of 500 12% Debenture of Rs 100 each as per Boar resolution dated)	ďs		
	Debenture Redemption Fund Policy A/c	Dr.	15,705	
	To Bank A/c			15,705
	(Payment of annual premium for the policy taken out provide cash for redemption of debentures)	to		
2016	Profit and Loss Appropriation A/c	Dr.	15,705	
March	To Debenture Redemption Fund A/c			15,705
31	(Transfer of profit to Debenture Redemption Fund Account)			
April 1	Debenture Redemption Fund Policy A/c	Dr.	15,705	
	To Bank A/c			15,705
	(Payment of annual premium for the policy taken out provide cash for redemption of debentures)	to		
2017	Profit and Loss Appropriation A/c	Dr.	15,705	
March	To Debenture Redemption Fund A/c			15,705
31	(Transfer of profit to Debenture Redemption Fund Account))		
April 1	Debenture Redemption Fund Policy A/c	Dr.	15,705	
	To Bank A/c			15,705
	(Payment of annual premium for the policy taken out to provide cash for redemption of debentures)			
2018	Profit and Loss Appropriation A/c	Dr.	15,705	
March	To Debenture Redemption Fund A/c			15,705
31	(Transfer of profit to Debenture Redemption Fund Account))		
	Bank A/c	Dr.	50,000	
	To Debenture Redemption Fund Policy A/c			50,000
	(Receipt of policy amount on maturity)			

Debenture Redemption Fund Policy A/c	Dr.	2,885	
To Debenture Redemption Fund A/c			2,885
(Transfer of accumulated interest on the policy to D Redemption Fund A/c)	Debenture		
12% Debentures A/c	Dr.	50,000	
To Debentureholders A/c			50,000
(Amount due on redemption)			
Debentureholders A/c	Dr.	50,000	
To Bank A/c			50,000
(Payment made for the amount due)			
Debenture Redemption Fund A/c	Dr.	50,000	
To General Reserve A/c			50,000
(Transfer of the balance of Debenture Redemption to General Reserve)	Fund A/c		

REDEMPTION BY CONVERSION

A company can issue convertible debentures. It means that the debentures would be converted into new class of debentures or shares.

Accounting Treatment

(a)	When	shares	are	issued	at	par
-----	------	--------	-----	--------	----	-----

	Debentures A/c	Dr	
	To Share capital A/c		
(b)	When shares are issued at a premium		
	Debentures A/c	Dr	
	To Share Capital A/c		(with the nominal value of shares issued)
	To Securities Premium A/c		(with the amount of premium)

Illustration 15.

Bima Ltd. had issued 11% 5,00,000 debentures of Rs. 100 each redeemable on 31st March 2019 at a premium of 5%.

The company offered three options to debenture holders as under:

- (i) 13% Preference shares of Rs.10 each at Rs.10.50
- (ii) 14% debentures of Rs. 100 at par.
- (iii) Redemption in cash.

The options were accepted as under :

Option (i) by holders of 1,00,000 debentures. Option (ii) by holders of 1,00,000 debentures. Option (iii) by holders of 3,00,000 debentures.

The company carried out the redemption. Pass the necessary journal entries.

Solution:

Bima Ltd.

Journal Entries (in Lacs)

Particulars		Debit (Rs.)	Credit (Rs.)
11% Debentures A/c	Dr.	500	
Premium on redemption of Debentures A/c	Dr.	25	
To Debenture holder A/c			525
(Being redemption due at premium@ 5%)			
Debenture holders account	Dr.	105	
To 13% Preference Share Capital Account			100
To Securities premium account			5
(Being debentures converted into preference shares)			
Debenture holders A/c	Dr.	105	
To 14% Debenture A/c			105
(Being debentures converted into 14% debentures)			
Debenture holders A/c	Dr.	315	
To Bank A/c			315
(Being payment made to remaining debenture holders)			

Purchase of Debentures in the Open Market

A company, if authorized by its Articles of Association, can buy its own debentures in the open market. The debentures so purchased can be used either for immediate cancellation or redemption of debentures or for investment. The debentures so purchased for investment can subsequently either be reissued when the company requires additional cash or be cancelled if the company so desires. Debentures when purchased for investment are popularly known as "Own Debentures". This can be categorized as follows:

(1) For immediate cancellation

When the company cancels the debentures so purchased, it amounts to redemption of debentures. It means after cancellation, redemption is automatic and these debentures cannot be reissued.

(2) For investment in the form of own debentures

If the company purchases its debentures from open market and holds them for sometime before cancellation, such debentures are known as own debentures. Own debentures are held by company as investment and may be resold till cancellation. After cancellation, the debentures are said to be redeemd and cannot be resold.

Accounting treatment for immediate cancellation of debentures

(a) Where no Sinking Fund exists

On purchase and cancellation of debentures -

Debentures A/c

Dr.

(with the amount paid)

To Bank A/c

Notes: 1. If there is any difference between the nominal value of the debentures cancelled and the price paid for them, the same has to be treated as profit or loss on cancellation, and should be credited or debited to Profit on Redemption of Debentures Account or Loss on Redemption of Debentures Account.

Thus, the entry for this will be as follows:		
In case of profit -		
Debentures A/c	Dr.	(with the nominal value of debentures cancelled)
To Bank A/c		(with the price paid for them)
To Profit on Redemption of Debentu	res A/c	(with the profit, if any).
In case of loss -		
Debentures A/c	Dr.	(with the nominal value of debentures cancelled)
Loss on Redemption of Debentures A/c	Dr.	(with the loss, if any)
To Bank A/c		(with the total)
Such profit or loss, being of capital nature, written off against the Profit and Loss Acco loss). The entry for this will be as follows:	should b ount or C	e transferred to Capital Reserve Account (if profit) or apital Profit including Securities Premium Account (if
In case of profit -		
	D	

Profit on Redemption of Debentures A/c	Dr.	
To Capital Reserve A/c		
In case of loss -		
Profit and Loss A/c	Dr.	
Or, Capital Reserve A/c (if any)	Dr.	
Or, Securities Premium A/c (if any)	Dr.	
To Loss on Redemption of Debenture	e A/c	
2. On transfer of profits which would oth Reserve -	herwise	be available for dividend to Debenture Redemption
Profit and Loss Appropriation A/c	Dr.	(with the nominal value of debentures cancelled)
To Debenture Redemption Reserve A	/c	
Where Sinking Fund Exists –		

1. On Sale of Sinking Fund Investments -

Bank A/c

(b)

Dr. (with the realisation value)

To Debenture Redemption Fund Investment A/c

Note: If there is any profit or loss on sale of investments, the same has to be transferred to Debenture Redemption Fund Account.

2. On purchase and cancellation of debentures -Debentures A/c Dr. (with the amount paid)

To Bank A/c

3. Profit or loss on cancellation or redemption of debentures shall be transferred to Sinking Fund or Debenture Redemption Fund Account. The accounting entries:

In case of profit:

Debentures A/c	Dr.	(with the nominal value)	
To Bank A/c		(with the price paid)	
To Profit on Redemption Debentures	sA/c	(with the amount of profit)	

Profit on Redemption of Debentures A/c Dr.					
To Sinking Fund A/c					
In case of loss:					
Debentures A/c		Dr.	(with the nominal value)		
Loss on Cancellation or Redemption of Debentures A	A/c	Dr.	(with the loss on cancellation)		
To Bank A/c			(with the amount paid)		
Sinking Fund A/c		Dr.			
To Loss on Cancellation or Redemption of Deb	entures .	A/c			
4. On transfer of the nominal value of the debentu Debenture Redemption Fund Account –	res canc	celled to	General Reserve Account from the		
Debenture Redemption Fund A/c	Dr.		(with the nominal value of the debentures cancelled)		
To General Reserve A/c					
Purchase of Debentures as Investment (Own Deb	oenture	s)			
The accounting entries in such a case will be as follo	WS:				
(a) Where no Sinking Fund Exists:					
On purchase of debentures as investment –					
Own Debentures A/c	Dr.				
Or Investment in Own Debentures A/c	Dr.	(with t	he amount paid for the debentures)		
To Bank A/c					
(b) Where Sinking Fund Exists:					
On sale of investments -					
Bank A/c	Dr	(with th	ne realised amount)		
To Debenture Redemption Fund Investment A	/c				
Note : If there is any profit or loss on sale of investi Redemption Fund Account.	ments th	ne same l	has to be transferred to Debenture		
On purchase of debentures as investment -					
Bank A/c	Dr.	(With t	he amount received)		
Own Debentures A/c	Dr.				
Or Investment in Own Debentures A/c	Dr.	(with th	ne amount paid for the debentures)		
To Bank A/c					
Cancellation of Own Debentures					
When own debentures are subsequently cancelled -					
Bank A/c	Dr.	(With t	he amount received)		
Debentures A/c	Dr.	(with th	ne nominal value of the debentures		
To Own Debentures A/c cancelled)					
Or					
To Investment in Own Debentures A/c					
In case of profit -					
Debentures A/c	Dr.	(nomina	al value of the debentures cancelled)		
To Own Debentures A/c		(book va	alue of the Own Debentures cancelled)		

To Profit on Redemption of Debentures A/c

In case of loss -

Debentures A/c

Loss on Redemption of Debentures A/c

To Own Debenture A/c

(nominal value of the debentures cancelled)

(book value of the Own Debentures cancelled)

- (2) If Sinking Fund exists, the accounts of profit on redemption of debentures or loss on redemption of debentures should be transferred to Debenture Redemption Fund Account.
- (3) If no Sinking Fund exists it is desirable that an amount equal to the nominal value of the debentures cancelled should be transferred to Debenture Redemption Reserve Account out of the profit of the company on cancellation.
- (4) If Sinking Fund exists, on cancellation, an amount equal to the nominal value of the debentures cancelled should be transferred to General Reserve from the Debenture Redemption Fund Account.

PURCHASE OF DEBENTURES BEFORE THE SPECIFIED DATE OF PAYMENT OF INTEREST [CUM-INTEREST AND EX-INTEREST QUOTATIONS]

Dr.

Dr.

Interest on debentures is generally paid half yearly to the holders on certain specified dates, e.g., 30th September and 31st March every year. If debentures are purchased exactly on these specified dates, it involves no problem. In such a case, interest is payable to the holders of debentures. But, where debentures are purchased at a date before the specified date of payment of interest the question which naturally arises is whether the price paid for

In case of Ex-interest quotation, interest has to be paid to the holders for the expired period in addition to the price paid for the debentures. In any case, the company must pay interest for the expired period and while making entry in its books at the time of purchase of the debentures, the amount paid by way of interest should be treated separately from the price actually paid for the debentures. such debentures includes the interest for the expired period (i.e., from the previous date of payment of interest up to the date of purchase) or not.

For this purpose it is important to note whether the price paid for the debentures is quoted as "Cuminterest" or "Ex-interest". If the purchase price for the debentures includes interest for the expired period, the quotation is said to be "Cum-interest". If, on the other hand, the purchase price for the debentures excludes the interest for the expired period, the quotation is said to be "Ex-interest".

Illustration 16. (Purchase of debentures for immediate cancellation)

XYZ Ltd. has 5000, 10% debentures of Rs.100 each. The interest on these debentures is paid half yearly on June 30, December 31 every year. The company is not maintaining any sinking fund. On 01-04-2018, the company purchased 500 debentures at Rs. 95 each cum – interest for immediate cancellation. On 01-10-2018, the company purchased 600 debentures at Rs. 90 each ex-interest for immediate cancellation. Journalize.

Solution:

XYZ	Ltd.
Journal	Entries

Date	Particulars		Debit (Rs.)	Credit (Rs.)
2018	10% Debentures A/c	Dr	50,000	
April1	Debenture Interest A/c	Dr	1250	
	To Bank A/c			47,500
	To Profit on cancellation of debentures A/c			3750
	(Purchase of debentures-cum-interest for immediate cancellation)			

June 30	Debenture Interest A/c	Dr	22,500	
	To Bank A/c			22,500
	(Payment of interest on Rs 4,50,000 debentures for six months)	or		
October 1	10% Debentures A/c	Dr	60,000	
	Debenture Interest A/c	Dr	1500	
	To Bank A/c			55,500
	To Profit on cancellation of debentures A/c			6,000
	(Purchase of debentures ex-interest for immediate cancellation)			
December	Debenture Interest A/c	Dr	19,500	
31	To Bank A/c			19,500
	(payment of interest on Rs 3,90,000 debentures for six months)	or		
December	Profit & Loss A/c	Dr	44,750	
31	To Debenture interest A/c			44,750
	(Transfer of debenture interest to P&LA/c)			
	Profit on cancellation of Debentures A/c	Dr	9750	
	To Capital Reserve A/c			9750
	(Profit on cancellation transferred to Capital Reserve)		
	Surplus A/c	Dr	1,10,000	
	To Debenture Redemption Reserve A/c			1,10,000
	(Transfer to DRR)			

Illustration 17. (Purchase of Own Debentures as investment)

Sugandha Ltd. issued 10,000 12% Debentures of Rs. 100 each on 1st April, 2017. Interest is payable on 30th September and 31st March every year. On 1st July, 2018, the company purchased 1,000 of its Own Debentures at Rs. 96 ex-interest as investments. On 1st January, 2019, the company purchased 2000 of its Own Debentures at Rs. 96 cum interest as investment. On 31st March 2019, the company cancelled all of its Own Debentures and books closes on 31st March every year. Journalize.

Solution:

Sugandha Ltd. Journal Entries

Date	Particulars	Debit (Rs.)	Credit (Rs.)
2017	Bank A/c Dr	10,00,000	
April1	To 12% Debentures A/c		10,00,000
	(Being issued 10,000, 12% debentures of Rs 100 each)		
September	Debenture Interest A/c Dr	60,000	
30	To Bank A/c		60,000
	(being paid interest on debentures for six months)		

2018	Debenture Interest A/c	Dr	60,000	
March 31	To Bank A/c			60,000
	(Being interest paid on debentures for six months)			
March 31	Profit & Loss A/cDr		1,20,000	
	To Debenture interest A/c			1,20,000
July 1	Own Debentures A/c	Dr	96,000	
	Debenture Interest A/c	Dr	3,000	
	To Bank A/c			99,000
	(Being purchase of 1000 debentures at Rs 96 ex inte	rest)		
September	Debenture interest A/c	Dr	57,000	
30	To Bank A/c			54,000
	To Interest on Own Debentures A/c			3,000
	(Being interest on 9000 debentures for 6 months an own debentures for 3 months)	d		
2019	Own Debentures A/c	Dr	1,86,000	
January 1	Debenture Interest A/c	Dr	6,000	
	To Bank A/c			1,92,000
	(Being 2000 own debentures purchased at Rs 96 interest)	cum		
March 31	Debenture Interest A/c	Dr	54,000	
	To Bank A/c			42,000
	To Interest on own debentures A/c			12,000
	(Being interest on 7000 debentures for 6 months an own debentures for 3 months)	d		
	Profit & Loss A/c	Dr	1,20,000	
	To Debenture Interest A/c			1,20,000
	Interest on Own Debentures A/c	Dr	15,000	
	To Profit & Loss A/c			15,000
	(Being transfer of interest on own debentures)			
	12% Debentures A/c	Dr	3,00,000	
	To Own Debentures A/c			2,82,000
	To Profit on Cancellation A/c			18,000
	(Being cancellation of 3000 own debentures)			
	Profit on Cancellation A/c	Dr	18,000	
	To Capital Reserve A/c			18,000
	(Being profit on cancellation transferred)			

LESSON ROUND-UP

- Debentures are Part of loan capital and the company is liable to pay interest thereon whether it earns profit or not
- Debentures may be of different kinds depending upon the conditions of their issue- secured, unsecured, bearer, registered, convertible, non- convertible, redeemable, irredeemable, first mortgage, second mortgage.
- Debentures may be issued at par, or at a premium, or at a discount
- Debentures can be issued for cash, consideration other than cash and as collateral security.
- The term 'Collateral Security may be defined as additional security given for a loan. Where a company obtains a secured loan from a bank or insurance company, it may mortgage some of its assets as a security against the said loan.
- Wherever a company issues debentures it undertakes to pay interest thereon at a fixed percentage. As the debentures acknowledge a debt, the payment of interest on the debt is obligatory on the part of the company issuing them irrespective of the fact whether the company earns profit or not. Thus, interest payable on debentures is a charge against the profits of the company.
- The discount/loss on debentures is in the nature of capital loss and therefore the same must be written off over the life time of debentures.
- When debentures are redeemed out of capital, no debenture redemption reserve is created out of profit of the company.
- Section 71(4) of the companies Act,2013 provides that the debentures shall be redeemed out of divisible profits of the company through the creation of Debenture Redemption Reserve.
- A company if authorized by its articles of association, can buy its own debentures in the open market. The debentures so purchased can be used either for immediate cancellation or redemption of debentures or for investment.
- If the purchase price for the debentures includes interest for the expired period, the quotation is said to be "Cum-interest". If, on the other hand, the purchase price for the debentures excludes the interest for the expired period, the quotation is said to be "Ex-interest".

GLOSSARY

Debentures : Debentures are part of loan capital and the company is liable to pay interest thereon whether it earns profit or not.

Collateral Security: Collateral Security may be defined as additional security given for a loan.

Debenture interest: the payment of interest on the debt is obligatory on the part of the company issuing them irrespective of the fact whether the company earns profit or not.

Discount/loss on issue of debentures: The discount/loss on issue of debentures is in the nature of capital loss and therefore the same must be written off over the life time of debentures.

Redemption of debentures : Redemption of debentures means repayment of loan due on debentures to the debenture holders.

Debenture Redemption Reserve : Debenture Redemption Reserve is created out of profits of the company available for payment of dividend.

Sinking fund: A sinking fund may be defined as a fund created by an appropriation of certain profits and investments of the same for the redemption of debentures.

Ex-interest quotation : In Ex-interest quotation, interest has to be paid to the holders for the expired period in addition to the price paid for the debentures.

	ILSI IOONSLLI		
1.	Kakloo Ltd issues Rs 1000, 15%, 5,000 debentures on which amount payables Rs 300 on allotment and balance on first call. In addition the company of mortgage debentures of Rs 1000 each. In case of 15% debentures, the comp for 6200 debentures and the directors made pro-rata allotment and exc Journalise.	le is Rs 200 on application, ffers 1,000 – 12% second pany received applications ress money was refunded.	
2.	Rajkumar Ltd, purchased a building from Alok Ltd. for Rs 65,00,000. The pay by accepting a bill of exchange, and for the balance debentures are allotted at in the books of purchaser.	vment was made as to 25% t 25% premium. Journalise	
3.	Babli Ltd has 10,00,000 12% Debentures on which the interest is payable on 30th September and 31st March. Show the entries related to debenture interest. Tax deducted at source is 10%.		
4.	A company issued 15,000 10% Debentures of Rs 100 each on 1 April, 2015 at a discount of 6% redeemable at par by drawings method as follows :		
	Date of redemption	Amt of Redemption (FV)	
	31 March 2017	5,00,000	
	31 March 2018	5,00,000	
	31 March, 2019	5,00,000	
5.	On 30th June 2018 following balances stood in the books of a company :	, ,	
		Rs	
	8% First Mortgage Debentures Stock	2,00,000	
	Debenture Redemption Fund	2,13,080	
	Debenture Redemption Fund Investments:		
	Rs 70,000 6% Punjab Electricity Board Bonds	71,260	
	Rs 80,000 5% UP Water Board Bonds	64,068	
	Rs 60,000 8% Government of India Loan	61,710	
	Rs 16,000 7% Cooperative Bank Loan	16,042	
	On the same day the investments were sold : Electricity bonds at par, 5% loan at Rs 91, 8% loan at 109 and 7% loan at Rs 103. On 1st July the debentures were redeemed at a premium of 5%.		
	Write up the accounts concerned :		
6.	MM Ltd. had the following among their ledger opening balances on January	1,2019:	
	11% Debentures A/c (2000 issue)	50,00,000	
	Debenture Redemption Reserve A/c	45,00,000	
	13.5% Debentures in XX Ltd. A/c (Face Value Rs. 20,00,000)	19,50,000	
	Own Debentures A/c (Face value Rs. 20,00,000)	18,50,000	
	As 31st December 2019 was the date for redemption of the 2000 debent buying Own Debentures and made the following purchases in the open mat	ures, the company started rket :	
	1-2-2019 2,000 debentures at Rs. 98 cum-interest.		
	1-6-2019 2,000 debentures at Rs. 99 ex-interest.		
	Half yearly interest is due on the debentures on the 30th June and 31st Det the companies.	cember in the case of both	
	On 31st December 2019 the debentures in XX Ltd. were sold for Rs. 95 each the outstanding debentures of MM Ltd. were redeemed by payment and entries in the following ledger accounts of MM Ltd. during 2019 :	h ex-interest. On that date, by cancellation. Show the	

TEST YOURSELF

- (a) Debenture Redemption Reserve A/c
- (b) Own Debentures A/c

The face value of a debenture was Rs. 100 (Round off calculations to the nearest rupee.).

7. On 1st April, 2015 A Ltd. made an issue of 10,00,000 14% debentures of Rs. 100 each at Rs. 98 per debenture. According to the terms of issue, the company should redeem 10000 debentures either by purchasing them from the open market or by drawing lots at par at the company's option. Profit, if any, on redemption is to be transferred to capital reserve.

The company's accounting year ends on 31st March. Interest is payable on 30th September and 31st March.

During 2015-16 the company wrote off 20% of Debenture Discount Account.

During 2018-19, the company purchased and cancelled the debentures as given below:

Rs. 200,00,000 at Rs. 95 per debenture on 30th September, and

Rs. 300,00,000 at Rs. 97 per debenture on 31st March. Give the journal entries in the books of A Ltd. for both the years

8. A company issued 100,000 debentures of Rs. 100 each redeemable at the end of 10th year, but reserves the right to redeem earlier from the end of the 5th year. The company decides at the end of the 5th year to redeem 20,000 debentures out of the profits it has made.

Pass necessary journal entries relating to redemption.