

Accounting for Debentures

Lesson 5

KEY CONCEPTS

■ Debentures ■ Redemption of debentures ■ Collateral security ■ Debenture Interest ■ Conversion of Debenture into Share

Learning Objectives

To understand:

- The meaning of debenture and explain the difference between debentures and shares
- Various types of debentures
- The journal entries for the issue of debentures at par, at a discount and at premium
- The concept of debentures issued for consideration other than cash and the accounting thereof
- The concept of issue of debentures as a collateral security and the accounting thereof
- The journal entries for issue of debentures with various terms of issue, terms of redemption
- The items relating to issue of debentures in company's balance sheet
- The methods of writing-off discount/loss on issue of debentures
- The methods of redemption of debentures and the accounting thereof

Lesson Outline

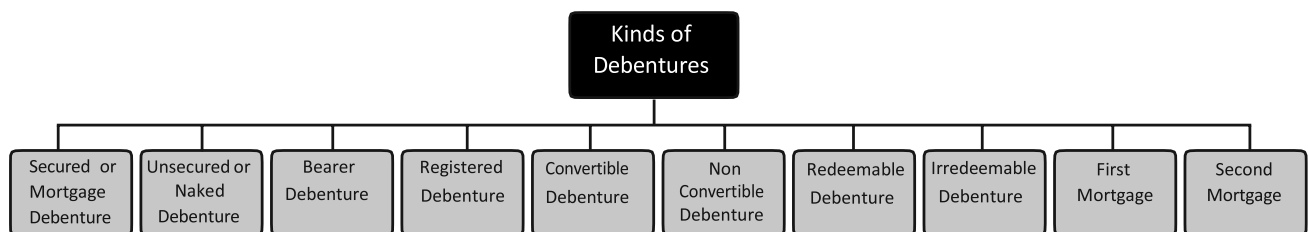
- Debenture
- Issue of Debentures at
 - Par
 - Premium
 - Discount
- Issue of Debentures for Consideration Other than Cash
- Issue of Debentures as Collateral Security
- Debenture Interest
- Accounting Treatment of Discount/loss on Issue of Debentures
- Redemption of Debentures
- Redemption of Debentures in Lumpsum
- Redemption of Debentures by Payment in installments
- Redemption of Debentures by Conversion
- Redemption of Debentures in the Open Market
- Purchase of debentures before the specified date of payment of interest
 - Par
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- Glossary
- Test Yourself
- List of Further Readings

DEBENTURES

The word ‘debenture’ has been derived from a Latin word ‘debere’ which means to borrow. Debenture is a written instrument acknowledging a debt under the common seal of the company. It contains a contract for repayment of principal after a specified period or at intervals or at the option of the company and for payment of interest at a fixed rate payable usually either half-yearly or yearly on fixed dates. Debentures are part of loan capital and the company is liable to pay interest thereon whether it earns profit or not.

According to section 2(30) of The Companies Act, 2013 ‘Debenture’ includes Debenture Inventory, Bonds and any other securities of a company whether constituting a charge on the assets of the company or not.

Kinds of Debentures



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.

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

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.

Registered Debenture: 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.

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.

Non-Convertible: Such debentures are paid into cash.

Redeemable Debenture: 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.

Irredeemable or Perpetual Debenture: 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.

First Mortgage Debentures: Such debentures are paid on the basis of priority as compared to other debentures.

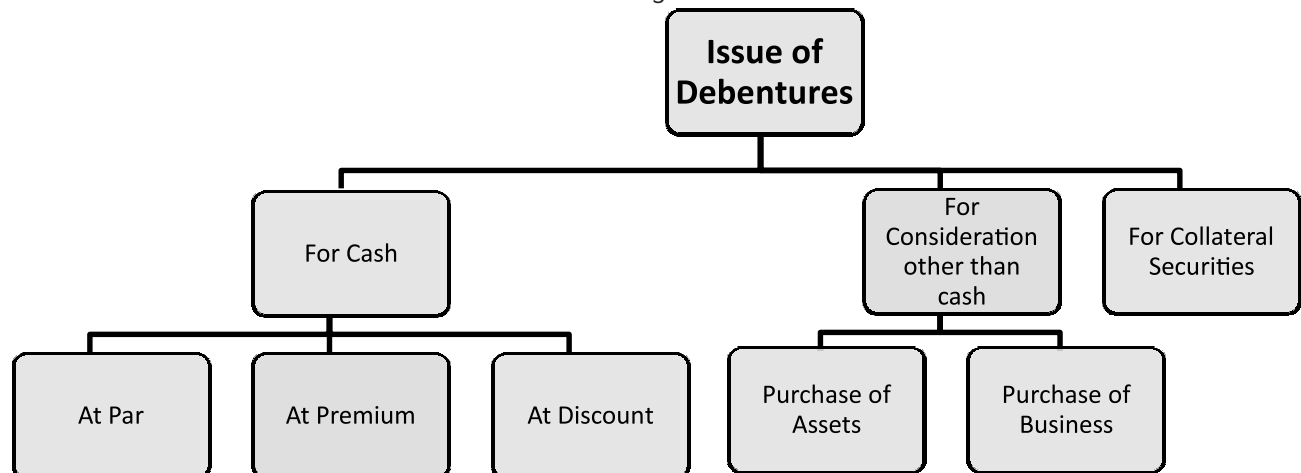
Second Mortgage Debentures: Such debentures are paid after the redemption of first mortgage debentures.

Difference between Shares and Debentures

<i>Points</i>	<i>Shares</i>	<i>Debentures</i>
Ownership	A 'share' represents ownership of the company. A share is a part of the owned capital	A 'debenture' is only acknowledgement of Debt. A debenture is a part of borrowed capital.
Return	The return on shares is known as dividend. The rate of return on shares may vary from year to year depending upon the profits of the company.	The return on debentures is called interest. The rate of interest on debentures is prefixed.
Repayment	Normally, the amount of shares is not returned during the life of the company.	Generally, the debentures are issued for a specified period and repayable on the expiry of that period.
Voting Rights	Shareholders enjoy voting rights.	Debenture holders do not normally enjoy any voting right.
Security	Shares are not secured by any charge.	Debentures are generally secured and carry a fixed or floating charge over the assets of the company.
Convertibility	Shares cannot be converted into debentures.	Debentures can be converted into shares if the terms of issue so provide, and in that case these are known as convertible debentures.

ISSUE OF DEBENTURES

The procedure for the issue of debentures is the same as that for the issue of shares. The intending investors apply for debentures on the basis of the prospectus issued by the company. The company may either ask for the entire amount to be paid on application or by means of instalments on application, on allotment and on various calls. Debentures can be issued at par, at a premium or at a discount. They can also be issued for consideration other than cash or as a collateral security.



Conditions for issue of debentures as per Companies Act, 2013

Issue of Debentures by Special Resolution
No Voting Rights
Terms for the Issue of Secured Debentures
Creation and Utilization of Debenture Redemption Reserve
Debenture Trustee(s) to protect the interest of debenture holder

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.

Issue of Debentures at Par

Accounting treatment

(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 application)
To Debentures Application and Allotment A/c	

(2) On allotment:

Debentures Application and Allotment A/c	Dr. (with the money received on debentures allotment)
To Debentures A/c	

(b) When the amount is payable in installments

(1) On receipt of application money:

Bank A/c	Dr. (with the money received on application)
To Debenture Application A/c	

(2) On Allotment of debentures:

Debenture Application A/c	Dr. (with the application money on debentures allotted)
To Debentures A/c	

(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 allotment)
To Debenture Allotment A/c	

(5) On making calls:

Debenture Calls A/c

Dr. (with the money due on respective calls)

To Debenture A/c

(6) On receipt of call money:

Bank A/c

Dr. (with the money received on respective calls)

To Debenture Calls A/c

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.

Solution:

ABC Ltd. Journal Entries

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

(iv)	Bank A/c To 12% Debenture Allotment A/c (Being allotment money received)	Dr	25,00,000	25,00,000
(v)	12% Debenture First and Final call A/c To 12% Debentures A/c (Being call money due on 50,000 debentures @ Rs 25 each)	Dr	12,50,000	12,50,000
(vi)	Bank A/c To 12% Debenture First and Final call A/c (Being the call money received)		12,50,000	12,50,000

ABC Ltd.
Balance Sheet as on

<i>Particulars</i>	<i>Note</i>	<i>Rs.</i>
EQUITY AND LIABILITIES		
Non Current Liabilities: Long Term Borrowings	1	50,00,000
ASSETS		
Cash and cash equivalent		50,00,000

Notes to Account

	<i>Particulars</i>	<i>Note</i>	<i>Rs.</i>
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.

Accounting Treatment

- (i) When allotment money becomes due

Debenture Allotment A/c	Dr
To Debenture A/c	
To Securities Premium A/c	
- (ii) 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

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. To Debenture Application A/c (Being application money received on 3,500 debentures)	70,000	70,000
(ii)	Debentures Application A/c Dr. To 10% Debentures A/c To Debentures Allotment A/c To Bank A/c (Being the application money adjusted and the surplus refunded)	70,000	50,000 5,000 15,000
(iii)	Debenture Allotment A/c Dr. To 10% Debentures A/c To Securities Premium A/c (Being the Amount due on allotment @ Rs. 50 on 2,500 debentures)	1,25,000	1,00,000 25,000
(iv)	Bank A/c Dr. To Debentures Allotment A/c (Being the Balance of the amount due on allotment received)	1,20,000	1,20,000
(v)	Debentures Call A/c Dr. To 10% Debentures A/c (Being the Amount due on Call @ Rs. 40 on 2,500 debentures)	1,00,000	1,00,000
(vi)	Bank A/c Dr. To Debentures Call A/c (Being the Amount due on call received)	1,00,000	1,00,000

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".

Accounting Treatment

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.

Solution:

Dr.	Cash Book (Bank Column)		Cr.
<i>Particulars</i>	<i>Amount (Rs.)</i>	<i>Particulars</i>	<i>Amount (Rs.)</i>
To 14% Debenture Application A/c (Application money on 5,000 debentures @ Rs 20 per debenture)	1,00,000	By Balance c/d	4,75,000
To 14% Debenture Allotment A/c (Allotment money on 5,000 debentures @ Rs.25 per debenture)	1,25,000		
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		4,75,000

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		
Non-current assets		
Other non-current assets		25,000
Current Assets		
Cash and cash equivalent		4,75,000

Notes to Account

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

Over Subscription

When the number of debentures applied for is more than the number of debentures offered to the public, the issue is said to be over subscribed. A company, however, cannot allot more debentures than it has invited for subscription. The excess money received on over subscription may, however, be retained for adjustment towards allotment and the respective calls to be made. But the money received from applicants to whom no debentures have been allotted, will be refunded to them.

Illustration 4

X Limited Issued 10,000, 12% debentures of Rs. 100 each payable Rs. 40 on application and Rs. 60 on allotment. The public applied for 14,000 debentures. Applications for 9,000 debentures were accepted in full; applications for 2,000 debentures were allotted 1,000 debentures and the remaining applications, were rejected. All money was duly received. Journalise the transactions.

Solution:

Books of X Limited

Journal Entries

S. No.	Particulars	Debit (Rs.)	Credit (Rs.)
	Bank A/c Dr. To 12% Debenture Application A/c (Receipt of application money on 14,000 debentures)	5,60,000	5,60,000
	12% Debenture Application A/c Dr. To 12% Debentures A/c To Debentures Allotment A/c To Bank A/c (Debenture Application money transferred to Debenture A/c, Excess application money credited to Debenture Allotment account and money refunded on rejected application)	5,60,000	4,00,000 40,000 1,20,000
	12% Debenture Allotment A/c Dr. To 12% Debentures A/c (Amount due on allotment on 10,000 debentures)	6,00,000	6,00,000
	Bank A/c Dr. To Debenture Allotment A/c (Allotment money received)	5,60,000	5,60,000

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 5

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. To 12% Debentures A/c (Being 3,000, 12% Debentures of Rs 100 each allotted to vendors for consideration other than cash as per Board's resolution dated.)	3,00,000	3,00,000
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Illustration 6

Rai Company purchased assets of the book value of Rs. 2,20,000 from another company and agreed to make the payment of purchase consideration by issuing 2,000, 10% debentures of Rs. 100 each at a premium of 10%.

Record necessary journal entries.

Solution:**Books of Rai Company Limited****Journal Entries**

S.No	Particulars	Debit (Rs.)	Credit (Rs.)
1	Sundry Assets A/c Dr. To Vendors (Assets purchased from vendors)	2,20,000	2,20,000
2	Vendors Dr. To 10% Debentures A/c To Securities Premium Reserve A/c (Allotment of 2,000 debentures of Rs. 100 each at a premium of 10% as purchase consideration)	2,20,000	2,00,000 20,000

DEBENTURES ISSUED AS A COLLATERAL SECURITY

A collateral security may be defined as a subsidiary or secondary or additional security besides the primary security when a company obtains a loan or overdraft from a bank or any other financial Institution. It may pledge or mortgage some assets as a secured loan against the said loan. But the lending institutions may insist on additional assets as collateral security so that the amount of loan can be realised in full with the help of collateral security in case the amount from the sale of principal security falls short of the loan money. In such situation, the company may issue its own debentures to the lenders in addition to some other assets already pledged. Such an issue of debentures is known as 'Debentures issued as Collateral Security'.

If the company fails to repay the loan along with interest, the lender is free to receive his money from the sale of primary security and if the realisable value of the primary security falls short to cover the entire amount, the lender has the right to invoke the benefit of collateral security whereby debentures may either be presented for redemption or sold in the open market.

Accounting Treatment

Debentures issued as collateral security can be dealt within two ways in the books of the company:

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 7

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.....

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

Notes to Account

	<i>Particulars</i>	<i>Amount</i>
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:

(i) On issue of debentures as collateral security

Debentures Suspense A/c Dr. (with the nominal value of the debentures issued)
 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 Dr. (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.

DEBENTURE INTEREST

When a company issues debentures, it is under an obligation to pay interest thereon at fixed percentage (half yearly) periodically until debentures are repaid. This percentage is usually as part of the name of debentures like 8% debentures, 10% debentures, etc., and interest payable is calculated at the nominal value of debentures. Interest on debenture is a charge against the profit of the company and must be paid whether the company has earned any profit or not.

According to Income Tax Act, 1961, a company must deduct income tax at a prescribed rate from the interest payable on debentures if it exceeds the prescribed limit. It is called Tax Deducted at Source (TDS) and is to be deposited with the tax authorities. Of course, the debenture holders can adjust this amount against the tax due from them.

Accounting Treatment**(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 Source		(with the amount of Income-tax to be deducted at source)
To Debenture holders' A/c		(with the net amount payable after deduction of income-tax)

(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 Government

Income-tax Payable A/c	Dr.	(with the amount of income-tax deducted at source and
To Bank A/c		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 9

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, 2022 assuming that all moneys were duly paid by the company. Tax deducted at source is 10%.

Solution:

M Ltd.
Journal Entries

Date	Particulars	Debit (Rs.)	Credit (Rs.)
2021 Sep, 30	Debenture Interest A/c Dr. To Income-tax Payable A/c 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%)	25,000	2,500 22,500

Sep,30	Debenture-holders' A/c To Bank A/c (Payment of interest to debenture-holders)	Dr.	22,500	22,500
Sep,30	Income-tax Payable A/c To Bank A/c (Deposit of income-tax deducted at source from Debenture Interest with the Government)	Dr.	2,500	2,500
March, 31	Debenture Interest A/c To Income-tax Payable A/c 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%)	Dr.	25,000	2,500 22,500
2022 March,31	Debenture-holders' A/c To Bank A/c (Payment of interest to debenture-holders)	Dr.	22,500	22,500
March,31	Income-tax Payable A/c To Bank A/c (Deposit of income-tax deducted at source from Debenture Interest with the Government)	Dr.	2,500	2,500
March,31	Profit and Loss A/c To Debenture Interest A/c (Transfer of Debenture Interest to Profit and Loss A/c)	Dr.	50,000	50,000

Interest accrued and due (outstanding interest)	Interest accrued but not due (accrued interest)
<p>Interest on debentures is paid periodically.</p> <p>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:</p>	<p>While preparing final accounts, interest upto closing date must be taken into account, though the same is simply accrued but not payable.</p> <p>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:</p>

Debenture Interest A/c To outstanding debenture interest A/c The liability of outstanding debenture interest will be shown as “other current liability” in Balance sheet	Debenture interest A/c To Accrued debenture interest A/c Accrued debenture interest will be shown as “other current liability” in Balance sheet.
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Terms of Issue of Debentures

When a company issues debentures, it usually mentions the terms on which they will be redeemed on their maturity. Redemption of debentures means discharge of liability on account of debentures by repayment made to the debenture holders. Debentures can be redeemed either at par or at a premium. Depending upon the terms and conditions of issue and redemption of debentures, the following six situations are commonly found in practice.

Issued at par and redeemable at par
Issued at discount and redeemable at par
Issued at a premium and redeemable at par
Issued at par and redeemable at a premium
Issued at a discount and redeemable at a premium
Issued at a premium and redeemable at a premium

In all the above six cases, the following journal entries will be passed:

(i) Issued at par and redeemable at par:

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 value)

(iii) Issued at premium and redeemable at par:

Bank Account	Dr.	(with the amount received)
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 Account	(with the premium on redemption)

(v) Issued at discount, and redeemable at premium

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)
To Premium on Redemption of Debentures Account		(with the premium on redemption)

(vi) Issued at a premium 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 Account		(with the premium on redemption)
To Securities Premium Reserve A/c		(with the premium on issue)

Note:

1. When debentures are redeemable at a premium, the premium payable on redemption is debited to 'Loss on Issue of Debentures A/c'. It may be noted that when debentures are issued at a discount and are redeemable at a premium, the amount of discount on issue is also debited to 'Loss on Issue of Debentures'. It may be noted that when the debentures are issued at a discount and are redeemable at par, the amount debited to 'Discount on Issue of Debentures A/c' as usual.
2. Premium on redemption is a liability of a company payable in future. It is a provision and is shown under the head Non-current liabilities under subhead 'Long-term Borrowings' until debentures are redeemed.

Illustration 10

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

ACCOUNTING 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.

The following are the two methods which are generally adopted for this purpose.

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.

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 11

Bee Ltd. issued 2,000, 12% Debentures of Rs.100 each at a discount of 6% on 01.04.2018 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:

$$= \text{Rs. } 2,00,000 \times 6/100 = \text{Rs. } 12,000$$

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:

$$1.4.2018 = \text{Rs. } 2,00,000$$

$$1.4.2019 = \text{Rs. } (2,00,000 - 50,000) = \text{Rs. } 1,50,000$$

$$1.4.2020 = \text{Rs. } (1,50,000 - 50,000) = \text{Rs. } 1,00,000$$

$$1.4.2021 = \text{Rs. } (1,00,000 - 50,000) = \text{Rs. } 50,000$$

$$\text{Outstanding balance ratio} = 2,00,000 : 1,50,000 : 1,00,000 : 50,000$$

$$= 4 : 3 : 2 : 1$$

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

	Rs.
31.3.2019 = $12,000 \times 4/10 =$	4,800
31.3.2020 = $12,000 \times 3/10 =$	3,600

31.3.2021 = 12,000 × 2/10 =	2,400
31.3.2022 = 12,000 × 1/10 =	1,200
Total	Rs. 12,000

REDEMPTION OF DEBENTURES

Section 71 (1) of the Companies Act, 2013	Section 71 (2) of the Companies Act, 2013	Section 71 (4) of the Companies Act, 2013
<p>Company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption.</p> <p>Provided that the issue of debentures with an option to convert such debentures into shares, wholly or partly, should be approved by a special resolution passed at a duly convened general meeting.</p>	<p>No company can issue any debentures which carry any voting rights.</p>	<p>Where debentures are issued by a company, the company should create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account should not be utilized by the company for any purpose other than the redemption of debentures.</p>

CREATION OF DEBENTURE REDEMPTION RESERVE

Section 71(4) of the Companies Act, 2013, read with Rule 18(7) of the Companies (Share Capital And Debentures) Rules, 2014, requires every company issuing redeemable non-convertible debentures to create a Debenture Redemption Reserve (DRR) account of at least a certain percentage of the total outstanding value of the issued debentures (described below), out of the profits of the company available for the payment of dividend and the amount credited to such account shall only be used for the redemption of debentures. This effort is to protect the debenture holders from the possibility of the company defaulting on repayments, as DRR ensures that enough funds are available to meet the obligations of the debenture holders.

Let us assume that an unlisted company issues ₹10 crore worth of debentures in January 2022 with a maturity date of January 2032. In this case, the company has to create ₹1 crore (representing 10% of the total outstanding of the issued debentures, i.e., ₹10 crore) as DRR before the maturity date.

Adequacy of Debenture Redemption Reserve (DRR)

The Debenture Redemption Reserve shall be created out of the profits of the company available for payment of dividend; the limits with respect to adequacy of DRR and investment or deposits, as the case may be, shall be as under:

Sr. No.	Debentures issued by	Adequacy of Debenture Redemption Reserve (DRR)
1	All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures	No DRR is required

Sr. No.	Debentures issued by	Adequacy of Debenture Redemption Reserve (DRR)
2	Other Financial Institutions (FIs) within the meaning of clause (72) of section 2 of the Companies Act, 2013	DRR will be as applicable to NBFCs registered with RBI (as per (3) below)
3	For listed companies (other than AIFIs and Banking Companies as specified in Sr. No. 1 above):	
a.	All listed NBFCs (registered with RBI under section 45-IA of the RBI Act,) and listed HFCs (Housing Finance Companies registered with National Housing Bank) for both public as well as privately placed debentures	No DRR is required
b.	Other listed companies for both public as well as privately placed debentures	No DRR is required
4	For unlisted companies (other than AIFIs and Banking Companies as specified in Sr. No. 1 above)	
a.	All unlisted NBFCs (registered with RBI under section 45-IA of the RBI (Amendment) Act, 1997) and unlisted HFCs (Housing Finance Companies registered with National Housing Bank) for privately placed debentures	No DRR is required
b.	Other unlisted companies	DRR shall be 10% of the value of the outstanding debentures issued

Investment of Debenture Redemption Reserve (DRR) Amount

As per Rule 18 (7) of the Companies (Share Capital and Debentures) Amendment Rules, 2019, following companies:

- (a) All listed NBFCs
- (b) All listed HFCs
- (c) All other listed companies (other than AIFIs, Banking Companies and Other FIs); and
- (d) All unlisted companies which are not NBFCs and HFCs

shall on or before the 30th day of April in each year, in respect of debentures issued, deposit or invest, as the case may be, a sum which should not be less than 15% of the amount of its debentures maturing during the year ending on the 31st day of March of next year, in any one or more of the following methods, namely:

- (a) in deposits with any scheduled bank, free from charge or lien;
- (b) in unencumbered securities of the Central Government or of any State Government;
- (c) in unencumbered securities mentioned in clauses (a) to (d) and (ee) of Section 20 of the Indian Trusts Act, 1882;
- (d) in unencumbered bonds issued by any other company which is notified under clause (f) of Section 20 of the Indian Trusts Act, 1882.

Important Point:

- The amount deposited or invested, as the case may be, above should not be utilised for any purpose other than for the redemption of debentures maturing during the year referred to above.

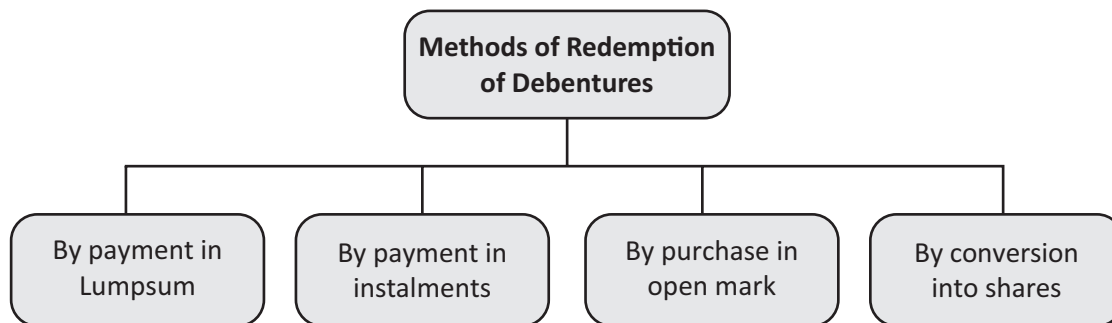
Provided that the amount remaining deposited or invested, as the case may be, shall not at any time fall below 15% of the amount of debentures maturing during the 31st day of March of that year.

- In case of partly convertible debentures, DRR shall be created in respect of non-convertible portion of debenture issue.
- The amount credited to DRR shall not be utilised by the company except for the purpose of redemption of debentures.
- It should be noted that appropriation to DRR can be made any time before redemption and Investments in specified securities as mentioned above can be done before 30th April for the debentures maturing that year, however, for the sake of simplicity and ease, it is advisable to make the appropriation and investment immediately after the debentures are allotted assuming that the company has sufficient amount of profits (issued if allotment date is not given in the question). Also, in some cases, the date of allotment could be missing, in such cases the appropriation and investments should be done on the first day of that year for which ledgers accounts are to be drafted.

Journal Entries				
Date	Particular	L.F.	Amount (Dr.)	Amount (Cr.)
	(a) For setting aside the fixed amount of profit for redemption			
	Profit and Loss A/c Dr.			
	To Debenture Redemption Reserve A/c			
	(b) For investing the amount set aside for redemption			
	Debenture Redemption Reserve Investment A/c Dr.			
	To Bank A/c			
	(c) For receipt of interest on Debenture Redemption Reserve Investments			
	Bank A/c Dr.			
	To Interest on Debenture Redemption Reserve Investment A/c			
	(d) For transfer of interest on Debenture Redemption Reserve Investments (DRRI)			
	Interest on Debenture Redemption Reserve Investment A/c Dr.			
	To Profit and loss A/c*			

At the time of redemption of debentures			
(a) For encashment of Debenture Redemption Reserve Investments			
Bank A/c	Dr.		
To Debenture Redemption Reserve Investment A/c			
(b) For amount due to debenture holders on redemption			
Debentures A/c	Dr.		
To Debenture holders A/c			
(c) For payment to debenture holders			
Debenture holders A/c			
To Bank A/c	Dr.		
After redemption of debentures, DRR should be transferred to general reserve			
DRR A/c	Dr.		
To General Reserve			

* Considering the fact that interest is received each year through cash/bank account and it is not re-invested. In the illustrations given in the chapter, the same has been considered and hence interest on DRR investment is not credited to DRR A/c but taken to P&L A/c.



By payment in lumpsum

Under payment in lumpsum method, at maturity or at the expiry of a specified period of debenture the payment of entire debenture is made in one lot or even before the expiry of the specified period.

By payment in Instalments

Under payment in instalments method, the payment of specified portion of debenture is made in instalments at specified intervals.

Purchase of Debentures in Open Market

Debentures sometimes are purchased in open market. This is not covered in the chapter as it has been specifically excluded from the syllabus at Foundation level.

Question 1

The following balances appeared in the books of a company (unlisted company other than AIFI, Banking company, NBFC and HFC) as on December 31, 2022: 6% Mortgage 10,000 debentures of Rs. 10 each; Debenture Redemption Reserve (for redemption of debentures) Rs. 5,000; Investments in deposits with a scheduled bank, free from any charge or lien Rs. 15,000 at interest 4% p.a. receivable on 31st December every year. Bank balance with the company is Rs. 90,000.

The Interest on debentures had been paid up to December 31, 2022.

On February 28, 2023, the investments were realised at par and the debentures were paid off at 10.1, together with accrued interest.

Write up the concerned ledger accounts (excluding bank transactions).

Solution:**6% Mortgage Debentures Account**

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
Feb. 28, 2023	To Debenture-holders A/c		1,00,000	Jan. 1 2023	By Balance b/d		1,00,000

Debentures Redemption Reserve Investment Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
Jan. 1, 2023	To Balance b/d		15,000	Feb. 28, 2023	By Bank		15,000

Debenture Interest Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
Feb. 28, 2023	To Bank (10,000 x 10 x 6% x 2/12)		1,000	Feb. 28, 2023	By Profit & Loss A/c		1,000

Bank A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
Jan 01, 2023	To Balance b/d		90,000	Feb. 28, 2023	By Debenture-holders (10,000 x 10.1)		1,01,000
Feb 28, 2023	To Interest on Debentures Redemption Investments (15,000 x 4% x 2/12)		1,00		By Debenture Interest A/c		1,000

	To Debentures Redemption Reserve investment A/c		15,000		By Balance c/d		3,100
			1,05,100				1,05,100

Debenture Redemption Reserve Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
Feb 28, 2023	To General Reserve- (note)		10,000	Jan.1, 2023	By Balance b/d		5,000
				Jan.1, 2023	By Profit & Loss (b/f)		5,000
			10,000				10,000

Note: Amount to be transferred to DRR before the redemption = Rs. 10,000 [i.e. 10% of (10,000 X 10)].

Question: 2

The following balances appeared in the books of Apple Ltd (unlisted company other than AIFI, Banking company, NBFC and HFC) as on 1-4-2022:

- (i) 12 % Debentures Rs. 75,000
- (ii) Balance of DRR Rs. 25,000
- (iii) DRR Investment Rs. 11,250 represented by 10% 1,125 Secured Bonds of the Government of India of Rs. 10 each.

Annual contribution to the DRR was made on 31st March every year. On 31-3-2023, balance at bank was Rs. 75,000 before receipt of interest. The investment were realised at par for redemption of debentures at a premium of 10% on the above date.

You are required to prepare the following accounts for the year ended 31st March, 2023:

- (1) Debentures Account
- (2) DRR Account
- (3) DRR Investment Account
- (4) Bank Account
- (5) Debenture Holders Account.

Solution:

12% Debentures Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
Mar 31 2023	To Debenture-holders A/c		75,000	April 1 2022	By Balance b/d		75,000

10% Secured Bonds of Govt. (DRR Investment) A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
Apr. 1, 2022	To Balance b/d		11250	Mar. 31, 2023	By Bank		11250

Bank A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
Apr 01, 2022	To Balance b/d		75,000	Mar 31, 2023	By Debenture-holders		82500
Mar 31, 2023	To Interest on Debentures Redemption Investments (11250 x 10%)		1125		By Debenture Interest A/c		
	To Debentures Redemption Reserve investment A/c		11250		By Balance c/d		4875
			87375				87375

Debenture Redemption Reserve Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
Mar 31, 2023	To General Reserve-(note)		7500	Apr.1, 2022	By Balance b/d		2,500
				Apr 1, 2022	By Profit & Loss (b/f)		5,000
			7500				7,500

Note: Calculation of DRR before redemption = 10% of Rs. 75,000 = 7500

Available balance = 2500

DRR required = 7500 - 2500 = 5000.

Debenture Holder Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
Mar 31, 2023	To Bank A/c		82500	Apr.1, 2022	By 12% Debenture		75000
				Apr 1, 2022	By Premium on redemption of debentures (75000 X 10%)		7500
			82500				82500

Question: 3

ABC Ltd. has issued 1,0000, 12% convertible debentures Rs. 100 each redeemable after a period of five years at a premium of 5%. The debenture holders also had the option at the time of redemption to convert 30% of their holdings into equity shares of Rs. 10 each at a price of Rs. 20 per share and balance in cash. Debenture holders amounting Rs. 2,00,000 opted to get their debentures converted into equity shares as per terms of the issue. You are required to calculate the number of shares issued and cash paid for redemption of Rs. 20,000 debenture holders.

Solution:

Particulars	No. of Debentures
Debenture holders opted for conversion (200000 /100)	2000
Option for conversion	30%
Number of debentures to be converted (30% of 2000)	600
Redemption value of 600 debentures at a premium of 5% [600 x (100+5)]	63000
Equity shares of Rs. 10 each issued on conversion[Rs. 63000/ Rs. 20]	3150 shares

Calculation of cash to be paid:

Number of debentures	2000
Less: number of debentures to be converted into equity shares	(600)
	<u>1400</u>

Redemption value of 1400 debentures (1400 x Rs. 105) i.e. Rs. 147000.

Question 4

The Balance Sheet of Shyam Co. Ltd. (unlisted company other than AIFI, Banking company, NBFC and HFC) as at 31st March, 2023 shown **Long term borrowings with respect to** 12% Debentures of Rs. 100000

At the Annual General Meeting, it was resolved that to repay the debentures at a premium of 5%. Give the necessary journal entries for these transactions.

Journal Entries			
Particular	L.F.	Amount (Dr.)	Amount (Cr.)
Profit and Loss A/c To Debenture Redemption Reserve (for DRR created 10% x 100000)	Dr.	10000	10000
Debenture Redemption Reserve Investment A/c To Bank A/c (for DRR Investment created 15% x 100000)	Dr.	15000	15000

12% Debentures A/c Premium Payable on Redemption A/c @ 5% To Debenture holders A/c (Amount payable to debentures holders)	Dr. Dr.		100000 5000	105000
Profit and loss A/c To Premium Payable on Redemption A/c (Premium payable on redemption of debentures charged to Profit & Loss A/c)	Dr.		5000	5000
Debenture Redemption Reserve A/c To General Reserve (for DRR transferred to general reserve)	Dr.		10000	10000
Bank A/c To Debenture Redemption Reserve Investment (for DRR Investment realised)	Dr.		15000	15000
Debenture holders A/c To Bank A/c (Amount paid to debenture holders on redemption)	Dr.		105000	105000

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

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.

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 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 “Cum- interest” 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 12**(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 01-04-2022, the company purchased 500 debentures at Rs. 95 each cum – interest for immediate cancellation. On 01-10-2022, 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.)
2022 April 1	10% Debentures A/c	Dr	50,000	
	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)			
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 31	Debenture Interest A/c	Dr	19,500	
	To Bank A/c			19,500
	(Payment of interest on Rs 3,90,000 debentures for six months)			
December 31	Profit & Loss A/c	Dr	44,750	
	To Debenture interest A/c			44,750
	(Transfer of debenture interest to P&L A/c)			

December 31	Profit on cancellation of Debentures A/c To Capital Reserve A/c (Profit on cancellation transferred to Capital Reserve)	Dr	9750	9750
December 31	Surplus A/c To Debenture Redemption Reserve A/c (Transfer to DRR)	Dr	1,10,000	1,10,000

Illustration 13**(Purchase of Own Debentures as investment)**

Sugandha Ltd. issued 10,000 12% Debentures of Rs. 100 each on 1st April, 2021. Interest is payable on 30th September and 31st March every year. On 1st July, 2022, the company purchased 1,000 of its Own Debentures at Rs. 96 ex-interest as investments. On 1st January, 2023, the company purchased 2000 of its Own Debentures at Rs. 96 cum interest as investment. On 31st March 2023, 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.)
2021 April 1	Bank A/c To 12% Debentures A/c (Being issued 10,000, 12% debentures of Rs 100 each)	Dr	10,00,000	10,00,000
September 30	Debenture Interest A/c To Bank A/c (Being paid interest on debentures for six months)	Dr	60,000	60,000
2022 March 31	Debenture Interest A/c To Bank A/c (Being interest paid on debentures for six months)	Dr	60,000	60,000
March 31	Profit & Loss A/c To Debenture interest A/c	Dr	1,20,000	1,20,000
July 1	Own Debentures A/c Debenture Interest A/c To Bank A/c (Being purchase of 1000 debentures at Rs 96 ex interest)	Dr Dr	96,000 3,000	99,000

September 30	Debenture interest A/c Dr 57,000 To Bank A/c 54,000 To Interest on Own Debentures A/c 3,000 (Being interest on 9000 debentures for 6 months and own debentures for 3 months)		
2023 January 1	Own Debentures A/c Dr 1,86,000 Debenture Interest A/c Dr 6,000 To Bank A/c 1,92,000 (Being 2000 own debentures purchased at Rs 96 cum interest)		
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 and own debentures for 3 months)		
	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.

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.

TEST YOURSELF

- Kakloo Ltd issues Rs 1000, 15%, 5,000 debentures on which amount payable is Rs 200 on application, Rs 300 on allotment and balance on first call. In addition the company offers 1,000 – 12% second mortgage debentures of Rs 1000 each. In case of 15% debentures, the company received applications for 6200 debentures and the directors made pro-rata allotment and excess money was refunded. Journalise.
- Rajkumar Ltd, purchased a building from Alok Ltd. for Rs 65,00,000. The payment was made as to 25% by accepting a bill of exchange, and for the balance debentures are allotted at 25% premium. Journalise in the books of purchaser.
- 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%.
- A company issued 15,000 10% Debentures of Rs 100 each on 1 April, 2018 at a discount of 6% redeemable at par by drawings method as follows :

<i>Date of redemption</i>	<i>Amt of Redemption (FV)</i>
31 March 2020	5,00,000
31 March 2021	5,00,000
31 March, 2022	5,00,000

- On 30th June 2022 following balances stood in the books of a company :

	<i>Rs.</i>
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 Rs 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 debentures, the company started buying Own Debentures and made the following purchases in the open market :

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 December in the case of both the companies.

On 31st December 2019 the debentures in XX Ltd. were sold for Rs. 95 each ex-interest. On that date, the outstanding debentures of MM Ltd. were redeemed by payment and by cancellation. Show the entries in the following ledger accounts of MM Ltd. during 2019 :

- (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, 2018 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 2018-19 the company wrote off 20% of Debenture Discount Account.

During 2021-22, 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.

9. Give Journal entries for the following:

- i. Issue of Rs. 1,00,000, 9% debentures of Rs. 100 each at par and redeemable at par.
- ii. Issue of Rs. 1,00,000, 9% debentures of Rs. 100 each at premium of 5% but redeemable at par.
- iii. Issue of Rs. 1,00,000, 9% debentures of Rs. 100 each at discount of 5% repayable at par.
- iv. Issue of Rs. 1,00,000, 9% debentures of Rs. 100 each at par but repayable at a premium of 5%.

- v. Issue of Rs. 1,00,000, 9% debentures of Rs. 100 each at discount of 5% but redeemable at premium of 5%.
- vi. Issue of Rs. 1,00,000, 9% debentures of Rs. 100 each at premium of 5% and redeemable at premium of 5%.
10. You are required to pass the journal entries relating to the issue of the debentures in the books of X Ltd., under the following cases:
- (a) 120, 8% debentures of Rs. 1,000 each are issued at 5% discount and repayable at par. Balance in Securities Premium Reserve is Rs. 10,000.
 - (b) 150, 7% debentures of Rs. 1,000 each are issued at 5% discount and repayable at premium of 10%. Balance in Securities Premium Reserve is Rs. 20,000.
 - (c) 80, 9% debentures of Rs. 1,000 each are issued at 5% premium.
 - (d) Another 400, 8% debentures of Rs. 100 each are issued as collateral security against a loan of Rs. 40,000
11. JK Ltd., a listed company, issued 6,000, 12% Debentures of 50 each at a premium of 5% on April 1, 2016. Interest on these debentures is payable annually on 31st March each year. The debentures are redeemable at par in four equal installments at the end of third, fourth, fifth and sixth year at a premium of 10%. The company invested in specified securities as investment for the redemption of debentures.
- You are required to pass journal entries at the time of issue and redemption of debentures in the books of the company.

LIST OF FURTHER READINGS

- **Advanced Accounts**
Author: M.C. Shukla, T.S. Grewal & S.C. Gupta
Publisher: S. Chand & Company Ltd.
- **Corporate Accounting**
Author: Dr. S. N. Maheshwari & Dr. Suneel K Maheshwari
Publisher: Vikas Publishing House
- **Fundamentals of Corporate Accounting**
Author: Bhushan Kumar Goyal
Publisher: Taxmann
- **Treatise of Ind AS**
Author: CA. (Dr.) Alok K. Garg
Publisher: Bloomsbury