

Unit 6: REDEMPTION OF DEBENTURES

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"When you stop chasing wrong things, you give right things a chance to catch you..."

MEANING OF DEBENTURE

A debenture is an instrument issued by a company under its seal, acknowledging a debt and containing provisions as regards repayment of the principal and interest.

LEGAL PROVISIONS

- Under Section 71 (1) of the Companies Act, 2013, a company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption.
- 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.
- Section 71 (2) further provides that no company can issue any debentures which carry any voting rights.
- If a charge has been created on any asset or the entire assets of the company, the nature of the charge & the asset(s) charged are described therein.
- Debentures are usually redeemable i.e. either redeemed in cash or convertible after a time period. Redeemable debentures may be redeemed:
 - after a fixed number of years; or
 - any time after a certain number of years has elapsed since their issue; or
 - on giving a specified notice; or
 - by annual drawing.

DEBENTURE REDEMPTION RESERVE (DRR)

A company issuing debentures may be required to create a debenture redemption reserve account out of the profits available for distribution of dividend and amounts credited to such account cannot be utilised by the company except for redemption of debentures.

Such an arrangement would ensure that the company will have sufficient liquid funds for the redemption of debentures at the time they fall due for payment.

In case of partly convertible debentures, DRR shall be created in respect of nonconvertible portion of debenture issue.

ADEQUACY OF DEBENTURE REDEMPTION RESERVE (DRR)

As per Rule 18 (7) of the Companies (Share Capital and Debentures) Amendment Rules, 2019, the company shall comply with the requirements with regard to Debenture Redemption Reserve (DRR) and investment or deposit of sum in respect of debentures maturing during the year ending on the 31st day of March of next year, in accordance with the conditions given below—

- 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:

S.No.	Debentures Issued by	Adequacy of 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
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 u/s 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

Further, as per Rule 18 (7) of the Companies (Share Capital and Debentures) Amendment Rules, 2019, following companies are required to make DRR Investment

- All listed NBFCs
- All listed HFCs
- All other listed companies (other than AIFIs, Banking Companies and Other FIs); and
- 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.

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.

ASSIGNMENT QUESTIONS

Question 1 (ICAI Study Material) _____ Pg no. _____

The following balances appeared in the books of Paradise Ltd (unlisted company other than AIFI, Banking company, NBFC and HFC) on 1-4-2021:

- (a) 12 % Debentures ₹ 7,50,000
- (b) Balance of DRR ₹ 25,000
- (c) DRR Investment 1,12,500 represented by 10% 1,125 secured bonds of government of India of ₹ 100 each.

Annual contribution to the DRR was made on 31st March each year. On 31-3-2022, balance at bank was ₹ 7,50,000 before receipt of interest. The investments were realized 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, 2022:

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

Question 2 (ICAI Study Material) _____ Pg no. _____

The following balances appeared in the books of a company (unlisted company other than AIFI, Banking company, NBFC and HFC) as on December 31, 2021:

6% Mortgage 10,000 debentures of ₹ 100 each; Debenture Redemption Reserve (for redemption of debentures) ₹ 50,000; Investments in deposits with scheduled bank free from any charge or lien ₹ 1,50,000, at interest 4% p.a. receivable on 31st December every year.

Bank Balance with company is ₹ 9,00,000. The Interest on debentures had been paid up to December 31, 2021. On February 28, 2022, the investments were realized at par and the debentures were paid off at 101, together with accrued interest. Write up the ledger accounts concerned.

Question 3 (ICAI Study Material) / (RTP Nov 2019 & 2021) (Similar) _____ Pg no. _____

Libra Limited (a listed company) recently made a public issue in respect of which the following information is available:

- (a) No. of partly convertible debentures issued 2,00,000; face value and issue price ₹ 100 per debenture.
- (b) Convertible portion per debenture 60%, date of conversion on expiry of 6 months from the date of closing of issue.
- (c) Date of closure of subscription lists 1.5.2021, date of allotment 1.6.2021, rate of interest on debenture 15% payable from the date of allotment, value of equity share for the purpose of conversion ₹ 60 (Face Value ₹ 10).
- (d) No. of debentures applied for 2,00,000.
- (e) Interest payable on debentures half-yearly on 30th September and 31st March.

Write relevant journal entries for all transactions arising out of the above during the year ended 31st March, 2022 (including cash and bank entries).

Question 4 (ICAI Study Material) _____ Pg no. _____

A company had issued 20,000, 13% debentures of ₹ 100 each on 1st April, 2021. The debentures are due for redemption on 1st July, 2022. The terms of issue of debentures provided that they were redeemable at a premium of 5% and also conferred option to the debentureholders to

convert 20% of their holding into equity shares (Nominal value ₹ 10) at a price of ₹ 15 per share. Debentureholders holding 2,500 debentures did not exercise the option.

Calculate no. of equity shares to be allotted to Debentureholders exercising the option to the maximum.

Question 5

Pg no. _____

The summarised Balance Sheet of Convertible Limited (unlisted company other than AIFI, Banking company, NBFC and HFC) as on 30th June, 2021, stood as follows:

Liabilities	₹
Share Capital: 5,00,000 equity shares of ₹ 10 each fully paid	50,00,000
General Reserve	90,00,000
Profit & Loss A/c	10,00,000
Debenture Redemption Reserve	10,00,000
13.5% Convertible Debentures, 1,00,000 Debentures of ₹ 100 each	1,00,00,000
Other loans	65,00,000
Current Liabilities and Provisions	1,25,00,000
	4,50,00,000
Assets:	
Fixed Assets (at cost less depreciation)	1,60,00,000
Debenture Redemption Reserve Investments	15,00,000
Cash and bank Balances	75,00,000
Other Current Assets	2,00,00,000
	4,50,00,000

The debentures are due for redemption on 1st July, 2021. The terms of issue of debentures provided that they were redeemable at a premium 5% and also conferred option to the debenture holders to convert 20% of their holding into equity shares at a predetermined price of ₹ 15.75 per share and the payment in cash. Assuming that:

- except for 100 debenture holders holding totally 25,000 debentures, the rest of them exercised the option for maximum conversion.
- the investments realize at par on sale; and
- all the transactions are put through, without any lag, on 1st July, 2021.

Pass necessary journal entries.

Question 6 *(ICAI Study Material) / (RTP Nov 2020 & 2022) (Similar)*

Pg no. _____

XYZ Ltd. has issued 1,000, 12% convertible debentures of ₹ 100 each redeemable after a period of five years. According to the terms & conditions of the issue, these debentures were redeemable at a premium of 5%. The debenture holders also had the option at the time of redemption to convert 20% of their holdings into equity shares of ₹ 10 each at a price of ₹ 20 per share and balance in cash. Debenture holders amounting ₹ 20,000 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 ₹ 20,000 debenture holders.

Question 7 *(ICAI Study Material)*

Pg no. _____

Case Ltd. (unlisted company other than AIFI, Banking company, NBFC and HFC) provides the following information as at 31st March, 2022:

	Particulars	₹
	Equity & Liabilities	
(1)	Shareholder's Funds	
	(a) Share Capital	

	Authorized share capital:	
	45,000 equity shares of ₹ 10 each fully paid	4,50,000
	Issued and subscribed share capital:	
	30,000 equity shares of ₹ 10 each fully paid	3,00,000
	(b) Reserves and Surplus	
	Profit & Loss Account	1,62,000
	Debenture Redemption Reserve	18,000
(2)	Non-current liabilities	
	(a) Long term borrowings	
	12% Debentures	1,80,000
(3)	Current Liabilities	
	(a) Trade payables	1,72,500
	Total	8,32,500
	<u>Assets</u>	
(1)	Non-current assets	
	(a) Property, Plant and Equipment (Freehold property)	1,72,500
	(b) Non-current Investment: DRR Investment	27,000
(2)	Current assets	
	(a) Inventories	2,02,500
	(b) Trade receivables	1,12,500
	(c) Cash and bank balances:	
	Cash at bank	2,73,000
	Cash in hand	45,000
	Total	8,32,500

At the Annual General Meeting on 1.4.2022, it was resolved:

- a) To give existing shareholders the option to purchase one ₹ 10 share at ₹ 15 for every four shares (held prior to bonus distribution). This option was taken up by all the shareholders.
- b) To issue one bonus share for every five shares held.
- c) To repay the debentures at a premium of 3%.

Give the necessary journal entries for these transactions.

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

- 1) Which of the following statements is true?
 - (a) A debenture holder is an owner of the company.
 - (b) A debenture holder can get his money back only on the liquidation of the company.
 - (c) A debenture issued at a discount can be redeemed at a premium.

- 2) Which of the following statements is false?
 - (a) Debentures can be redeemed by payment in lump sum at the end of a specified period.
 - (b) Debentures cannot be redeemed during the life time of the company.
 - (c) Debentures can be redeemed by payments in annual instalments.

- 3) For debentures issued by unlisted companies (other than AIFs, Banking companies, NBFCs and HFCs), Debentures Redemption reserve will be considered adequate if it is:
 - (a) 25% of the value of debentures issued through public issue.
 - (b) 10% of the value of debentures issued through public issue.
 - (c) 5% of the value of debentures issued through public issue.

- 4) A company has issued 6% debentures for ₹ 10,00,000, interest being payable on 31st March and 30th September. The company redeems ₹ 10,000 debentures at ₹ 96 (ex-interest) on 1st August 2021. The amount of Profit/loss on cancellation of debentures will be
 - (a) Profit of ₹ 600
 - (b) Profit of ₹ 400
 - (c) Loss of ₹ 400

ANSWERS MCQs

1. (c) 2. (b) 3. (b) 4. (b)

TRUE / FALSE

State with reasons whether the following statement is true or false:

- a) Amounts credited to the debenture redemption reserve may be utilised by the company for any purpose.
- b) All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures need not create any Debenture Redemption Reserve (DRR).
- c) Under payment in instalments method, the payment of entire debenture is made in one lot.
- d) At redemption of debentures, DRR should be transferred to general reserve.

Solution

- a) False: Amounts credited to the debenture redemption reserve should not be utilised by the company for any purpose except for the purpose other than for redemption of debentures.
- b) True: All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures need not create any DRR.
- c) False: Under payment in instalments method, the payment of specified portion of debentures are made in instalments at specified intervals.
- d) True: DRR is transferred to general reserve at the time of redemption of debentures.

HOMEWORK QUESTIONS

Question 1 (RTP May 2020) / (RTP May 2021) / (RTP Nov 2023) (Similar) _____ Pg no. _____

The following balances appeared in the books of Lakshya Ltd. as on 1-4-2021:

- a) 10 % Debentures ₹ 37,50,000
- b) Balance of DRR ₹ 1,25,000
- c) DRR Investment 5,62,500 represented by 10% ₹ 5,625 Secured Bonds of the Government of India of ₹ 100 each.

Annual contribution to the DRR was made on 31st March every year. On 31-3-2022, balance at bank was ₹ 37,50,000 before receipt of interest. Interest on Debentures had already been paid. The investment were realized at par for redemption of debentures at a premium of 10% on the above date.

Lakshya Ltd. is an unlisted company (other than AIFI, Banking company, NBFC and HFC). You are required to prepare Debenture Redemption Reserve Account, Debenture Redemption Reserve Investment Account and Bank Account in the books of Lakshya Ltd. for the year ended 31st March, 2022.

Question 2 _____ Pg no. _____

The following balances appeared in the books of a company (unlisted company other than AIFI, Banking company, NBFC and HFC) as on December 31st, 2021, 6% Mortgage 25,000 Debentures of ₹ 100 each. Debenture Redemption Reserve (for redemption of debentures) ₹ 1,50,000.

DRR Investments ₹ 3,75,000 at 4% interest receivable on 31st December every year.

Bank Balance with the company ₹ 30,00,000.

The interest on debentures had been paid up to December 31st, 2021. On February 28th, 2022, the investments were sold at par and the debentures were paid off at ₹ 101 together with accrued interest. Write up the ledger accounts concerned.

Question 3 (CA Inter Jan 2021) (8 Marks) _____ Pg no. _____

During the year 2021-2022, A Limited (a listed company) made a public issue in respect of which the following information is available:

- (i) No. of partly convertible debentures issued-1,00,000; face value and issue price ₹ 100 per debenture. (Whole issue was underwritten by X Ltd.)
- (ii) Convertible portion per debenture -60%, date of conversion -on expiry of 6 months from the date of closing of issue.
- (iii) Date of closure of subscription lists -1st May,2021, date of allotment - 1st June, 2021, rate of interest on debenture -15% p.a. payable from the date of allotment, value of equity share for the purpose of conversion - ₹ 60 (face value ₹ 10)
- (iv) Underwriting Commission -2%
- (v) No. of debentures applied for by public -80,000
- (vi) Interest is payable on debentures half yearly on 30th September and 31st March each year.

Pass relevant journal entries for all transactions arising out of the above during the year ended 31st March, 2022. (including cash and bank entries)

Question 4 (CA Inter July 2021) (10 Marks) _____ Pg no. _____

AB Limited (a listed company) recently made a public issue in respect of which the following information is available:

- (i) No. of partly convertible 8% debentures issued 3,00,000; face value and issue price ₹ 100 per debenture.

- (ii) Convertible portion per debenture- 60%, date of conversion- on expiry of 7 months from the date of closing of issue.
- (iii) Date of closure of subscription lists 1-5-2020, date of allotment 1-6-2020, rate of interest on debenture 8% payable from the date of allotment, market value of equity share as on date of conversion ₹ 60 (Face Value ₹ 10).
- (iv) Underwriting Commission 1%
- (v) No. of debentures applied for 2,50,000.
- (vi) Interest payable on debentures half-yearly on 30th September and 31st March.
- Write relevant journal entries for all transactions arising out of the above during the year ended 31st March, 2021 (including cash and bank entries).

Question 5 (CA Inter Dec 2021) (5 Marks) Pg no. _____

A Company had issued 25,000, 12% Debentures of ₹ 100 each on 1st April, 2018. The Debentures were due for redemption on 1st July, 2020. The terms of issue of Debentures provided that they will be redeemable at a premium of 5% and also conferred option to convert 20% of their holding into equity Shares (Nominal value ₹ 10 each) at a price of ₹ 20 per share. Debenture holders holding 5,000 Debentures did not exercise the option. Calculate the number of Equity shares to be allotted to the debenture holders exercising the option to the maximum.

Question 6 (CA Inter Nov 2019) (5 Marks) Pg no. _____

A company had issued 40,000, 12% debentures of ₹100 each on 1st April, 2018. The debentures are due for redemption on 1st March, 2022. The terms of issue of debentures provided that they were redeemable at a premium of 5% and also conferred option to the debenture holders to convert 20% of their holding into equity shares (nominal value ₹10) at a predetermined price of ₹15 per share and the payment in cash. 50 debentures holders holding totally 5,000 debentures did not exercise the option. Calculate the number of equity shares to be allotted to the debenture holders and the amount to be paid in cash on redemption.

Question 7 (ICAI Study Material) / (RTP May 2022) (Similar) Pg no. _____

The Balance Sheet of BEE Co. Ltd. (unlisted company other than AIFI, Banking company, NBFC and HFC) as at 31st March, 2023 is as under:

	Particulars	Note No	₹
I.	Equity and liabilities		
(1)	Shareholder's Funds		
(a)	Share Capital	1	2,00,000
(b)	Reserves and Surplus	2	1,20,000
(2)	Non-current liabilities		
(a)	Long term borrowings	3	1,20,000
(3)	Current Liabilities		
(a)	Trade payables		1,15,000
	Total		5,55,000
II.	Assets		
(1)	Non-current assets		
(a)	Property, Plant and Equipment	4	1,15,000
(2)	Current assets		
(a)	Inventories		1,35,000
(b)	Trade receivables		75,000
(c)	Cash and bank balances	5	2,30,000
	Total		5,55,000

Notes to Accounts

	Particulars		₹
1.	Share Capital		
	Authorised share capital:		3,00,000
	30,000 shares of ₹ 10 each fully paid		
	Issued and subscribed share capital		
	20,000 shares of ₹ 10 each fully paid		2,00,000
2.	Reserve and Surplus		
	Profit & Loss Account		1,20,000
3.	Long term borrowings		
	12% Debentures		1,20,000
4.	Property, Plant and Equipment		
	Freehold property		1,15,000
5.	Cash and bank balances		
	Cash at bank	2,00,000	
	Cash in hand	30,000	2,30,000

At the Annual General Meeting, it was resolved:

- To give existing shareholders the option to purchase one ₹ 10 share at ₹ 15 for every four shares (held prior to bonus distribution). This option was taken up by all the shareholders.
- To issue one bonus share for every five shares held.
- To repay the debentures at a premium of 3%.

Give the necessary journal entries for these transactions.

Question 8

Pg no. _____

Mention the ways by which Redeemable Debentures may be redeemed under the Companies Act, 2013.

Question 9 *(CA Inter May 2023) (5 Marks)*

Pg no. _____

On 1st April, 2018 Improvis Limited issued ₹ 75,000, 9% Debentures of ₹ 100 each at a premium of 5%. The Debentures are redeemable at 10% premium on 31.03.2023, Investment as required by law was made in Fixed Deposit of Bank on 30.04.2022 earning interest @8% p.a.

You are required to pass Journal Entries for the year 2022-2023 related to Investment and Redemption of the Debentures.