12128CH02

Issue and Redemption of Debentures

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Learning Objectives

After studying this chapter you will be able to :

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

A company raises its capital by means of issue of shares. But the funds raised by the issue of shares are seldom adequate to meet their long term financial needs of a company. Hence, most companies turn to raising long-term funds also through debentures which are issued either through the route of private placement or by offering the same to the public. The finances raised through debentures are also known as long-term debt. This chapter deals with the accounting treatment of issue and redemption of debentures and other related aspects.

SECTION I

2.1 Meaning of Debentures

Debenture: 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. 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.

Bond: Bond is also an instrument of acknowledgement of debt. Traditionally, the Government issued bonds, but these days, bonds are also being issued by semi-government and non-governmental organisations. The terms ‘debentures’ and ‘Bonds’ are now being used inter-changeably.

2.2 Distinction between Shares and Debentures

Ownership: A ‘share’ represents ownership of the company whereas a debenture is only acknowledgement of Debt. A share is a part of the owned capital whereas a debenture is a part of borrowed capital.

Return: The return on shares is known as dividend while the return on debentures is called interest. The rate of return on shares may vary from year to year depending upon the profits of the company but the rate of interest on debentures is prefixed. The payment of dividend is an appropriation of profits, whereas the payment of interest is a charge on profits and is to be paid even if there is no profit.

Repayment: Normally, the amount of shares is not returned during the life of the company, whereas, generally, the debentures are issued for a specified period and repayable on the expiry of that period. However, in the year 1998, the amendements (Section 77A and 77 B sub Section 2) in the Companies Act, permitted companies to buy back its shares specially when market value of shares are less than its book value.

Voting Rights: Shareholders enjoy voting rights whereas debentureholders do not normally enjoy any voting right.

Security : Shares are not secured by any charge whereas the debentures are generally secured and carry a fixed or floating charge over the assets of the company.

Convertibility: Shares cannot be converted into debentures whereas debentures can be converted into shares if the terms of issue so provide, and in that case these are known as convertible debentures.

2.3 Types of Debentures

A company may issue different kinds of debentures which can be classified as under:

2.3.1 From the Point of view of Security

(a) *Secured Debentures*: Secured debentures refer to those debentures where a charge is created on the assets of the company for the purpose of payment in case of default. The charge may be fixed or floating. A fixed charge is created on a specific asset whereas a floating charge is on the general assets of the company. The fixed charge is created against those assets which are held by a company for use in operations not meant for sale whereas floating charge involves all assets excluding those assigned to the secured creditors.

(b) *Unsecured Debentures*: Unsecured debentures do not have a specific charge on the assets of the company. However, a floating charge may be created on these debentures by default. Normally, these kinds of debentures are not issued.

2.3.2 From the Point of view of Tenure

(a) *Redeemable Debentures:* Redeemable debentures are those which are payable on the expiry of the specific period either in lump sum or in Instalments during the life time of the company. Debentures can be redeemed either at par or at premium.

(b) *Irredeemable Debentures:* Irredeemable debentures are also known as *Perpetual Debentures* because the company does not give any undertaking for the repayment of money borrowed by issuing such debentures. These debentures are repayable on the winding-up of a company or on the expiry of a long period.

2.3.3 From the Point of view of Convertibility

(a) *Convertible Debentures:* Debentures which are convertible into equity shares or in any other security either at the option of the company or the debentureholders are called convertible debentures. These debentures are either fully convertible or partly convertible.

(b) *Non-Convertible Debentures:* The debentures which cannot be converted into shares or in any other securities are called non-convertible debentures. Most debentures issued by companies fall in this category.

2.3.4 From Coupon Rate Point of view

(a) *Specific Coupon Rate Debentures*: These debentures are issued with a specified rate of interest, which is called the coupon rate. The specified rate may either be fixed or floating. The floating interest rate is usually tagged with the bank rate.

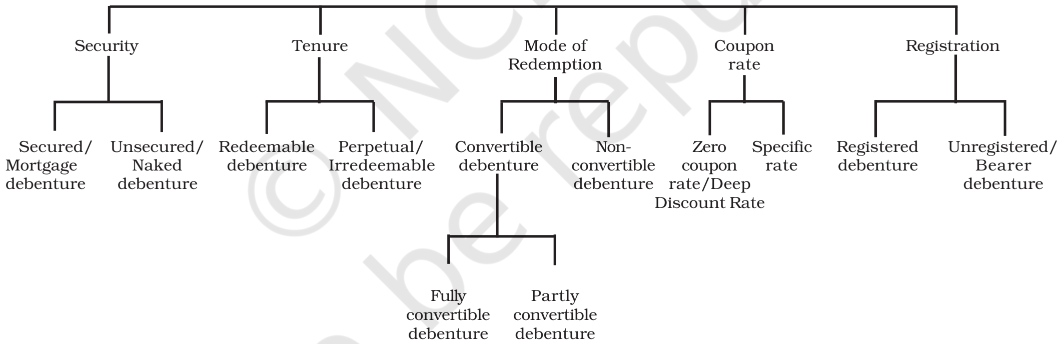
(b) *Zero Coupon Rate Debentures*: These debentures do not carry a specific rate of interest. In order to compensate the investors, such debentures are issued at substantial discount and the difference between the nominal value and the issue price is treated as the amount of interest related to the duration of the debentures.

2.3.5 From the view Point of Registration

(a) *Registered Debentures*: Registered debentures are those debentures in respect of which all details including names, addresses and particulars of holding of the debentureholders are entered in a register kept by the company. Such debentures can be transferred only by executing a regular transfer deed.

(b) *Bearer Debentures*: Bearer debentures are the debentures which can be transferred by way of delivery and the company does not keep any record of the debentureholdeRs Interest on debentures is paid to a person who produces the interest coupon attached to such debentures.

Types of Debenture/Bond



2.4 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.

2.4.1 Issue of Debentures for Cash

Debentures are said to be issued at par when their issue price is equal to the face value. The journal entries recorded for such issue are as under:

(a) *If whole amount is received in one instalment:*

(i) On receipt of the application money
Bank A/c Dr.
To Debenture Application & Allotment A/c

(ii) On Allotment of debentures
Debenture Application & Allotment A/c Dr.
To Debentures A/c

(b) *If debenture amount is received in two instalments:*

(i) On receipt of application money
Bank A/c Dr.
To Debenture Application A/c

(ii) For adjustment of applications money on allotment
Debenture Application A/c Dr.
To Debentures A/c

(iii) For allotment money due
Debenture Allotment A/c Dr.
To Debentures A/c

(iv) On receipt of allotment money
Bank A/c Dr.
To Debenture Allotment A/c

(c) *If debenture money is received in more than two instalments*
Additional entries:

(i) On making the first call
Debenture First Call A/c Dr.
To Debentures A/c

(ii) On the receipt of the first call
Bank A/c Dr.
To Debenture First Call A/c

Note: Similar entries may be made for the second call and final call. However, normally the whole amount is collected on application or in two instalments, i.e., on application and allotment.

Illustration 1

ABC Lmited issued Rs 10,000, 12% debentures of Rs 100 each payable Rs 30 on application and remaining amount on allotment. The public applied for 9,000 debentures which were fully allotted, and all the relevant allotment money was duly received. Give journal entries in the books of ABC Ltd., and exhibit the relevent information in the balance sheet.

Solution:

Books of ABC Limited
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Bank A/c Dr. To 12% Debenture Application A/c (Application money on 9,000 debentures received)		2,70,000	2,70,000
	12% Debenture Application A/c Dr. To 12% Debentures A/c (Application money transferred to debentures Account on allotment)		2,70,000	2,70,000
	12% Debenture Allotment A/c Dr. To 12% Debentures A/c (Amount due on 9,000 debentures on allotment @ Rs 70 per debenture)		6,30,000	6,30,000
	Bank A/c Dr. To 12% Debenture Allotment A/c (Amount received on allotment)		6,30,000	6,30,000

ABC Limited
***Balance Sheet as at ....**

Particulars	*Note No.*	*Amount (Rs)*
I. Equity and Liabilities		
Non-current liabilities	1	**9,00,000**
Long-term borrowings		
II. Assets		
Current assets		
Cash and cash equivalents	2	**9,00,000**

* Relevant data only

Notes to Accounts

Particulars	*Amount (Rs)*
1. Long-term borrowings	
9,000, 12% Debentures of Rs 100 each	**9,00,000**
2. Cash and cash equivalents	
Cash at bank	**9,00,000**

2.4.2 Issue of Debentures at a Discount

When a debenture is issued at a price below its nominal value, it is said to be issued at a discount. For example, the issue of Rs. 100 debentures at Rs. 95, Rs. 5 being the amount of discount. Discount on issue of debentures is a capital loss and is shown under the line item 'Other Non-Current Assets' or 'Other Current Assets' depending upon the time period in which it is to be written off. The discount on issue of debentures can be written off either by debiting it to Statement of Profit and Loss or out of Securities Premium Reserve A/c, if any, during the life time of debentures.

Discount on issue of debentures to be written off within 12 months of the balance sheet date or the period of operating cycle is shown under 'Other Current Assets' and the part which is to be written off after 12 months of balance sheet is shown under 'Other Non-Current Assets'.

The Companies Act, 2013 does not impose any restrictions upon the issue of debentures at a discount.

Illustration 2

TV Components Ltd., issued 10,000, 12% debentures of Rs 100 each at a discount of 5% payable as follows:

On application Rs 40
On allotment Rs 55

Show the journal entries including those for cash, assuming that all the instalments were duly collected. Also show the relevant portion of the balance sheet.

Solution:

Books of TV Components Ltd.
Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Bank A/c	Dr.		4,00,000	
	To 12% Debenture Application A/c				4,00,000
	(Receipt of application money @ Rs 30 per debenture)				
	12% Debenture Application A/c	Dr.		4,00,000	
	To 12% Debenture A/c				4,00,000
	(Transfer of application money to debenture account)				
	12% Debenture Allotment A/c	Dr.		5,50,000	
	Discount on Issue of Debentures A/c			50,000	
	To 12% Debenture A/c				6,00,000
	(Allotment money due on debentures)				
	Bank A/c	Dr.		5,50,000	
	To 12% Debenture Allotment A/c				5,50,000
	(Receipt of allotment money on debentures)				

TV Components Limited

Balance Sheet as at..................

Particulars	*Note No.*	*Amount (Rs)*
I. Equity and Liabilities		
1. Non-current Liabilities		
Long-term borrowings	1	**10,00,000**
II. Assets		
1. Non-current assets		
Other non-current assets	2	45,000
2. Current assets		
a) Cash and cash equivalents	3	9,50,000
b) Other current assets	4	5,000
		10,00,000

Notes to Accounts

Particulars	*Amount (Rs)*
1. Long-term borrowings	
10,000, 12% secured debentures of Rs 100 each	10,00,000
2. Other non-current assets	
Discount on issue of debentures	45,000
3. Cash and cash equivalents	
Cash at bank	9,50,000
4. Other current assets	
Discount on issue of debentures (To be written-off within 12 months of the balance sheet date or the period of operating cycle)	5,000

Notes:
1 It is presumed that debentures are redeemable after 10 years.
*Relevant data only.

2.4.3 Debentures issued at Premium

A debenture is said to be issued at a premium when the price charged is more than its nominal value. For example, the issue of Rs 100 debentures for Rs 110, (Rs 10 is being the premium). The amount of premium is credited to Securities Premium Reserve account and is shown on the liabilities side of the balance sheet under the head "Reserves and Surpluses".

Illustration 3

XYZ Industries Ltd., issued 2,000, 10% debentures of Rs 100 each, at a premium of Rs 10 per debenture payable as follows:

On application	Rs 50
On allotment	Rs 60

The debentures were fully subscribed and all money was duly received. Record the journal entries in the books of a company. Show how the amounts will appear in the balance sheet.

Solution:

Books of XYZ Industries Limited
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Bank A/c Dr.		1,00,000	
	To 10% Debenture Application A/c			1,00,000
	(Application money Rs 50 per debentures received)			
	10% Debenture Application A/c Dr.		1,00,000	
	To 10% Debentures A/c			1,00,000
	(Transfer of application money to debenture account)			
	10% Debenture Allotment A/c Dr.		1,20,000	
	To 10% Debentures A/c			1,00,000
	To Securities Premium Reserve A/c			20,000
	(Allotment money due on debentures including the premium)			
	Bank A/c Dr.		1,20,000	
	To 10% Debenture Allotment A/c			1,20,000
	(Allotment money received)			

XYZ Industries Limited
Balance Sheet as at ———

Particulars	*Note No.*	*Amount (Rs)*
I. Equity and Liabilities		
1. Shareholders' Funds		
Reserve and Surplus	1	20,000
2. Non-current Liabilities		
Long-term borrowings	2	2,00,000
		2,20,000
II. Assets		
Current Assets		
Cash and cash equivalents		**2,20,000**

Notes to Accounts

Particulars	*Amount (Rs)*
1. Reserve and surplus	
Securties Premium Reserve	**20,000**
2. Long-term borrowings	
2,000, 10% debentures of Rs 100 each	**2,00,000**
3. Cash and cash equivalents	
Cash at bank	**2,20,000**

Illustration 4

A Limited issued 5,000, 10% debentures of Rs 100 each, at a premium of Rs 10 per debenture payable as follows:

On application	Rs 25
On allotment	Rs 45 (including premium)
On first and final call	Rs 40

The debentures were fully subscribed and all money was duly received. Record the necessary entries in the books of the company. Show how the amounts will appear in the balance sheet.

Solution:

Books of *A Limited*
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Bank A/c Dr.		1,25,000	
	To 10% Debenture Application A/c			1,25,000
	(Application money on 10% debentures received)			
	10% Debenture Application A/c Dr.		1,25,000	
	To 10% Debentures A/c			1,25,000
	(Transfer of application money on allotment)			
	10% Debenture Allotment A/c Dr.		2,25,000	
	To 10% Debentures A/c			1,75,000
	To Securities Premium Reserve A/c			50,000
	(Allotment money of due on debentures including the premium)			

	Bank A/c Dr. To 10% Debenture Allotment A/c (Allotment money received)		2,25,000	2,25,000
	10% Debenture First & Final Call A/c Dr. To 10% Debentures A/c (First and final call money due on debentures)		2,00,000	2,00,000
	Bank A/c Dr. To 10% Debenture First & Final Call A/c (First and final call money received)		2,00,000	2,00,000

A Limited

Balance Sheet as at ———

Particulars	*Note No.*	*Amount (Rs)*
I. Equity and Liabilities		
1. Shareholders' Funds		
a) Reserve and Surplus	1	50,000
2. Non-current Liabilities		
Long term borrowings	2	5,00,000
Total		**5,50,000**
II. Assets		
1. Current assets		
a) Cash and cash equivalents		**5,50,000**

Notes to Accounts

Particulars	*Amount (Rs)*
1. Reserve and surplus	
Securities Premium Reserve	**50,000**
2. Long-term borrowings	
5,000, 10% debentures of Rs 100 each	**5,00,000**

2.5 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 5

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

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Bank A/c Dr.		5,60,000	
	To 12% Debenture Application A/c			5,60,000
	(Receipt of application money on 14,000 debentures)			
	12% Debenture Application A/c Dr.		5,60,000	
	To 12% Debentures A/c			4,00,000
	To Debentures Allotment A/c			40,000
	To Bank A/c			1,20,000
	(Debenture Application money transferred to Debenuture A/c, Excess application money credited to Debenture Allotment account and money refunded on rejected application)			
	12% Debenture Allotment A/c Dr.		6,00,000	
	To 12% Debentures A/c			6,00,000
	(Amount due on allotment on 10,000 debentures)			
	Bank A/c Dr.		5,60,000	
	To Debenture Allotment A/c			5,60,000
	(Allotment money received)			

2.6 Issue of Debentures for Consideration other than Cash

Sometimes a company purchase assets from vendors and instead of making payment in cash issues debentures for consideration thereof. Such issue of debentures is called debentures issued for consideration other than cash. In that case also, the debentures may be issued at par, at a premium or at a discount then entries made in such a situation are similar to those of the shares issued for consideration other than cash, which are as follows :

1. *On purchase of assets*

   Sundry Assets A/c Dr.
   To Vendor's

2. *On issue of debentures*

   (a) At par

   Vendors Dr.
   To Debentures A/c

   (b) At premium

   Vendors Dr.
   To Debentures A/c
   To Securities Premium Reserve A/c

   (c) At a discount

   Vendors Dr.
   Discount on Issue of Debenture A/c Dr.
   To Debentures A/c

Illustration 6

Aashirward Company Limited purchased assets of the book value of Rs 2,00,000 from another company and agreed to make the payment of purchase consideration by issuing 2,000, 10% debentures of Rs 100 each.

Record the necessary journal entries.

Solution:

Books of Aashirwad Company Limited
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Sundry Assets A/c Dr. To Vendors (Assets purchased from vendors)		2,00,000	 2,00,000
	Vendors Dr. To 10% Debentures A/c (Allotment of debentures to vendors as purchase consideration)		2,00,000	 2,00,000

Illustration 7

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

Date	*Particulars*		*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Sundry Assets A/c	Dr.		2,20,000	
	To Vendors				2,20,000
	(Assets purchased from vendors)				
	Vendors	Dr.		2,20,000	
	To 10% Debentures A/c				2,00,000
	To Securities Premium Reserve A/c				20,000
	(Allotment of 2,000 debentures of Rs 100 each at a premium of 10% as purchase consideration)				

Illustration 8

National Packaging Company purchased assets of the value of Rs 1,90,000 from another company and agreed to make the payment of purchase consideration by issuing 2,000, 10% debentures of Rs 100 each at a discount of 5%.

Record necessary journal entries.

Solution:

Books of National Packaging Company
Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Sundry Assets A/c	Dr.		1,90,000	
	To Vendors				1,90,000
	(Assets purchased from vendors)				
	Vendors	Dr.		1,90,000	
	Discount on Issue of Debenture A/c	Dr.		10,000	
	To 10% Debentures A/c				2,00,000
	(Allotment of 2,000 debentures of Rs 100 each at a discount of 5% as purchase consideration)				

Illustration 9

G.S. Rai company purchased assets of the book value of Rs. 99,000 from another firm. It was agreed that purchase consideration be paid by issuing 11% debentures of Rs. 100 each. Assume debentures have been issued.

1. At par
2. At discount of 10%, and
3. At a premium of 10%.

Record necessary journal entries.

Solution:

Books of G.S. Rai Company Limited
Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Sundry Assets A/c	Dr.		99,000	
	To Vendors				99,000
	(Assets purchased from vendors)				
In Ist Case	Vendors	Dr.		99,000	
	To 10% Debentures A/c				99,000
	(Allotment of debentures to vendors as purchase consideration)				
In IInd Case	Vendors	Dr.		99,000	
	Discount on Issue of Debenture A/c	Dr.		11,000	
	To 10% Debentures A/c				1,10,000
	(Allotment of 1,100 debenture of Rs 100 issued at discount of 10% to vendor)				
In IIIrd Case	Vendors	Dr.		99,000	
	To 11% Debentures A/c				90,000
	To Securities Premium Reserve A/c				9,000
	(Allotment of 900 debentures of Rs 100 issued at a premium of 10% to the vendors)				

Sometimes a company may purchase the assets as well as takeover its liabilities of another concern. It happens usually in case of purchase of the whole business of the other concern. In such a situation, the purchase consideration will be equal to the value of net assets (Assets - Liabilities) taken over, and if the whole amount of the consideration is paid by issue of debentures, the journal entry will be:

Sundry Assets A/c Dr.
To Sundry Liabilities A/c
To Vendors
(Purchase of the Vendors' business)

Illustration 10

Romi Ltd. acquired assets of Rs. 20 lakh and took over creditors of Rs. 2 lakh from Kapil Enterprises. Romi Ltd., issued 8% debentures of Rs 100 each at par as purchase consideration. Record necessary journal entries in the books of Romi Ltd.

Solution:

Books of Romi Ltd.
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Sundry Assets A/c Dr.		20,00,000	
	To Kapil Enterprises			18,00,000
	To Sundry Creditors A/c			2,00,000
	(Purchase of business from Kapil Enterprises)			
	Kapil Enterprises Dr.		18,00,000	
	To 8% Debentures A/c			18,00,000
	(Issue of 18,000, 8% debentures of Rs 100 each)			

In case of the whole business being taken over if the amount of debentures issued is more than the amount of the net assets taken over, the difference (excess) will be treated as value of goodwill and the same shall also be debited while passing the journal entry for the purchase of vender's business (see Illustration 11). But if it is the other way round, i.e., the value of debentures is less than the value of the net assets taken over the difference will be credited to capital Reserve accounts (See Illustration 12).

Illustration 11

Blue Prints Ltd., purchased building worth Rs.1,50,000, machinery worth Rs.1,40,000 and furniture worth Rs.10,000 from XYZ Co., and took over its liabilities of Rs. 20,000 for a purchase consideration of Rs. 3,15,000. Blue Prints Ltd., paid the purchase consideration by issuing 12% debentures of Rs.100 each at a premium of 5%. Record necessary journal entries.

Solution:

Books of Blue Prints Limited
Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Building A/c	Dr.		1,50,000	
	Plant & Machinery A/c	Dr.		1,40,000	
	Furniture A/c	Dr.		10,000	
	Goodwill A/c [1]	Dr.		35,000	
	To Liabilities (Sundry)				20,000
	To XYZ Co.				3,15,000
	(Purchase of assets and taking over of liabilities of XYZ Co.)				
	XYZ Co.	Dr.		3,15,000	
	To 12% Debentures A/c				3,00,000
	To Securities Premium Reserve A/c				15,000
	(Issue of 3,000 debentures at a premium of 5%)				

Note: 1. Since the purchase consideration is more than net assets taken over, the difference has been debited to goodwill account.

2. No. of debentures issued $= \dfrac{\text{Purchase Consideration}}{\text{Issue Price of a Debenture}}$

$= \dfrac{\text{Rs } 3{,}15{,}000}{105} = 3{,}000$

Illustration 12

A Limited took over the assets of Rs. 3,00,000 and liabilities of Rs.10,000 from B & Co. Ltd., for an agreed purchase consideration of Rs. 2,70,000 to be satisfied by issue of 15% debentures of Rs. 100 at 20% premium. Show the journal entries in the journal of *A Limited.*

Solution:

Books of *A Limited*
Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Sundry Assets A/c	Dr.		3,00,000	
	To Sundry Liabilities A/c				10,000
	To B & Co. Ltd.				2,70,000
	To Capital Reserve				20,000
	(Purchased assets and took over liabilities from B Ltd.)				

	B & Co. Ltd. Dr.		2,70,000	
	To 15% Debentures A/c			2,25,000
	To Securities Premium Reserve A/c			45,000
	(Issue of 2,250 debentures of Rs 100 each at a premium of 20%)			

Do it Yourself

1. Amrit Company Limited purchased assets of the 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.
2. A company purchased assets of the value of Rs.1,90,000 from another company and agreed to make the payment of purchase consideration by issuing 2,000, 10% debentures of Rs. 100 each at a discount of 5%. Record necessary journal entries.
3. Rose Bond Limited purchased a business for Rs. 22,00,000. Purchase Price was paid by 6% debentures. Debentures of Rs. 20,00,000 were issued at a premium of 10% for the purpose. Record necessary journal entries.
4. Nikhil and Ashwin Limited bought business of Agarwal Limited consisting sundry assts of Rs. 3,60,000, sundry creditors Rs.1,00,000 for a consideration of Rs. 3,07,200. It issued 14% debentures of Rs. 100 each fully paid at a discount of 4% in satisfaction of purchase consideration. Record necessary journal entries.

Illustration 13

Suvidha Ltd. purchased machinery worth Rs.1,98,000 from Suppliers Ltd. The payment was made by issue of 12% debentures of Rs.100 each.

Pass the necessary journal entries for the purchase of machinery and issue of debentures when:

(i) Debentures are issued at par;
(ii) Debentures are issued at 10% discount; and
(iii) Debentures are issued at 10% premium

Solution:

Books of Suvidha Ltd.
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Machinery A/c Dr.		1,98,000	
	To Suppliers Ltd.			1,98,000
	(Machinery purchased)			

Case (i)	When debentures are issued at par:			
	Suppliers Ltd. Dr.		1,98,000	
	To 12% Debentures A/c			1,98,000
	(12% Debentures issued to Suppliers Ltd.)			
Case (ii)	When debentures are issued at 10% discount:			
	Suppliers Ltd. Dr.		1,98,000	
	Discount on Issue of Debentures A/c Dr.		22,000	
	To 12% Debentures A/c			2,20,000
	(12% Debentures issued to Suppliers Ltd. at 10% discount)			
Case (iii)	When debentures are issued at 10% premium:			
	Suppliers Ltd. Dr.		1,98,000	
	To 12% Debentures A/c			1,80,000
	Securities Premium Reserve A/c			18,000
	(12% Debentures issued to Suppliers Ltd. at 10% premium)			

Workings:

(a)

	(Rs)
Face value of debenture	100
Less: Discount 10%	10
Value at which debenture issued	90

Number of debentures issued in case of 10% discount $= \dfrac{\text{Rs. } 1,98,000}{90}$

= 2,200 debenture

(b)

	(Rs)
Face value of debenture	100
Add: Premium 10%	10
Value at which debenture issued	110

Number of debentures issued in case of 10% premium $= \dfrac{\text{Rs.} 1,98,000}{110}$

= 1,800 Debentures

2.7 Issue of Debentures 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.

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

First Method

No entry is made in the books of accounts since no liability is created by such issue. However, on the liability side of the balance sheet, below the item of loan, a note to the effect that it has been secured by issue of debentures as a collateral security is appended. For example, X Company has issued 9%, 10,000 debentures of Rs.100 each for a loan of Rs.10, 00,000 taken from a bank. This fact may be shown in the balance sheet as under:

X Company
Balance Sheet as at __________

Particulars	*Note No.*	*Amount (Rs)*
I. Equity and Liabilities		
1. Non-current Liabilities		
Long-term borrowings	1	**10,00,000**

Notes to Accounts

Particulars	*Amount (Rs)*
1. Long-term borrowings Bank Loan (Secured by issue of 10,000, 10% debentures of Rs. 10 each as Collatoral Security)	**10,00,000**

Second Method

The issue of debentures as a collateral security may be recorded by means of journal entry as follows:

Journal Entries

i. Issue of 10,000, 9% debentures of Rs. 100 each as collateral security for bank loan of Rs. 10,00,000.

Debenture Suspense A/c	Dr.	10,00,000	
To 9% Debentures A/c			10,00,000

ii. For cancellation of 9% debentures as collateral security on repayment of bank loan.

Debenture Suspense account will appear as a deduction from the debentures in notes to accounts of long-term borrowings. When loan is repaid the above entry will be cancelled by a reverse entry :

9% Debentures A/c	Dr.	10,00,000	
To Debenture Suspense A/c			10,00,000

Balance Sheet of X Co. ____________ (Extract)

Particulars	*Note No.*	*Amount (Rs)*
I. Equity and Liabilities		
1. Non-current Liabilities		
Long term borrowings	1	**10,00,000**

Notes to Accounts

Particulars	*(Rs)*	*Amount (Rs)*
1. Long term borrowings		10,00,000
Bank loan		
10,000, 9% debentures of		
Rs 100 each	10,00,000	
Less: Debenture suspense	10,00,000	—
		10,00,000

Illustration 14

A company took a loan of Rs. 10,00,000 from Punjab National Bank and issued 10% debentures of Rs. 12,00,000 of Rs. 100 each as a collateral security. Explain how you will deal with the issue of debentures in the books of the company.

Solution:

First Method:

Balance Sheet (Extract)

Particulars	*Note No.*	*Amount (Rs)*
I. Equity and Liabilities		
1. Non-current Liabilities		
Long-term borrowings	1	**10,00,000**

Notes to Accounts

Particulars	*Amount (Rs)*
1. Long-term borrowings Bank loan (Secured by issue of 12,000, 10% debentures of Rs. 100 each as Collatoral Security	 **10,00,000**

Second Method:

Journal Entries

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Debenture Suspense A/c Dr.		12,00,000	
	To 10% Debentures A/c			12,00,000
	(12,000 debenture of Rs. 100 each issued as collateral security to P.N.Bank)			

Balance Sheet (Extract)

Particulars	*Note No.*	*Amount (Rs)*
I. Equity and Liabilities		
1. Non-current Liabilities		
Long-term borrowings	1	**10,00,000**

Notes to Accounts

Particulars	*(Rs)*	*Amount (Rs)*
1. Long-term borrowings		
Secured Loan from PNB		10,00,000
12,000, 10% debentures of Rs. 100 each	12,00,000	
Less: Debenture Suspense	12,00,000	—
		10,00,000

Do it Yourself

1. Raghuveer Limited issued Rs 10,00,000, 8% debentures as follows to:

		Rs
1.	Sundry Subscribers for Cash at 90%	5,50,000
2.	Vendor of Machinery for Rs 2,00,000 in satisfaction of his claim	2,00,000
3.	Bankers as Collateral Security for a bank loan worth Rs 20,00,000 for which principal security is Business Premises worth Rs 22,50,000.	2,50,000

   The issue (1) and (2) are redeemable at the end of 10 years at par. State how the debenture will be dealt with while preparing the balance sheet of a company.
2. Hassan Limited took a loan of Rs 30,00,000 from a bank against primary security worth Rs 40,00,000 and issued 4,000, 6% debentures of Rs 100 each as a collateral security. The company again after one year took a loan of Rs 50,00,000 from bank against Plant as primary security and deposited 6,000, 6% debentures of Rs 100 each as collateral security. Record necessary journal entries and prepare balance sheet of the company.
3. Meghnath Limited took a loan of Rs 1,20,000 from a bank and deposited 1,400, 8% debentures of Rs 100 each as collateral security along with primary security worth Rs 2 lakh. Company again took a loan of Rs 80,000 after two months from a bank and deposited 1,000, 8% debentures of Rs 100 each as collateral security. Record necessary journal entries and prepare balance sheet of the company.

2.8 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.

(i) Issued at par and redeemable at par

(ii) Issued at discount and redeemable at par

(iii) Issued at a premium and redeemable at par

(iv) Issued at par and redeemable at a premium

(v) Issued at a discount and redeemable at a premium

(vi) Issued at a premium and redeemable at a premium

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

1. *Issue at par and redeemable at par*

(a)	Bank A/c	Dr.
	To Debenture Application & Allotment A/c	
	(Receipt of application money)	
(b)	Debenture Application & Allotment A/c	Dr.
	To Debentures A/c	
	(Allotment of debentures)	

2. *Issue at a discount and redeemable at par*

(a)	Bank A/c	Dr.
	To Debenture Application & Allotment A/c	
	(Receipt of application money)	
(b)	Debenture Application & Allotment A/c	Dr.
	Discount on Issue of Debentures A/c	Dr.
	To Debentures A/c	
	(Allotment of debentures at a discount)	

3. *Issue at premium and redemption at par*

(a)	Bank A/c	Dr.
	To Debenture Application & Allotment A/c	
	(Receipt of application money)	
(b)	Debenture Application & Allotment A/c	Dr.
	To Debentures A/c	
	To Securities Premium Reserve A/c	
	(Allotment of debentures at a premium)	

4. *Issue at par and redeemable at premium*

(a)	Bank A/c	Dr.
	To Debenture Application & Allotment A/c	
	(Receipt of application money)	
(b)	Debenture Application & Allotment A/c	Dr.
	Loss on Issue of Debentures A/c	Dr. (with premium on redemption)
	To Debentures A/c	(with nominal value of debenture)
	To Premium on Redemption of Debenture A/c	(with premium on redemption)
	(Allotment of debentures at par and redeemade at a premium)	

5. *Issue at discount and redemption at premium*

Bank A/c	Dr.	
To Debenture Application & Allotment A/c		
(Receipt of application money)		
Debenture Application & Allotment A/c	Dr.	
Loss on Issue of Debentures A/c	Dr.	(with discount on issue plus premium on redemption)
To Debentures A/c		(with nominal value of debenture)
To Premium on Redemption of Debentures A/c		(with premium on redemption)
(Allotment of debentures at a discount and redeemable at premium)		

6. *Issued at a premium and redeemable at premium*

Bank A/c	Dr.	
To Debenture Application & Allotment A/c		
(Receipt of application money)		
Debenture Application & Allotment A/c	Dr.	
Loss on Issue of Debentures A/c	Dr.	(with premium on redemption)
To Debentures A/c		(with nominal value of debenture)
To Securities Premium Reserve A/c		(with premium on issue)
To Premium on Redemption of Debentures A/c		(with premium on redemption)

Notes:
1. When debentures are redeemable at a premium, a provision has to be made right at the time of the issue by debiting the amount 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 sub-head 'Long-term Borrowings' until debentures are redeemed.
3. Loss on issue of debentures is a capital loss and it is to be written-off gradually charged to statement of profit and loss or securities premium account.

Illustration 15

Give Journal entries for the following:

1. Issue of Rs 1,00,000, 9% debentures of Rs 100 each at par and redeemable at par.

2. Issue of Rs 1,00,000, 9% debentures of Rs 100 each at premium of 5% but redeemable at par.
3. Issue of Rs 1,00,000, 9% debentures of Rs 100 each at discount of 5% repayable at par.
4. Issue of Rs 1,00,000, 9% debentures of Rs 100 each at par but repayable at a premium of 5%.
5. Issue of Rs 1,00,000, 9% debentures of Rs 100 each at discount of 5% but redeemable at premium of 5%.
6. Issue of Rs 1,00,000, 9% debentures of Rs 100 each at premium of 5% and redeemable at premium of 5%.

Solution:

Journal

Date	Particulars	L.F.	Debit Amount (Rs)	Credit Amount (Rs)
1	Bank A/c Dr.		1,00,000	
	To 9% Debenture Application & Allotment A/c			1,00,000
	(Debentures Application money received)			
	Debenture Application & Allotment A/c Dr.		1,00,000	
	To 9% Debentures A/c			1,00,000
	(Application money transferred to Debentures Account)			
2	Bank A/c Dr.		1,05,000	
	To 9% Debenture Application & Allotment A/c			1,05,000
	(Debentures application money received)			
	Debenture Application & Allotment A/c Dr.		1,05,000	
	To 9% Debentures A/c			1,00,000
	To Securities Premium Reserve A/c			5,000
	(Debentures application money transferred to Debentures & Securities Premium account)			
3	Bank A/c Dr.		95,000	
	To 9% Debenture Application & Allotment A/c			95,000
	(Debentures application money received)			
	9% Debenture Application & Allotment A/c Dr.		95,000	
	Discount on Issue of Debentures A/c Dr.		5,000	
	To 9% Debentures A/c			1,00,000
	(Debentures application money transferred to Debentures account)			

4	Bank A/c Dr.		1,00,000	
	To 9% Debenture Application & Allotment A/c			1,00,000
	(Debentures Application money received)			
	Debenture Application & Allotment A/c Dr.		1,00,000	
	Loss on Issue of Debentures A/c Dr.		5,000	
	To 9% Debentures A/c			1,00,000
	To Premium on Redemption of Debentures A/c			5,000
	(Debentures Application money transferred to Debentures account)			
5	Bank A/c Dr.		95,000	
	To 9% Debenture Application & Allotment A/c			95,000
	(Debentures Application money received)			
	Debenture Application & Allotment A/c Dr.		95,000	
	Loss on Issue of Debentures A/c Dr.		10,000	
	To 9% Debentures A/c			1,00,000
	To Premium on Redemption of Debentures A/c			5,000
	(Debentures application money transferred to debentures and Premium on debenture account)			
6	Bank A/c Dr.		1,05,000	
	To 9% Debenture Application & Allotment A/c			1,05,000
	(Debentures Application money received)			
	Debenture Application & Allotment A/c Dr.		1,05,000	
	Loss on Issue of Debentures A/c Dr.		5,000	
	To 9% Debenture A/c			1,00,000
	To Premium on Redemption of Debentures A/c			5,000
	To Securities Premium Reserve A/c			5,000
	(Debenture application money transferred to debentures account)			

Illustration 16

You are required to pass the journal entries relating to the issue of the debentures in the books of X Ltd., and show how they would appear in its balance sheet under the following cases:

(a) 120, 8% debentures of Rs 1,000 each are issued at 5% discount and repayable at par.

(b) 150, 7% debentures of Rs 1,000 each are issued at 5% discount and repayable at premium of 10%.

(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.

Solution:

Books of X Ltd.

(a) **Journal**

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Bank A/c Dr.		1,14,000	
	To Debenture Application and Allotment A/c			
	(Debenture application money received)			1,14,000
	Debenture Application and Allotment A/c Dr.		1,14,000	
	Loss on Issue of Debentures A/c Dr.		6,000	
	To 8% Debentures A/c			1,20,000
	(Debentures application money transferred to Debentures A/c)			

Books of X Ltd.
Balance Sheet as at____________

Particulars	Note No.	Amount (Rs)
I. Equity and Liabilities		
1. Non-current Liabilities		
Long-term borrowings	1	1,20,000
		1,20,000
II. Assets		
1. Non-current assets		
Other non-current assets	2	4,800
2. Current assets		
Cash and cash equivalents	3	1,14,000
Other current assets	4	1,200
		1,20,000

Notes to Accounts

Particulars	Amount (Rs)
1. Long-term borrowings	
120, 8% debentures of Rs 1,000 each	**1,20,000**
2. Other non-current assets	
Discount on issue of debentures	**4,800**
3. Cash and cash equivalents	
Cash at bank	**1,14,000**
4. Other current assets	
Discount on issue of debentures	**1,200**

Note: Discount on Issue of Debentures is written-off in 5 years, presuming that debentures are redeemable after 5 years.

(b)

Books of X Ltd.
Journal

Date	Particulars	L.F.	Debit Amount (Rs)	Credit Amount (Rs)
	Bank A/c Dr.		1,42,500	
	To Debenture Application and Allotment A/c			
	(Debenture application money received)			1,42,500
	Debenture Application and Allotment A/c Dr.		1,42,500	
	Loss on Issue of Debentures A/c Dr.		22,500	
	To 8% Debentures A/c			1,50,000
	To Premium on Redemption of Debenture A/c			15,000
	(Debentures application money transferred to Debentures A/c)			

Books of X Ltd.
Balance Sheet as at________________

Particulars	Note No.	Amount (Rs)
I. Equity and Liabilities		
1. Non-current Liabilities		
a) Long-term borrowings	1	1,50,000
b) Other long-term liabilities	2	15,000
		1,65,000
II. Assets		
1. Non-current assets		
Other non-current assets	3	18,000
2. Current assets		
a) Cash and cash equivalents	4	1,42,500
b) Other current assets	5	4,500
		1,65,000

Notes to Accounts

Particulars	Amount (Rs)
1. Long-term borrowings	
150, 7% debentures of Rs 1,000 each	**1,50,000**
2. Other long-term liabilities	
Premium on redemption of debentures	**15,000**
3. Other non-current assets	
Loss on issue of debentures	**18,000**
4. Cash and cash equivalents	
Cash at bank	**1,42,500**
5. Other current assets	
Loss on issue of debentures	**4,500**

Note: Discount on Issue of Debentures is written-off in 5 years, presuming that debentures are redeemable after 5 years.

Books of X Ltd.

(c) **Journal**

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Bank A/c Dr.		84,000	
	To Debenture Application and Allotment A/c			84,000
	(Debenture application money received)			
	Debenture Application and Allotment A/c Dr.		84,000	
	To 9% Debentures A/c			80,000
	To Securities Premium Reserve A/c			4,000
	(Debentures application money transferred to Debentures A/c and securities premium reserve A/c)			

X Ltd.

Balance Sheet as at ....

Particulars	*Note No.*	*Amount (Rs)*
I. Equity and Liabilities		
1. Shareholder's funds		
Reserves and surplus	1	4,000
2. Non-current Liabilities		
Long-term borrowings	2	80,000
		84,000
II. Assets		
1. Current assets		
Cash and cash equivalents	3	84,000
		84,000

Notes to Accounts

Particulars	*Amount (Rs)*
1. Reserves and surplus	
Securities premium reserve	**4,000**
2. Long-term borrowings	
80, 9% debentures of Rs 1,000 each	**80,000**

Books of X Ltd.

(d) **Journal**

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Debenture Suspense A/c Dr.		40,000	
	To 8% Debentures A/c			40,000
	(Issue of 400, 8% debentures of Rs 100 each as collateral security against a loan of Rs 40,000)			

X Ltd.

Balance Sheet as at ____________ (Extract)

Particulars	Note No.	Amount (Rs)
I. Equity and Liabilities		
1. Long-term borrowings	1	**40,000**

Notes to Accounts

Particulars	Amount (Rs)	Amount (Rs)
1. Long-term borrowings		
Bank loan		40,000
400, 8% debentures of Rs 100 each	40,000	
Less: Debentures suspense	40,000	-
		40,000

Do it Yourself

1. Nena Limited issued 50,000, 10% debentures of Rs 100 each on the basis of the following conditions:
   a. Debentures issued at par and redeemable at par.
   b. Debentures issued at discount @ 5% and redeemable at par.
   c. Debentures issued at premium @ 10% and redeemable at par.
   d. Debentures issued at par and redeemable at premium @ 10%.
   e. Debentures issued at discount of 5% and redeemable at a premium of 10%.
   f. Debentures issued at premium of 6% and redeemable at a premium of 4%.

   Record necessary journal entries in the above mentioned cases at the time of issue and redemption of debentures.
2. Record necessary journal entries in each of the following cases:
   a. 27,000, 7% debentures of Rs 100 each issued at par, redeemable at par.
   b. 25,000, 7% debentures of Rs 100 each issued at par redeemable at 4% premium.
   c. 20,000, 7% debentures of Rs 100 each issued at 5% discount and redeemable at par.
   d. 30,000, 7% debentures of Rs 100 each issued at 5% discount and redeemable at 2½ % premium.
   e. 35,000, 7% debentures of Rs 100 each issued at 4% premium and redeemable at premium of 5%.

2.9 Interest on Debentures

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 debentureholders can adjust this amount against the tax due from them.

2.9.1 Accounting Treatment

The following journal entries are recorded in the books of a company in connection with the interest on debentures:

1. *When interest is due*
   Debenture Interest A/c Dr.
   To Income Tax payable A/c
   To Debentureholders A/c
   (Amount of interest due on debenture and tax deducted at source)

2. *For payment of interest to debentureholders*
   Debentureholders A/c Dr.
   To Bank A/c
   (Amount of interest paid to debentureholders)

3. *On transfer debenture Interest Account to statement of Profit and Loss*
   Statement of Profit and Loss Dr.
   To Debenture Interest A/c
   (Debenture interest transferred to profit and loss A/c)

4. *On payment of tax deducted at source to the Government*
   Income Tax Payable A/c Dr.
   To Bank A/c
   (Payment of tax deducted at source on interest on debentures)

Illustration 17

A Ltd., issued 2,000, 10% debentures of Rs 100 each on April 01, 2016 at a discount of 10% redeemable at a premium of 10%.

Give journal entries relating to the issue of debentures and debenture interest for the period ending March 31, 2017 assuming that interest was paid half yearly on September 30 and March 31 and tax deducted at source is 10%.

Solution:

Book of A Ltd.

Journal

Date	Particulars	L.F.	Debit Amount (Rs)	Credit Amount (Rs)
2016 Apr. 01	Bank A/c Dr. To 10% Debenture Application & Allotment A/c (Application money received on 2,000, 10% debentures)		1,80,000	 1,80,000
Apr. 01	10% Debentures Application & Allotment A/c Dr. Loss on Issue of Debenture A/c Dr. To 10% Debentures A/c To Premium on Redemption of Debentures A/c (Allotment of debentures at a discount of 10% and redeemable at a premium of 10%)		1,80,000 40,000	 2,00,000 20,000
Sept.30	Debenture Interest A/c Dr. To Debentureholders A/c To Income Tax Payable A/c (Interest due for 6 months and tax deducted at source)		10,000	 9,000 1,000
	Income Tax payable A/c Dr. Bank A/c (Tax deducted at source paid to the government)		1,000	 1000
2017 Sept.	Debentureholders A/c Dr. To Bank A/c (Payment of interest)		9,000	 9,000
March 31	Debenture interest A/c Dr. To Debentureholders A/c To Income Tax Payable A/c (Interest due for 6 months and tax deducted at source)		10,000	 9,000 1,000
March 31	Debenturesholders A/c Dr. To Bank A/c (Payment of interest)		9,000	 9,000
March 31	Income Tax Payable A/c Dr. To Bank A/c (Paid tax deducted at source to the government)		1,000	 1,000
March 31	Statement of Profit and Loss Dr. To Debenture Interest A/c (Debenture interest transferred to profit and loss account)		20,000	 20,000

Do it Yourself

1. Diwakar enterprises Ltd. Issued 10,00,000, 6% debentures on April 1, 2016. Interest is paid on September 30, 2016 and March 31, 2017.

   Record necessary journal entries assuming that income tax is deducted @10% of the amount of interest.
2. Laser India Ltd. Issued 7,00,000, 8% debentures of Rs 100 each at par. Interest is to be paid on these debentures half-yearly on September 30 and March 31, every year. Record necessary journal entries asuming that income tax is deducted @ 10% of the amount of interest.

2.10 Writing-off Discount/Loss on Issue of Debentures

The discount/loss on issue of debentures is a capital loss or a fictitious asset and, therefore, must be written-off during the life time of debentures. The amount of discount/loss on issue of debentures should normally not be written-off in the year of issue itself since the benefit of the debentures would accrue to the company till their redemption. The discount/loss on it is, therefore, treated as capital loss. The discount may be charged to Securities Premium A/c or may be written-off over 3 to 5 years through statement of profit and loss as per guidelines issued by ICAI. In case, however, there are no capital profits or if the capital profits are not adequate, the amount of such discount/loss can be written-off against the revenue profits every year by passing the following journal entry.

Statement of Profit and Loss Dr.
  To Discount/Loss on Issue of
    Debentures A/c
(Discount/loss on issue of debentures
written-off)

There are two methods, which can be adopted to write off discount/loss on issue of debentures against the revenue profits. These are as follows.

1. *Fixed Instalment Method:* When the debentures are redeemed at the end of a specified period, the total amount of discount should be written off in equal instalments of fixed amount over that period. For example, if the debentures are to be redeemed after 10 years then out of the total amount of discount of Rs. 1,00,000, Rs. 10,000 will be written-off every year.
2. *Fluctuating Instalment Method:* When debentures are repaid by annual drawings or in instalments, the discount should be written-off in the ratio of debentures outstanding as at the end of each accounting year. The amount of discount, under this method, goes on reducing year. The amount of discount, under this method, goes on reducing every year and so this method may also be known as Reducing Instalment Method.

For example, a company issues Rs. 15,00,000, 9% debentures at a discount of 10% redeemable by annual drawings of Rs. 3,00,000 at the end of each year. The amount of discount to be written-off will be calculated as under:

Year	Amount utilised during the Year	Ratio
First Year	Rs. 15,00,000	5
Second Year	Rs. 12,00,000	4
Third Year	Rs. 9,00,000	3
Fourth Year	Rs. 6,00,000	2
Fifth Year	Rs. 3,00,000	1

Hence, the amount of discount to be written-off every year will be as under :

First Year	Rs. 1,50,000 5/15	=	Rs. 50,000
Second Year	Rs. 1,50,000 4/15	=	Rs. 40,000
Third Year	Rs. 1,50,000 3/15	=	Rs. 30,000
Fourth Year	Rs. 1,50,000 2/15	=	Rs. 20,000
Fifth Year	Rs. 1,50,000 1/15	=	Rs. 10,000

Do it Yourself

1. X Ltd. issued 2,000, 10% debentures of Rs 100 each at a discount of 8% on April, 2014 which are redeemable at par by annual drawings in 4 years commencing from March 31, 2015 as per the following redemption plan:

   Ist Draw 10%, 2nd Draw 20%, 3rd Draw 30%, and 4th Draw 40%. Calculate the amount of discount to be written-off each year assuming that X Ltd., follows calendar year as its accounting year.

2. Z Ltd. issued 15,00,000, 10% debentures of Rs 50 each at premium of 10% payable as Rs 20 on application and balance on allotment. Debentures are redeemable at par after 6 years All the money due on allotment was called and duly received. Record necessary entries when premium money is included:
   (i) in application money
   (ii) in allotment money

3. Z Ltd. issued 5,000, 10% debentures of Rs 100 each at a discount of 10% on 1.4.2014. The debentures are to be redeemed every year by draw of lots – 1,000 debentures to be redeemed every year starting on 31.03.2015. Record the necessary journal entries including the payment of interest and writing off the discount on issue of debentures. The interest is payable on September 30 and March 31. Z Ltd. closes its books of accounts on March 31 every year.

4. M Ltd. issued 10,000, 8% debentures of Rs 100 each at a premium of 10% on 1.1.2016. It purchased sundry assets of the value of Rs,2,50,000 and took over the liabilities of Rs,60,000 and issued 8% debentures at a discount of 5% to the vendor. On the same date, it took loan from the Bank for Rs 1,00,000 and issued 8% debentures as Collateral Security. Record the relevant journal entries in the books of M Ltd. and prepare the extract of balance sheet on 31.03.2017. Ignore interest.

5. On 1.4.2016, Fast Computers Ltd. issued 20,00,000, 6% debentures of Rs 100 each at a discount of 4%, redeemable at a premium of 5% after three years. The amount was payable as follows:

   On application Rs 50 per debenture,

   Balance on allotment.

Record the necessary journal entries for issue of debentures.

6. D Ltd. purchased machinery worth Rs 2,00,000 from E Ltd. on 1.4.2016. Rs 50,000 were paid immediately and the balance was paid by issue of Rs 1,60,000, 12% Debentures in D Ltd. Record the necessary journal entries for recording the transactions in the books of D Ltd.

Illustration 18

A Ltd. Company has issued Rs 1,00,000, 9% debentures at a discount of 6%. These debentures are to be redeemed equally, spread over 5 annual instalments. Show Discount on issue of debentures account for five years

Solution:

Books of A Ltd.
Discount on Issue of Debentures Account

Dr. *Cr.*

Date	*Particulars*	*Amount (Rs)*	*Date*	*Particulars*	*Amount (Rs)*
Ist year	Debenture	6,000	Ist year	Statement of Profit & Loss Balance c/d	2,000 4,000
		6,000			**6,000**
IInd year	Balance b/d	4,000	IInd year	Statement of Profit & Loss Balance c/d	1,600 2,400
		4,000			**4,000**
IIIrd year	Balance b/d	2,400	IIIrd year	Statement of Profit & Loss Balance c/d	1,200 1,200
		2,400			**2,400**
IVth year	Balance b/d	1,200	IVth year	Statement of Profit & Loss Balance c/d	800 400
		1,200			**1,200**
Vth year	Balance b/d	400	Vth year	Statement of Profit & Loss	400
		400			**400**

Workings Notes:

Total discount on the issue of debentures = $1,00,000 \times \frac{6}{100} = \text{Rs } 6,000$

Amount of discount to be written-off is determined as follows:

Year	Amount (Rs.)	Ratio	Amount (Rs)
1	1,00,000	5	$\frac{5}{15} \times 6,000 =$ 2,000
2	80,000	4	$\frac{4}{15} \times 6,000 =$ 1,600
3	60,000	3	$\frac{3}{15} \times 6,000 =$ 1,200
4	40,000	2	$\frac{2}{15} \times 6,000 =$ 800
5	20,000	1	$\frac{1}{15} \times 6,000 =$ 400
		15	

Test your Understanding-I

State whether the following statements are True (T) or False (F):

1. Debenture is a part of owned capital.
2. The payment of interest on debentures is a charge on the profits of the company.
3. The debentures cannot be issued at a discount of more than 10% of the face value.
4. Redeemable debentures are those debentures, which are payable on the expiry of the specific period.
5. Perpetual debentures are also known as irredeemable debentures.
6. Debentures cannot be converted into shares.
7. Debentures cannot be issued at a premium.
8. A collateral security is a subsidiary security.
9. Debentures cannot be issued at a premium and redeemable at par.
10. Loss on issue of debentures account is a revenue loss.
11. Premium on redemption of debentures account is shown under the 'Securities Premium' in the balance sheet.

SECTION II

2.11 Redemption of Debentures

Redemption of debentures refers to extinguishing or discharging the liability on account of debentures in accordance with the terms of issue. In other words redemption of debentures means repayment of the amount of debentures by the company. There are four ways by which the debentures can be redeemed. These are :

1. Payment in lump sum
2. Payment in instalments
3. Purchase in the open market
4. By conversion into shares or new debentures.

Methods of Redemption of Debentures

Payment in Lump sum	Payment in Instalments	Purchase in Open Market	Conversion into Shares or New Debentures

Payment in lump sum : The company redeems the debentures by paying the amount in lump sum to the debentureholders at the maturity thereof as per terms of issue.

Payment in instalments **:** Under this method, normally redemption of debentures is made in instalments on the specified date during the tenure of the debentures. The total amount of debenture liability is divided by the number of years. It is to note that the actual debentures redeemable are identified by means of drawing the requisite number of lots out of the debentures outstanding for payment.

Purchase in open market: When a company purchases its own debentures for the purposes of cancellation, such an act of purchasing and cancelling the debentures constitutes redemption of debentures by purchase in the open market.

Conversion into shares or new debentures : A company can redeem its debentures by converting them into shares or new class of debentures. If debentureholders find that the offer is beneficial to them, they can exercise their right of converting their debentures into shares or new class of debentures. These new shares or debentures can be issued at par, at a discount or at a premium. It should be noted that only the actual proceeds of debentures are to be taken into account for ascertaining the number of shares to be issued in lieu of the debentures to be converted. If debentures were originally issued at discount, the actual amount realised from them at the time of issue would be used as the basis for computing the actual number of shares to be issued. It may be noted that this method is applicable only to convertible debentures.

The following factors should be taken into consideration by the company at the time of redemption of debentures :

1. **Time of redemption of debentures :-** Generally, debentures are redeemed on due date but a company may redeem its debentures before maturity date, if its articles provides for such.
2. **Sources of Redemption of debentures :-** A company may source its redemption of debentures either out of capital or out of profits.

a. *Out of Capital :-* Only those companies which are exempted from creating DRR may redeem debentures out of Capital.

b. *Out of Profits :-* When any company planning to redeem its debentures purely out of profit, it should transfer 100 percent of the face value of the redeemable debentures to DRR out of the surplus available for payment of dividend.

c. *Out of Capital and Profits :-* In case, Company is planning to redeem its debentures by using both the sources partially, it does not transfer 100 percent of face value of outstanding debentures of a particular class to DRR out of the surplus available for payment of dividend.

2.12 Redemption by Payment in Lump Sum

When the company pays the whole amount in lump sum, the following journal entries are recorded in the books of the company:

1. If debentures are to be redeemed at par

(a)	Debentures A/c	Dr.
	To Debentureholders	
(b)	Debentureholders	Dr.
	To Bank A/c	

2. If debentures are to be redeemed at premium

(a)	Debentures A/c	Dr.
	Premium on Redemption of Debentures A/c	Dr.
	To Debentureholders	
(b)	Debentureholders	Dr.
	To Bank A/c	

Illustration 19

Give the necessary journal entries at the time of redemption of debentures in each of the following cases.

1. X Ltd. issued 5,000, 9% debentures of Rs 100 each at par and redeemable at par at the end of 5 years out of capital.
2. X Ltd. issued 1,000, 12% debentures of Rs 100 each at par. These debentures are redeemable at 10% premium at the end of 4 years
3. X Ltd. issued 12% debentures of the total face value of Rs 1,00,000 at premium of 5% to be redeemed at par at the end of 4 years
4. X Ltd. issued Rs 1,00,000, 12% debentures at a discount of 5% but redeemable at a premium of 5% at the end of 5 years

Solution:

Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
1.	9% Debentures A/c	Dr.		5,00,000	
	To Debentureholders A/c				5,00,000
	(Amount due on redemption debentures)				
	Debentureholders A/c	Dr.		5,00,000	
	To Bank A/c				5,00,000
	(Payment made to debentureholders)				
2.	12% Debentures A/c	Dr.		1,00,000	
	Premium on Redemption of Debentures A/c	Dr.		10,000	
	To Debentureholders				1,10,000
	(Amount due on redemption of debentures)				
	Debentureholders A/c	Dr.		1,10,000	
	To Bank A/c				1,10,000
	(Payment made to debentureholders)				
3.	12% Debentures A/c	Dr.		1,00,000	
	To Debentureholders A/c				1,00,000
	(Amount due on redemption)				

	Debentureholders A/c Dr.		1,00,000	
	To Bank A/c			1,00,000
	(Payment made to debentureholders)			
4.	12% Debentures A/c Dr.		1,00,000	
	Premium on Redemption of Debentures A/c Dr.		5,000	
	To Debentureholders A/c			1,05,000
	(Amount due on redemption of debentures)			
	Debentureholders A/c Dr.		1,05,000	
	To Bank A/c			1,05,000
	(Payment made to debentureholders)			

As per the provisions of the Companies Act, 2013, the company must set aside a portion of profits every year and transfer it to Debenture Redemption Reserve for redemption of debentures until the debentures are redeemed. The journal entry recorded for the purpose is as follows :

(a) Where a company has issued debentures, it shall create a Debenture Redemption Reserve for the redemption of such debentures, to which adequate amount shall be credited, from out of its profit every year until such debentures are redeemed.

(b) The amount credited to the Debenture Redemption Reserve shall not be utilised by the company except for the purpose of redemption of debentures.

According to Rule 18(7) of COMPANIES (SHARE CAPITAL AND DEBENTURES) RULES, 2014, the company shall create a Debenture Redemption Reserve for the purpose of redemption of debentures, in accordance with the conditions given below:

(a) The Debenture Redemption Reserve shall be create out of the profits of the company available for payment of dividend;

(b) The company shall create Debenture Redemption Reserve (DRR) in accordance with following conditions:

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

  ii. For NBFCs registered with the RBI and for Housing Finance Companies registered with the National Housing Bank, 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 no DRR is required in the case of privately placed debentures.

iii. 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.

iv. 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.

(c) Every company required to create Debenture Redemption Reserve 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 fifteen per cent, of the amount of its debentures maturing during the year ending on the 31st day of March of the next year, in any one or more of the following methods, namely :-

i. Deposits with any scheduled bank, free from any charge or lien;

ii. Securities of the Central Government or of any State Government;

iii. Securities mentioned in sub-clauses (a) to (d) and (ee) of section 20 of the Indian Trusts Act, 1882;

iv. Bonds issued by any other company which is notified under sub-clause (f) of section 20 of the Indian Trusts Act, 1882;

v. The amount invested or deposited as above shall not be used for any purpose other than for redemption of debentures maturing during the year referred above:

(d) In case of partly convertible debentures, Debenture Redemption Reserve shall be created in respect of non-convertible portion of debenture issue.

(e) The amount credited to the Debenture Redemption Reserve shall not be utilised by the company except for the purpose of redemption of debentures.

Illustration 20

XYZ Ltd. issued 200, 15% debentures of Rs 100 each on April 01, 2013 at discount of 10% redeemable at premium of 10% out of profits. Give journal entries at the time of issue and redemption of debentures if debentures are to be redeemed in lump sum at the end of 4th year. The directors decided to transfer the minimum amount to Debenture Redemption Reserve on March 31, 2016.

Solution:

Books of XYZ Ltd.
Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
2013 April 01	Bank A/c	Dr.		18,000	
	To Debenture Application and Allotment A/c				18,000
	(Application money received on debentures)				
April 01	Debenture Application and Allotment A/c	Dr.		18,000	
	Loss on Issue of Debentures A/c	Dr.		4,000	
	To 15% Debentures A/c				20,000
	To Premium on Redemption of Debentures A/c				2,000
	(Issue of Debentures at 10% discount an redeemable at 10% premium)				
2016 March 31	Balance in Statement of Profit and loss	Dr.		5,000	
	To Debenture Redemption Reserve A/c				5,000
	(Transfer of profits to DRR)				
April 30	Debenture Redemption Investment A/c	Dr.		3,000	
	To Bank A/c				3,000
	(Required amount invested in DRI)				
2017 March 31	Bank A/c	Dr.		3,000	
	To Debenture Redemption Investment				3,000
	(DRI encashed at the time of redemption of debentures)				
March 31	15% Debentures A/c	Dr.		20,000	
	Premium on Redemption of Debentures A/c	Dr.		2,000	
	To Debentureholders A/c				22,000
	(Amount due on redemption)				
March 31	Debentureholders A/c	Dr.		22,000	
	To Bank A/c				22,000
	(Amount paid to debentureholders)				
March 31	Debenture Redemption Reserve A/c	Dr.		5,000	
	To General Reserve				5,000
	(Transfer of DRR to General Reserve After redemption of debentures)				

2.12.2 Redemption by Payment in Instalments

When, as per terms of the issue, the debentures are to be redeemed in instalments beginning from a particular year, the actual debentures to be redeemed are selected usually by draw of lots, and the redemption to be made either out of profits or out of capital. The entries will be:

1. *If redeemed out of profits*
   - (a) Statement of profit and loss Dr.
     To Debenture Redemption Reserve A/c
   - (b) Debentures A/c Dr.
     To Debentureholders
   - (c) Debentureholders Dr.
     To Bank A/c
2. *If redeemed out of capital*
   - (a) Debentures A/c Dr.
     To Debentureholders
   - (b) Debentureholders Dr.
     To Bank A/c

Illustration 21

ABC Ltd. issued 3,000, 14% Debentures of Rs 100 each at a discount of 5% on April 1, 2012. Interest on these debentures is payable annually on March 31 each year. The debentures are redeemable at par in three equal instalments at the end of the third, fourth and fifth year. Prepare 14% Debentures Account, Discount on Issue of Debentures Account and Debenture Interest Account in the books of the company.

Solution:

14% Debentures Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs)*
2013 Mar.31	Balance c/d		3,00,000	2012 Apr.01	Debenture Application		2,85,000
					Discount on Issue of Debentures		15,000
			3,00,000				**3,00,000**

Date	Particulars	J.F.	Amount (Rs)	Date	Particulars	J.F.	Amount (Rs)
2014 Mar.31	Balance c/d		3,00,000	2013 Apr.01	Balance b/d		3,00,000
			3,00,000				**3,00,000**
2015 Mar.31	Bank A/c		1,00,000	2014 Apr.01	Balance b/d		3,00,000
Mar.31	Balance c/d		2,00,000				
			3,00,000				**3,00,000**
2016 Mar.31	Bank A/c		1,00,000	2015 Apr.01	Balance b/d		2,00,000
Mar.31	Balance c/d		1,00,000				
			2,00,000				**2,00,000**
2017 Mar.31	Balance c/d		1,00,000	2016 Apr.01	Balance b/d		1,00,000
			1,00,000				**1,00,000**

Debentures Interest Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs)*
2013 Mar.31	Bank		**42,000**	2013 Mar.31	Statement of Profit and Loss		**42,000**
2014 Mar.31	Bank		**42,000**	2014 Mar.31	Statement of Profit and Loss		**42,000**
2015 Mar.31	Bank		**42,000**	2015 Mar.31	Statement of Profit and Loss		**42,000**
2016 Mar.31	Bank		**28,000**	2016 Mar.31	Statement of Profit and Loss		**28,000**
2017 Mar.31	Bank		**14,000**	2017 Mar. 31	Statement of Profit and Loss		**14,000**

Discount on Issue Debentures Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs)*
2012 Apr.01	To 14% debentures A/c		15,000	2013 Mar.31	Statement of Profit and Loss		3,750
				Mar.31	Balance c/d		11,250
			15,000				**15,000**

2013 Apr.01	Balance b/d		11,250	2014 Mar. 31	Statement of Profit and Loss		3,750
				Mar. 31	Balance c/d		7,500
			11,250				**11,250**
2014 Apr.01	Balance b/d		7,500	2015 Mar. 31	Statement of Profit and Loss		3,750
				Mar. 31	Balance c/d		3,750
			7,500				**7,500**
2015 Apr.01	Balance b/d		3,750	2016 Mar. 31	Statement of Profit and Loss		2,500
				Mar. 31	Balance c/d		1,250
			3,750				**3,750**
2016 Apr.01	Balance b/d		1,250	2017 Mar. 31	Statement of Profit and Loss		1,250
			1,250				**1,250**

Working Notes:

1. Debenture interest is calculated @ 14% on the amount of debentures outstanding in the beginning of each year. The amount of debentures outstanding on April 1, each year is:

	Debenture Outstanding Rs
April 2012	3,00,000
April 2013	3,00,000
April 2014	3,00,000
April 2015	2,00,000
April 2016	1,00,000

2. Discount on Issue of Debentures is written-off in the ratio of the amount of debentures outstanding in the beginning of each year. The ratio is 3:3:3:2:1. So amount of discount to be written-off will be

Year	*Rs*	*Amount Rs*
2012	Rs 15,000 $\times \frac{3}{12}$	3,750
2013	Rs 15,000 $\times \frac{3}{12}$	3,750
2014	Rs 15,000 $\times \frac{3}{12}$	3,750
2015	Rs 15,000 $\times \frac{2}{12}$	2,500
2016	Rs 15,000 $\times \frac{1}{12}$	1,250

2.13 Redemption by Purchase in Open Market

When a company purchases its own debentures in the open market for the purpose of immediate cancellation, the purchase and cancellation of such debentures are termed as redemption by purchase in the open market. The advantage of such an option is that a company can redeem the debentures at its convenience whenever it has surplus funds. Secondly, the company can purchase them when they are available in market at a discount.

When the debentures are purchased from the market at a discount and cancelled, the journal entries are recorded as follows :

1. *On purchase of own debentures for immediate cancellation*
   Debentures A/c Dr.
   To Bank A/c
   To Profit on Redemption of Debentures A/c
2. *On transfer of Profit on Redemption*
   Profit on Redemption of Debenture A/c Dr.
   To Capital Reserve

In case, the debentures are purchased from the market at a price which is above the nominal value of debenture, the excess will be debited to loss on redemption of debentures. The journal entry in that case will be

1. Debentures A/c Dr.
   Loss on Redemption of Debentures A/c Dr.
   To Bank A/c
2. Statement of profit and loss Dr.
   To Loss on Redemption of Debentures A/c

Illustration 22

X Ltd. purchased its own debentures of Rs 100 each of the face value of Rs 20,000 from the open market for cancellation at Rs 92. Record necessary journal entries.

Solution:

Books of X Limited
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Debentures A/c Dr.		20,000	
	To Bank A/c			18,400
	To Profit on Redemption of Debentures A/c			1,600
	(Own debentures purchased at Rs 92 from the market)			

	Profit on Redemption of Debenture A/c Dr. To Capital Reserve (Transfer of profit on cancellation of debentures to capital reserve)		1,600	1,600

* Alternatively, the following two journal entries may be passed:

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Own Debentures A/c To Bank A/c (Purchased its own debentures of Rs. 20,000 @ Rs. 92 each)		18,000	18,000
	Debentures A/c To Own Debentures A/c To Profit on Redemption of Debentures A/c (Own debentures purchased being cancelled)		20,000	18,000 2,000

Illustration 23

X Ltd. decided to redeem 250, 12% debentures of Rs 100 each amounting to Rs 25,000. For this purpose, the company purchased debentures amounting to Rs 20000 in the open market at Rs 98.50 each. Expenses of Rs 100 was incurred on it. The balance of debentures amounting to Rs 5,000 were reedemed by draw of lots. Journalise.

Solution:

Books of X Ltd.
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Balance in Statement of profit and loss A/c Dr. To Debenture Redemption Reserve A/c (Transfer of profits to Debenture Reserve A/c		6,250	6,250
	Debenture Redemption Investment A/c Dr. To Bank A/c (Required amount invested in DRI)		3,750	3,750
	Bank A/c Dr. To Debenture Redemption Investment A/c (DRI encashed at the time of redemption of debentures)		3,750	3,750

	12% Debentures A/c Dr. To Bank A/c To Profit on Redemption of Debentures A/c (Purchase of 200 debentures @ Rs. 98.50 plus expenses amounting to Rs. 100.)		20,000	 19,800 200
	Profit on Redemption of Debentures A/c Dr. To Capital Reserve (Profit on Redemption transferred to Capital Reserve.)		200	 200
	12% Debentures A/c Dr. To Bank A/c (Redemption of Rs. 50 debentures)		5,000	 5,000
	Debenture Redemption Reserve A/c Dr. To General Reserve (Balance is DRR transferred to General Reserve on Redemption of Debentures)		6,250	 6,250

Illustration 24

On April 01, 2013, a company made an issue of 1,000, 6% debentures of Rs 1,000 each at Rs 960 per debenture. The terms of issue provided for the redemption of 200 debentures every year starting from 31 March 2015 either by purchase or by draw of lot at par at the company's option. Rs 10,000 was written-off as the debenture discount account in years ending on March 31, 2014–15. On 31.03.2015, the company purchased for cancellation debentures of the face value of Rs 80,000 at Rs 950 per debenture and of the face value of Rs 1,20,000 at Rs 900 per debenture.

Journalise the above transaction and show the profit on redemption would be treated.

Solution:

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
2013 Apr. 01	Bank A/c Dr. To 6% Debentures Application & Allotment A/c (Debentures application money received)		9,60,000	 9,60,000
Apr. 01	6% Debentures Application & Allotment A/c Dr. Discount on Issue of Debentures A/c Dr. To 6% Debentures A/c (Debentures application money transferred to Debentures A/c)		9,60,000 40,000	 10,00,000

2014 Mar. 31	Statement of profit and loss Dr. To Discount on Issue of Debenture A/c (Discount on issue of debentures written-off)		10,000	10,000
Mar. 31	Balance in Statement of profit and loss Dr. To Debenture Redemption Reserve A/c (Transfer of profits DRR)		2,00,000	2,00,000
Apr. 30	Debenture Redemption Investment A/c Dr. To Bank A/c (Required amount invested in DRI)		30,000	30,000
2015 Mar. 31	Bank A/c Dr. To Debenture Redemption Investment A/c (DRI encashed at the time of Redemption of debentures)		30,000	30,000
Mar. 31	6% Debentures A/c Dr. To Bank A/c To Profit on Redemption of Debenture A/c (Redemption of 80 debentures by purchasing @ Rs 950 per debenture)		80,000	76,000 4,000
Mar. 31	6% Debentures A/c Dr. To Bank A/c To Profit on Redemption of Debentures A/c (Redemption of 80 debentures @ Rs 900 by purchasing in open market)		1,20,000	1,08,000 12,000
Mar. 31	Profit on Redemption of Debentures A/c Dr. To Capital Reserve A/c (Transfer of profits on cancellation of debentures of Capital Reserve A/c)		16,000	16,000
Mar. 31	Statement of profit and loss Dr. To Discount on Issue of Debentures A/c (Discount on debentures written-off)		10,000	10,000
Mar. 31	Debenture Redemption Reserve A/c Dr. To General Reserve A/c (Debenture Redemption Reserve in r/o debentures redeemed transferred to General Reserve A/c)		50,000	50,000

2.14 Redemption by Conversion

As stated earlier the debentures can also be redeemed by converting them into shares or new debentures. If debentureholders find that the offer is beneficial to them, they will take advantage of this offer. The new shares or debentures may be issued at par, at a discount or at a premium. It may be noted that no Debenture Redemption Reserve is required in case of convertible debentures because no funds are required for redemption.

Illustration 25

Arjun Plastics Limited redeemed 1,000, 15% debentures of Rs 100 each by converting them into equity shares of Rs 10 each at a premium of Rs 2.50 per share. The company also redeemed 500 debentures by utilising Rs 50,000 out of profit. Give the necessary journal entries.

Solution:

Books of Arjun Plastic Limted
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Statement of Profit and Loss Dr. To Debenture Redemption Reserve A/c (Transfer of profit to Debenture Redemption Reserve)		50,000	 50,000
	Debenture Redemption Investment A/c Dr. To Bank A/c (Required amount invested in DRI)		7,500	 7,500
	15% Debentures A/c Dr. To Debentureholders A/c (Amount due to debentureholders)		1,00,000	 1,00,000
	Debentureholders A/c Dr. To Equity Shares Capital A/c To Securities Premium Reserve A/c (Issue of 800 equity shares at a premium of Rs 2.50 per share)		1,00,000	 80,000 20,000
	Bank A/c Dr. To Debenture Redemption Investment A/c (DRI encashed at the time of redemption of debentures)		7,500	 7,500
	Debenture A/c Dr. To Debentureholders A/c (Amount due to debentureholders)		50,000	 50,000
	Debentureholders A/c Dr. To Bank A/c (Payment to debentureholders)		50,000	 50,000
	Debenture Redemption Reserve A/c Dr. To General Reserve (Debenture Redemption Reserve transferred to General Reserve on redemption of Debentures)		50,000	 50,000

Illustration 26

On April 01, 2013, a company made an issue of 10,000, 9% Debentures of Rs 100 each at Rs. 92 per debenture. The terms of issue provided for the redemption of 2,000 debentures every year starting from the March 31, 2016 either by conversion in to equity shares of Rs 20 each or by draw of lot at per at the company's option. On March 31, 2016, company redemption, 2,000, 9% debentures by converting them into Equity shares of Rs 20 each. Give the necessary Journal entries.

Books of a Company
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
2016 Mar. 31	9% Debentures A/c Dr. To Debentureholders A/c To Statement of Profit & Loss To Discount on Issue of Debentures A/c (Amount due to debentureholders on redemption by conversion)		2,00,000	 1,84,000 9,600 8,400
Mar. 31	Debentureholders A/c Dr. To Equity Share Capital A/c (New equity shares issued to debentureholders)		1,84,000	 1,84,000

Working Notes :-

i. Total Discount on the issue of 10,000 Debentures $= 10,00,000 \times \frac{8}{100}$
$= \text{Rs } 80,000$

Amount of Discount to be written off is determined as follows :

Year	*Amount (Rs)*	*Ratio*	*Amount (Rs)*
2013-14	10,00,000	5	$80,000 \times \frac{5}{25} = 16,000$
2014-15	10,00,000	5	$80,000 \times \frac{5}{25} = 16,000$
2015-16	10,00,000	5	$80,000 \times \frac{5}{25} = 16,000$
2016-17	8,00,000	4	$80,000 \times \frac{4}{25} = 12,800$
2017-18	6,00,000	3	$80,000 \times \frac{3}{25} = 9,600$
2018-19	4,00,000	2	$80,000 \times \frac{2}{25} = 6,400$
2019-20	20,000	1	$80,000 \times \frac{1}{25} = 3,200$
		25	**80,000**

ii. Up to March 31, 2016 discount on issue of debentures written off is Rs 48,000 out of total amount of Rs. 80,000.
So, on 2,000 debentures, now converted into shares amount of discount on issue of debentures written off is = $(2,00,000 \times \frac{8}{100}) \times \frac{48000}{80000}$ = Rs. 9,600

Remaining amount of discount amounting to Rs. 6,400 (Rs. 16,000 – Rs. 9,600) is not written off till March 31, 2016.

Illustration 27

The balance sheet of XYZ Ltd., disclosed the following information as on March 31, 2015.

	Rs
15% debentures	15,00,000
Debenture Redemption Fund	11,63,600
Debenture Redemption Fund Investment (10% Govt. Securities)	11,63,600

The contribution to Debenture Redemption Fund was Rs 1,30,800 p.a. for the year 2015–16 and 2016–17. Debentures are due for payment on December 31, 2017. Prepare the above accounts in the books of company assuming that securities were realised on March 31, 2017 for a sum of Rs 13,52,000 and interest on securities on March 31, was immediately invested.

Solution:

Debentures Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs)*
2016 Mar.31	Balance c/d		15,00,000	2015 Apr.01	Balance b/d		15,00,000
			15,00,000				**15,00,000**
2017 Mar.31	Bank		15,00,000	2016 Apr.01	Balance b/d		15,00,000
			15,00,000				**15,00,000**

Debentures Redemption Fund Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs)*
2016				2015			
Mar.31	Balance c/d		14,10,760	Apr.01	Balance b/d		11,63,600
				Mar.31	Interest on DRFI		1,16,360
				Mar.31	Statement of profit and loss		1,30,800
			14,10,760				**14,10,760**
2017	Debenture			2016			
Mar.31	Redemption Fund Investment		58,760	Apr.01	Balance b/d		14,10,760
					Interest on DRFI		1,41,076
Mar.31	General Reserve		16,23,876	2017	Statement of		1,30,800
				Mar.31	profit and loss		
			16,82,636	Mar.31			**16,82,636**

Debenture Redemption Fund Investment Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs)*
2015				2016			
Apr.01	Balance b/d		11,63,600	Mar.31	Balance c/d		14,10,760
2016	Bank		2,47,160*				
Mar.31			**14,10,760**				**14,10,760**
2016				2017			
Apr.01	Balance b/d		14,10,760	Mar.31	Bank		13,52,000
					Debenture Redemption Fund		58,760
			14,10,760				**14,10,760**

* (Interest + Instalment = Rs 1,16,360 + Rs 1,30,800 = Rs 2,47,160)

Illustration 28

LCM Ltd. purchased for cancellation its own 10,00,000, 9% Debentures of Rs 500 each at Rs 480 each. Record necessary journal entries.

Solution:

Books of LCM Ltd.
Journal

Date	Particulars	L.F.	Debit Amount (Rs)	Credit Amount (Rs)
	Own Debentures A/c Dr.		48,00,00,000	
	To Bank A/c			48,00,00,000
	(Purchased its own debentures @ Rs 480 each)			
	9% Debenture A/c Dr.		50,00,00,000	
	To Own Debenture			48,00,00,000
	To Profit on cancellation of debentures A/c			2,00,00,000
	(Own debenture purchased being cancelled)			
	Profit on cancellation of debentures A/c Dr.		2,00,00,000	
	To Capital Reserve			2,00,00,000
	(Profits on cancellation of debentures transferred to capital reserve)			

Illustration 29

The following balances appeared in the books of Madhu Ltd. as on April 01, 2016:

	(Rs)
12% Debentures	1,50,000
Debenture Redemption Fund	1,25,000
Debenture Redemption Fund Investments	1,25,000

The Debenture Redemption Fund Investments were represented by Rs 1,30,000, 9% Govt. Securities.

The annual instalment added to the fund was Rs 20,600. On March 31 2017, the bank balance before the receipt of interest on investments was Rs 40,000. On the date, all the investments were sold at 84% and the debentures were duly redeemed.

Prepare Debentures Account, Debenture Redemption Fund Account, Debenture Redemption Fund Investment Account and Bank Account for 2016–2017. The company closes its books on March 31, every year.

Solution:

Books of Madhu Ltd.

Debenture Redemption Fund Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs)*
2017				2016	Balance b/d		1,25,000
Mar.31	Debenture Redemption Fund Investment (Loss on Sale)			April 1 2017 Mar.31	Interest on Debenture Redemption Fund Investment		11,700
Mar.31	General Reserve		15,800		(9% on Rs 1,30,000)		
	(Transfer)		1,41,500	Mar.31	Statement of profit and loss		20,600
			1,57,300				**1,57,300**

Debenture Redemption Fund Investment Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs)*
2016				2017			
April 01	Balance b/d (Face value Rs 1,30,000)		1,25,000	Mar.31	Bank (84% of Rs 1,30,000)		1,09,200
							15,800
					By Debenture Redemption Fund		
			1,25,000		(Loss on Sale)		**1,25,000**

Bank Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs)*
2017				2017			
Mar.31	Balance b/d		40,000	Mar.31	Debenture		1,50,000
	Interest on D.R.F Investment		11,700	Mar.31	Balance c/d		10,900
Mar.31	Debenture Redemption Fund Investment (Sales Proceeds)		1,09,200				
			1,60,900				**1,60,900**

12% Debentures Account

Dr. *Cr.*

Date	Particulars	J.F.	Amount (Rs)	Date	Particulars	J.F.	Amount (Rs)
2017 Mar.31	Bank A/c		1,50,000	2016 April 30	Balance b/d		1,50,000
			1,50,000				**1,50,000**

Working Notes :

1. Interest on Debenture Redemption Fund Investments of 1,30,000 at 9% will be Rs 11,700.
2. Investments realised at 84%. Hence, the investments of Rs 1,30,000 will realise Rs 1,09,200.

Test your Understanding – II

Select the correct answer for the following multiple choice questions:

1. Debentures which are transferable by mere delivery are:
   (a) Registered debentures, (b) First debentures,
   (c) Bearer debentures.
2. The following journal entry appears in the books of X Co. Ltd.

Bank a/c	Dr.	4,75,000	
Loss on issue of debenture a/c	Dr.	75,000	
To 12% Debentures a/c			5,00,000
To Premium on Redemption of Debenture A/c			50,000

   Debentures have been issued at a discount of:
   (a) 15%, (b) 5%, (c) 10%.
3. X Co. Ltd. purchased assets worth Rs 28,80,000. It issued debentures of Rs 100 each at a discount of 4 per cent in full satisfaction of the purchase consideration. The number of debentures issued to vendor is:
   (a) 30,000, (b) 28,800, (c) 32,000.
4. Convertible debentures cannot be issued at a discount if:
   (a) They are to be immediately converted,
   (b) They are not to be immediately converted,
   (c) None of the above.
5. Discount on issue of debentures is shown under the following head in the Balance Sheet:
   (a) Statement of profit and loss,
   (b) Other non-Corrent Assets,
   (c) Debentures account.

6. When debentures are issued at par and are redeemable at a premium, the loss on such an issues debited to :
   (a) Statement of profit and loss,
   (b) Debentures applications and allotment account,
   (c) Loss on issue of debentures account.
7. Excess value of net assets over purchase consideration at the time of purchase of business is credited to :
   (a) General reserve,
   (b) Capital reserve,
   (c) Vendors' account.
8. When all the debentures are redeemed, balance in the debentures redemption fund account is transferred to :
   (a) Capital reserve,
   (b) General reserve,
   (c) Statement of profits and loss.
9. The nominal and book values of debenture redemption fund investments account are respectively Rs 1,00,000 and Rs 96,000. The company sold investments of nominal value of Rs 30,000 at a price which was just sufficient to redeem debentures of Rs 30,000 at 10% premium, the profit on sale of investment is :
   (a) Rs 4,200, (b) Rs 3,000, (c) Rs Nil.
10. Own debentures are those debentures of the company which:
    (a) The company allots to its own promoters,
    (b) The company allots to its Director,
    (c) The company purchases from the market and keeps them as investments.
11. Profit on cancellation of own debentures is transferred to :
    (a) Statement of profit and loss,
    (b) Debenture redemption reserve,
    (c) Capital reserve.
12. When debentures are redeemed out of profits, an equal amount is transferred to :
    (a) General reserve,
    (b) Debenture redemption reserve,
    (c) Capital reserve.
13. Profit on sale of debenture redemption fund investments in the first instance is credited to :
    (a) Debenture redemption fund account,
    (b) Statement of profit and loss,
    (c) General reserve account.

14. The balance of sinking fund investment account after the realisation of investments is transferred to:
    (a) Statement of Profit and Loss,
    (b) Debentures account,
    (c) Sinking fund account.
15. When debentures are issued at a discount and are redeemable at a premium, which of the following accounts is debited at the time of issue:
    (a) Debentures account,
    (b) Premium on redemption of debentures account,
    (c) Loss on issue of debentures account.

Test your Understanding – III

I. Identify the account to be debited in case of the following transactions.

1. Issue of debentures to a vendor in consideration of the business purchase.
2. Setting aside the amount for creating sinking fund for redemption of debentures.
3. The balance of debenture redemption reserve account after redemption of the debentures.
4. Purchase of own debentures by the company.
5. Writing-off discount on issue of debentures.

II. Identify the account to be credited in case of the following transactions.

1. Debentures issued at a discount and are redeemable at par.
2. Transfer of interest on Sinking fund investments to sinking fund account.
3. Balance of DRR account after the redemption of Debentures.
4. Profit on sale of sinking fund investment account.
5. Writing-off the loss on issue of debentures.

Do it Yourself

1. G. Ltd., has Rs 800 lakh, 10% debentures of Rs 100 each due for redemption on March 31, 2017. Assume that Debenture Redemption Reserve has a balance of Rs 3,40,00,00,000 on that date. Record necessary entries at the time of redemption of debentures.
2. R. Ltd., issued 88,00,000, 8% debenture of Rs 50 each at a premium of 5 % on July 1, 2014 redeemable at par by conversion of debentures into shares of Rs 20 each at a premium of Rs 2 per share on June 30, 2017. Record necessary entries for redemption of debentures.
3. C. Ltd. has outstanding 11,00,000, 10% debentures of Rs 200 each, on April 1, 2017. The Board of Directors have decided to purchase 20% of own debentures for cancellation at Rs 200 each. Record necessary entries for the same.
4. Record necessary journal entries in the books of the Company in each of the following cases for redemption of 1,000, 12% Debentures of Rs 10 each issued at par:
    (a) Debentures redeemed at par by conversion into 12% Preference Shares of Rs 100 each,

(b) Debentures redeemed at a premium of 10% by conversion into Equity Shares issued at par,

(c) Debentures redeemed at a premium of 10% by conversion into Equity Shares issued at a premium of 25%.

5. On 31 March, 2017 Janta Ltd. converted its Rs 88,00,000, 6% debentures into equity shares of Rs 20 each at a premium of Rs 2 per share. Record necessary journal entries in the books of the company for redemption of debentures.
6. Anirudh Ltd. has 4,000, 8% debentures of Rs 100 each due for redemption on March 31, 2017. The company has a debenture redemption reserve of Rs 50,000 on that date. Assuming that no interest is due, record the necessary journal entries at the time of redemption of debentures.

Bank Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs)*
2016				2017			
Apr.1	Balance b/d balance includes Rs 40,000, interest @ 10% on Rs 4,00,000)		3,00,000	Mar.31	12% Debentures		4,00,000
					Balance c/d		2,28,000
Mar.31	12% Debentures Sinking Fund Investment		3,28,000				
			6,28,000				**6,28,000**

Illustration 30

The following balances stood as on 31 March, 2017 in the books of a Company:

12% Debentures			Rs 10,00,000
Debenture Redemption Fund			Rs 10,00,360
Debenture Redemption Fund Investments represented by:			
Rs 4,00,000	9% Loan	Rs 3,80,000	
Rs 7,00,000	8% Govt. Paper	Rs 6,20,360	

On the above date, the investments were sold as follows: 9% loan at par, and 8% Govt. Paper at 90% of nominal value. The Debentures were also redeemed accordingly. Show the necessary ledger accounts.

Solution:

12% Debentures Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs)*
2017 March 31	Bank		10,00,000	2017 March 31	Balance b/d		10,00,000
			10,00,000				**10,00,000**

Debenture Redemption Fund Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs)*
2017 March 31	General Reserve		10,30,000	2017	balance b/d		10,00,360
				March 31	Debenture Redemption Fund Investment		29,640
			10,30,000				**10,30,000**

Debenture Redemption Fund Investment Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs)*
2017	Balance b/d			2017	Bank (9% Loan)		4,00,000
March 31	9% Loan		3,80,000	March 31	Bank		6,30,000
March 31	8% Govt.Paper		6,20,360	March 31	(8% Govt.Paper)		
March 31	Debenture Redemption Fund		29,640				
			10,30,000				**10,30,000**

Bank Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs)*
2017 March 31	To Debenture Redemption Fund Investment:			2017 March 31	By 12% Debentures		10,00,000
	9% Loan		4,00,000		By Balance c/d		30,000
	8% Govt. Paper		6,30,000				
			10,30,000				**10,30,000**

Note: The Bank Balance has not been given in the question.

Do it Yourself

1. X Ltd. decides to redeem 8,000, 10% debentures of Rs 100 each on April 1, 2017 at a premium of 5%. The company has a surplus of Rs 9,00,000 in the statement of profit and loss. The company closes its books on December 31 every year. What journal entries the company will be recording to redeem the above debentures ?

2. G Ltd. issued 5,00,000, 12% debentures of Rs 100 each on April 1, 2013 redeemable at par on July 1, 2017. The company received applications for 6,00,000 debentures and the allotment was made to all the applicants on pro-rata basis. The debentures were redeemed on due date. How much amount of Debenture Redemption Reserve is to be created before the redemption is carried out? Also record necessary journal entries regarding issue and redemption of debenture. Ignore tax deducted at source.

Terms Introduced in the Chapter

1. Debenture
2. Bond
3. Mortgaged Debenture
4. Perpetual Debenture
5. Zero Coupon Rate Debenture
6. Specific Coupon Rate Debenture
7. Registered Debenture
8. Bearer Debenture
9. Charge
10. Fixed Charge
11. Floating Charge
12. First Charge
13. Maturity Date
14. Principal
15. Discount/Loss on Issue of Debenture
16. Purchase Consideration
17. Redemption of Debenture
18. Draw of Lots
19. Own Debentures
20. Redemption out of Capital
21. Redemption out of Profits
22. Redemption of Convertible Debenture
23. Debentures Sinking Fund
24. Collateral Security
25. Second Charge
26. Purchase of Debenture from Open Market

Summary

Debenture: Debenture is the acknowledgements of debt. It is a loan capital raised by the company from general public. A person/holder of such a written acknowledgement is called 'debenture holder'.

Bond: Bond is similar to debenture in terms of contents and texture. The only difference is with respect of issue condition, i.e, bonds can be issued without pre-determined rate of interest as it is in case of deep discount bonds.

Charge: Charge is an incumbrance to meet the obligation under trust deed on certain assets which company agrees to mortgage either by way of first or second charge. First charge implies the priority in repayment of loan. Those who hold first charge against any specific asset will realise their claim from the net realisable value of such assets. Any amount of surplus from such assets given under first charge will be utilised for setting the claims for holder of second charge.

Types of Debenture: Debentures are of various types such as: secured and unsecured debentures redeemable and perpetual debentures, convertible and non-convertible debentures, zero coupon rate and specific rate, registered and bearer debentures.

Issue of Debenture: Debentures are said to be issued at par when the amount to be collected on them is equal to their nominal or face value. If the issue price is more than nominal or face value, it is said to be issued at a premium. If the issue price is less than the nominal or face value, it is said to be issued on discount. The amount received as premium is credited to 'securities premium account' whereas amount of discount allowed is debited to "loss/discount on issue" and is written-off over the years

Issue of Debentures for consideration other than Cash: Sometimes debentures can be issued to vendor or suppliers of patents, copyrights and for transfer of intellectual property rights on preferential basis without receiving money in cash.

Purchase Consideration: Purchase consideration is amount paid by purchasing company in consideration for purchase of assets/business firm, another enterprise/vendor.

Collateral Security: Any security in addition to primary security is called 'collateral security'.

Redemption of Debenture: Means discharge of liability on account of debenture/bond by repayment made to debenture holders Normally, the redemption takes place on the expiry of period for which they have been issued, depending upon the terms and conditions of issue.

Questions for Practice

Short Answer Questions

1. What is meant by a Debenture?
2. What does a Bearer Debenture mean?
3. State the meaning of 'Debentures issued as a collateral security'.
4. What is meant by 'Issue of debentures for consideration other than cash'?
5. What is meant by Issue of debenture at discount and redeemable at premium?
6. What is 'Capital Reserve'?
7. What is meant by a 'Irredeemable Debenture'?
8. What is a 'Convertible Debenture'?

9. What is meant by 'Mortgaged Debentures'?
10. What is discount on issue of debentures?
11. What is meant by 'Premium on Redemption of Debentures'?
12. How debentures are different from shares? Give two points.
13. Name the head under which 'discount on issue of debentures' appears in the balance sheet of a company.
14. What is meant by redemption of debentures?
15. Can the company purchase its own debentures?
16. What is meant by redemption of debentures by conversion?
17. How would you deal with 'Premium on Redemption of Debentures?
18. What is meant by 'Redemption out of Capital?
19. What is meant by redemption of debentures by 'Purchase in the Open Market'?
20. Under which head is the 'Debenture Redemption Reserve' shown in the balance sheet.

Long Answer Questions

1. Explain the different types of debentures?
2. Distinguish between a debenture and a share. Why debenture is known as loan capital? Explain.
3. Describe the meaning of 'Debenture Issued as Collateral Securities'. What accounting treatment is given to the issue of debentures in the books of accounts?
4. How is 'Discount on Issue of Debentures' treated in the books of accounts? How will you deal with the 'discount in issue of debentures' when the debentures are to be redeemed in instalments?
5. Explain the different terms for the issue of debentures with reference to their redemption.
6. Differentiate between redemption of debentures out of capital and out of profits.
7. Explain the guidelines of SEBI for creating Debenture Redemption Reserve.
8. Describe the steps for creating Sinking Fund for redemption of debentures.
9. Can a company purchase its own debentures in the open market? Explain.
10. What is meant by conversion of debentures? Describe the method of such a conversion.

Numerical Questions

1. G. Ltd. issued 75,00,000, 6% debentures of Rs 50 each at par payable Rs 15 on application and Rs 35 on allotment, redeemable at par after 7 years from the date of issue of debentures. Record necessary entries in the books of Company.
2. Y. Ltd. issued 2,000, 6% debentures of Rs 100 each payable as follows: Rs 25 on application; Rs 50 on allotment and Rs 25 on first and final call.

3. A. Ltd. issued 10,000, 10% debentures of Rs 100 each at a premium of 5% payable as follows:

   Rs 10 on Application;

   Rs 20 along with premium on allotment and balance on first and final call.

   Record necessary Journal Entries.

4. A. Ltd. issued 90,00,000, 9% debenture of Rs 50 each at a discount of 8%, redeemable at par any time after 9 years Record necessary entries in the books of A. Ltd.

5. A. Ltd. issued 4,000, 9% debentures of Rs 100 each on the following terms:

   Rs 20 on Application;

   Rs 20 on Allotment;

   Rs 30 on First call; and

   Rs 30 on Final call.

   The public applied for 4,800 debentures. Applications for 3,600 debentures were accepted in full. Applications for 800 Debentures were allotted 400 debentures and applications for 400 Debentures were rejected.

6. T. Ltd. offered 2,00,000, 8% debenture of Rs 500 each on June 30, 2014 at a premium of 10% payable as Rs 200 on application (including premium) and balance on allotment, redeemable at par after 8 years But application are received for 3,00,000 debentures and the allotment is made on pro-rata basis. All the money due on application and allotment is received. Record necessary entries regarding issue of debentures.

7. X. Ltd. invites application for the issue of 10,000, 14% debentures of Rs 100 each payable as to Rs 20 on application, Rs 60 on allotment and the balance on call. The company receives applications for 13,500 debentures, out of which applications for 8,000 debentures are allotted in full, applications for 5000 debentures were alloted 40% of received application, and the remaining applications were rejected. The surplus money on partially allotted applications is utilised towards allotment. All the sums due are duly received.

8. R. Ltd. offered 20,00,000, 10% debentures of Rs 200 each at a discount of 7% redeemable at premium of 8% after 9 years Record necessary entries in the books of R. Ltd.

9. M. Ltd. took over assets of Rs 9,00,00,000 and liabilities of Rs 70,00,000 of S.Ltd. and issued 8% debentures of Rs 100 each. Record necessary entries in the books of M. Ltd.

10. B. Ltd. purchased assets of the book value of Rs 4,00,000 and took over the liability of Rs 50,000 from Mohan Bros. It was agreed that the purchase consideration, settled at Rs. 3,80,000, be paid by issuing debentures of Rs 100 each.

    What Journal entries will be made in the following three cases, if debentures are issued: (a) at par; (b) at discount; (c) at premium of 10%? It was agreed that any fraction of debentures be paid in cash.

    (Note: Goodwill Rs 30,000)

11. X. Ltd. purchased a Machinery from Y. Ltd. at an agreed purchase consideration of Rs 4,40,000 to be satisfied by the issue of 12% debentures of Rs 100 each at a premium of Rs 10 per debenture. Journalise the transactions.
12. X. Ltd. issued 15,000, 10% debentures of Rs 100 each. Give journal entries and present it in the balance sheet in each of the following cases:
    (i) The debentures are issued at a premium of 10%;
    (ii) The debentures are issued at a discount of 5%;
    (iii) The debentures are issued as a collateral security to bank against a loan of Rs 12,00,000; and
    (iv) The debentures are issued to a supplier of machinery costing Rs 13,50,000.
13. Journalise the following:
    (i) A debenture issued at Rs 95, repayable at Rs 100;
    (ii) A debenture issued at Rs 95, repayable at Rs 105; and
    (iii) A debenture issued at Rs 100, repayable at Rs 105;
    The face value of debenture in each of the above cases is Rs 100.
14. A. Ltd. issued 50,00,000, 8% debentures of Rs 100 at a discount of 6% on April 01, 2009, redeemable at premium of 4% by draw of lots as under:
    20,00,000 debentures on March, 2011
    10,00,000 debentures on March, 2013
    20,00,000 debentures on March, 2014.
    Compute the amount of discount to be written-off in each year till debentures are paid. Also prepare discount/loss on issue of debenture account.
15. A company issues the following debentures:
    (i) 10,000, 12% debentures of Rs 100 each at par but redeemable at premium of 5% after 5 years;
    (ii) 10,000, 12% debentures of Rs 100 each at a discount of 10% but redeemable at par after 5 years;
    (iii) 5,000, 12% debentures of Rs 1000 each at a premium of 5% but redeemable at par after 5 years;
    (iv) 1,000, 12% debentures of Rs 100 each issued to a supplier of machinery costing Rs 95,000. The debentures are repayable after 5 years; and
    (v) 300, 12% debentures of Rs 100 each as a collateral security to a bank which has advanced a loan of Rs 25,000 to the company for a period of 5 years
    Pass the journal entries to record the: (a) issue of debentures; and (b) repayment of debentures after the given period.
16. A company issued debentures of the face value of Rs,5,00,000 at a discount of 6% on April 01, 2012. These debentures are redeemable by annual drawings of Rs,1,00,000 made on March 31 each year. The directors decided to write-off discount based on the debentures outstanding each year.

    Calculate the amount of discount to be written-off each year. Give journal entries also.

17. A company issued 10% debentures of the face value of Rs.1,20,000 at a discount of 6% on April 01, 2011. The debentures are payable by annual drawings of Rs 40,000 commencing from the end of third year.

    How will you deal with discount on debentures?

    Show the discount on debentures account in the company ledger for the period of duration of debentures. Assume accounts are closed on March 31 every year.

18. B. Ltd. issued debentures at 94% for Rs 4,00,000 on April 01, 2011 repayable by five equal drawings of Rs 80,000 each. The company prepares its final accounts on March 31 every year.

    Indicate the amount of discount to be written-off every accounting year assuming that the company decides to write-off the debentures discount during the life of debentures. (Amount to be written-off: 2012 Rs 8,000; 2013 Rs 6,400; 2014 Rs 4,800; 2015 Rs 2,000; 2016 Rs 1,600).

19. B. Ltd. issued 1,000, 12% debentures of Rs 100 each on April 01, 2014 at a discount of 5% redeemable at a premium of 10%.

    Give journal entries relating to the issue of debentures and debentures interest for the period ending March 31, 2015 assuming that interest is paid half-yearly on September 30 and March 31 and tax deducted at source is 10%.

20. What journal entries will be made in the following cases when company redeems debentures at the expiry of period by serving the notice: (a) when debentures were issued at par with a condition to redeem them at premium; (b) when debentures were issued at premium with a condition to redeem at par; and (c) when debentures were issued at discount with a condition to redeem them at premium?

Answers to Test your Understanding

Test your Understanding – I

1. False, 2. True, 3. False, 4. True, 5. True, 6. False, 7. False, 8. True, 9. False, 10. False, 11. False.

Test your Understanding – II

1 (c), 2 (b), 3 (a), 4 (a), 5 (b), 6 (c), 7 (b), 8 (b), 9 (a), 10 (c),
11 (c), 12 (b), 13 (a), 14 (c), 15 (c).

Test your Understanding – III

(I) Vendors Account, (2) Surplus i.e, Balance in Statement of Profit and Loss (3) Debenture Redemption Reserve Account, (4) Own Debentures Account, (5) Statement of Profit and Loss.

(II) (1) Debenture Account, (2) Sinking Fund Account, (3) General Reserve Account, (4) Sinking Fund Account, (5) Loss on Issue of Debentures Account.