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# **Diploma in Accounting (DIA)**

**DIA-5  
Company Account**

**Block**

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**UNIT –I: Issue and Redemption of Debenture**

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## UNIT-I : ISSUE AND REDEMPTION OF DEBENTURE

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### Learning objectives:

After studying this lesson, you will be able to know:

Meaning of debenture ,features of debenture, classification of debenture, advantages of debenture, disadvantages of debenture, difference between share and debenture, difference between debenture and bank loan, difference between debenture and bond, rules regarding issue of debenture, ways, source and methods of redemption of debenture, cancellation of debenture, conversion of debenture, how to calculate ex interest and cum interest.

### Structure:

- 1.1 Introductions
- 1.2 Features
- 1.3 Meaning
- 1.4 Classification
- 1.5 Advantages
- 1.6 Procedures of issue of debenture
- 1.7 Difference between share, debenture, bond and bank loan
- 1.8 Issue of debenture
- 1.9 Debentures as collateral securities
- 1.10 Redemption of debenture
- 1.11 Source and methods of debenture
- 1.12 Own debenture
- 1.13 Ex interest and cum interest

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## 1.1 Introduction:

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Need of huge amount of capital can be met by issuing debenture to the general public. Debenture is the source of debt capital. It is an acknowledgement of indebtedness.

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## 1.2 Meaning of debenture:

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According to section 2(12) of the companies act, 1956, debenture includes debentures, stock, bonds and any other securities of company whether constituting a charge on the assets of the company or not. By issuing this certificates company acknowledges its debt and undertake to repay the debt stipulated period with a fixed interest after a regular intervals.

### Definition of debenture:

According to pham,

“Debenture is a document given by a company as evidence of debt to the holder usually arising out of a loan and most commonly secured by a charge.”

A debenture may be defined as an instrument issued by a company under its common seal acknowledging a debt due by it to the debenture holder.

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## 1.3 Features of debenture:

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1. Acknowledgement of debt owned by a company to its holder.
2. Fixed interest bearing security where interest is paid at regular intervals.
3. It is issued under the common seal of the company.
4. Undertake to pay the stated money after a stipulated period.
5. It may or may not create any charge on the asset of the company.

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## 1.4 Classification of debentures:

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A company may issue different kind of debentures that can be classified on the basis of their features. The different types of debentures are as follows:

1. On the basis of security:

(a) Secured debenture: This specific types of debentures are always secured by a charge on the assets of the company. A fixed charge is a mortgage on particular assets. Whereas floating charge covers all the assets of the company.

(b) Unsecured or naked debentures: This type of debentures does not enjoy charge on any assets. That is why it is very risky for the investors.

## 2. On the basis of priority:

(a) First mortgage debenture: This kind of debenture enjoy first claim on the assets charged.

(b) Second mortgage debenture: this kind of debenture have second claim on assets charged.

## 3. On the basis of redemption:

(a) Redeemable debentures: Redeemable are paid at lump sum after the expiry of its tenure or by instalments during the life time of the company.

(b) Irredeemable debentures: These debentures are payable only at the time of liquidation of the company. It is also called preferential debenture.

## 4. On the basis of convertibility:

(a) Convertible debentures: This type of debenture facilitates the debenture holder to be an owner from a lender of the company by converting the share into share>

(b) Non convertible debentures: The holder of these debenture does not enjoy any right of conversion into shares.

## 5. On the basis of negotiability:

(a) Registered debenture: Name and address of the holder of this debenture is entered in the register of debenture holder kept by the company. Interest is paid only to the person whose name is registered.

(b) Bearer debenture: The name of the holder of such debenture is not written on the register of the company. Interest is paid to the last holder of the debenture.

6. On the basis of interest:

(a) With interest: Debenture is issued with a specified rate of interest. These types of interests are two types, i.e. Fixed, Floating.

(b) Without interest: Zero interest (coupon) bond which does not carry any lend of interest. It is issued at a substantial discount. Another name of this bond is deep discount bond.

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### **1.5 Advantages and disadvantages of issue of debenture:**

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Advantages:

From the view point of company:

1. Interest on debentures are deductible in determining taxable income of the company.
2. Cost of debenture capital is lower as compare to cost of share capital.
3. Issue of debenture instead of equity share helps to enhance the earning per share.

From the view point of the investor:

1. Debenture can be converted into shares.
2. Debentures cannot be forfeited due to non payment of allotment and call money.
3. Debenture holder enjoys priority in payment of interest and capital.

Disadvantages:

1. Huge outflow of cash at the time of redemption may hamper the liquidity of the company.
2. Recurring payment of interest on debenture is the periodical financial burden of the company.

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### **1.6 Procedure to issue debentures under the companies act, 2013:**

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Call and hold Board meeting and decide which types of the debenture will be issued by the Company.

If the Company decides to issue secured debenture the company has to comply with the condition prescribed in the Rule 18 of the Companies (Share Capital & Debentures) Rules, 2014.

In case appointment of Debenture Trustee, consent shall be obtained from a SEBI registered Debenture Trustee, who is proposed to be appointed. If debentures to be issued are Secured Debentures, a Debenture Trust Deed in Form No. SH – 12 or as near thereto as possible shall be executed by the Company in favour of Debenture Trustees within sixty days of allotment of Debentures.

In the Board meeting pass resolutions for

- i) Approval of Offer letter for private placement in Form No. PAS – 4 and Application Forms (In case of private placement of debentures);
- ii) Approval of Form No. PAS – 5 (In case of private placement of debentures);
- iii) Approval of Debenture Trustee Agreement and appointment of a Debenture Trustee (In case of Secured Debentures only);
- iv) Appointment of an expert for valuation (In case of private placement of debentures);
- v) Approval of increase of borrowing powers, if required;
- vi) To authorize for creation of charge on the assets of the company;
- vii) Approve the Debenture Subscription Agreement;
- viii) To fix day, date and time for the extraordinary general meeting of shareholders.

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### **1.7 Difference between share and debenture:**

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<b>Sl. No.</b>	<b>Share</b>	<b>Debenture</b>
1	Share is the part of share capital of the company.	Debenture is the part of debt capital of the company.
2	Share holders are the owners of the company.	Debenture holders are the lenders of the company.
3	Share holder get dividend from time to time as a return of their investment.	Debenture holder use to get interest from time to time as a return of their investment.
4	Rate of dividend is variable if it is equity share.	Rate of interest on debenture is fixed.
5	Share cannot be converted into debenture.	Debenture can be converted into shares.

6	Generally share capital is not pay back during the life time of the company.	Amount due on debenture pay back to the holder after a specified period.
7	Share holder does not enjoy any priority on payment of capital and dividend as compare to debenture.	Debenture holder gets priority in this issue before share holder.
8	Shares can be forfeited due to non payment of allotment and calls money.	Debentures cannot be forfeited due to non payment allotment and calls money.
9	Cost of share is an appropriation of profit.	Cost of debenture is charge against profit.
10	There are only two kinds of shares equity and preference.	There are more than ten kind of debentures.

### Difference between Debenture vs. Bank Loan

Both debenture and bank loan are ways to finance the long-term debt. However, there are various differences between the two:

- **Lending Partner:** In debenture, the public lends its money to the company in return for a certificate promising a fixed rate of interest. In loans, the lending institutions are banks and other financial institutions.
- **Collateral:** Debentures do not require any physical asset or collateral from the firm, whereas banks and other institutions require collateral for the loans unless it is a small amount of unsecured loan.
- **Transferability:** Debentures can be transferred from one person to another. However, bank loans are non-transferable.

### Difference between Debenture vs. Bond

Debenture and bond are used often as interchangeable terms. However, there are subtle and noteworthy differences between the two instruments:

- **Security:** A bond is a more secure instrument than a debenture. A debenture does not have any collateral backing; whereas a bond will always have collateral attached.
- **Rate of Interest:** Debenture holders are entitled to a higher rate of interest in comparison to bond holders. The reason is that debenture is an unsecured loan and therefore, is riskier than a bond.
- **Liability:** In a case of a bankruptcy, the company is liable to pay bondholders on priority, whereas debenture holders are paid later.



- Periodical Payments: Debenture holders are paid periodical interest on their loan and the principal is paid back at the completion of the entire term. Bondholders, on the other hand, are not paid any periodical payments. They receive the accrued interest and the principal upon the term completion at one go.

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### **1.8 Issue of debenture:**

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The procedure and process of issue of debentures are as like as issue of shares. So the accounting entries on the issue of debentures are also similar to the issue of shares. The only difference is that the term share will be replaced by the word debenture.

Issue of debenture for cash:

Issue of debenture at par:

When money is received in instalment:

1. On receipt of application money

Bank A/C ..... Dr.

To Debenture application A/C

2. On transfer of application money to debenture account

Debenture application A/C..... Dr.

To debenture A/C

3. On making allotment money due

Debenture allotment A/C..... Dr.

To debenture A/C

4. On receipt of allotment money

Bank A/C..... Dr.

To debenture allotment A/C

5. On making the call

Debenture calls A/C..... Dr.

To debenture A/C

6. On receipt of call money

Bank A/C..... Dr.

To debenture call A/C

Issue of debenture for consideration other than cash:

1. On acquisition of assets

Assets A/C ..... Dr.

To vendor A/C

2. On allotment of debenture

Vendor A/C..... Dr.

To debenture A/C

**Illustration:**

ABC Ltd. took over the assets of Rs.4, 00,000 and liabilities of 30,000 of XYZ Ltd. For an agreed purchase consideration of Rs.3, 60,000 to be paid by the issue of 10% debenture of Rs.100 each at a discount of 10%. Show the necessary journal entries in the book of ABC Ltd.

Date	Particulars	L/F	Dr.	Cr.
	Sundry asset A/C..... Dr.		4,00,000	
	To sundry liabilities A/C			30,000
	To capital reserve A/C			10,000
	To XYZ Ltd. A/C			3,60,000
	(Being the purchase of assets and liabilities from XYZ Ltd.)			
	XYZ Ltd. A/C..... Dr.		3,60,000	
	Discount on issue of debenture A/C..... Dr.		40,000	
	To 10% debenture A/C			4,00,000
	(Being the issue of 4000 debentures of Rs.100 each at a discount of 10%)			

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### 1.9 Issue of debenture as collateral security:

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Sometimes debentures are used as a collateral security. It is used as an additional security against the loan taken by the company for to meet its long term needs.

1. on issue of such debenture

Debenture suspense A/C..... Dr.

To debenture A/C

2. On release of such debentures

Debenture A/C..... Dr.

To debenture suspense A/C

#### Illustration:

Vinayak Ltd issue 20,000 10% debentures of Rs.50 each As collateral security to a commercial bank against a loan of Rs.8,00,000. On 1st September, 2016

#### Journal entry

Date	Particulars	L/F	Dr.	Cr.
	Debenture suspense A/C..... Dr. To 10% debenture A/C (Being the issue if 20,000 10% debenture @ Rs.50 each as collateral security for a loan of Rs.8, 00,000 from bank.		1,00,000	1,00,000

#### Vinayak Ltd.

#### An extract of balance sheet as at

Liabilities	Rs.	Assets	Rs.
Secured loans	10,00,000	Miscellaneous	
20,000 10% debenture of		expenditure	10,00,000
Rs.50 each.	8,00,000	Debenture	
(Issued at collateral		suspense	
Security)			
Loan from bank			
(Secured by debenture)			

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### **1.10 Redemption of debenture:**

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Debentures may be redeemed as per the terms and conditions already stated in the debenture certificate. The debentures may be redeemed in one of the four ways,

1. By lump sum payment
2. By instalment payment
3. By conversion
4. By buy back

Accounting entries when payment is made by lump sum

a. When debentures are redeemed at par:

1. Debenture A/C..... Dr.  
    To debenture holders A/C
2. Debenture holders A/C..... Dr,  
    To bank A/C

b. When debentures are redeemed at a premium:

1. Debenture A/C..... Dr.  
    Premium on redemption of debenture A/C..... Dr.  
    To debenture holders A/C
2. Debenture holders A/C..... Dr  
    TO bank A/c

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### **1.11 Redemption of Debentures: Sources and Methods!**

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Redemption of debentures means payment of the amount of debentures by the company. When debentures are redeemed, liability on account of debentures is discharged. Amount of funds required for redemption of debentures is quite large and, therefore, prudent companies make sufficient provision out of profits and accumulate funds to redeem debentures.

In this connection, The Companies (Amendment) Act, 2000 has introduced section 117 C which provides that:

1. Where a company issues debentures after the commencement of this Act, it shall create a debenture redemption reserve for the redemption of such debentures, to which adequate amounts shall be credited, from out of its profits every year until such debentures are redeemed.

2. The amounts credited to the debenture redemption reserve shall not be utilized by the company except for the purpose aforesaid.

It should also be noted that before the introduction of this section, there was no provision in the Companies Act 1956 for the redemption of debentures. However Securities and Exchange Board of India has provided some guidelines.

The relevant points of these guidelines are:

(i) Every company shall create DRR in case of issue of debentures redeemable after a period of more than 18 months from the date of issue.

(ii) The creation of DRR is obligatory only for non-convertible debentures and non-convertible portion of partly convertible debentures.

(iii) A company shall create DRR equivalent to 50% of the amount of debenture issue before starting the redemption of debenture.

(iv) Drawal from D.R.R. is permissible only after 10% of the debenture liability has already been redeemed by the company.

SEBI has no powers to administer the provisions of section 117 C. But Sec. 117 C does not specify the amount up to which D.R.R. should be created. In the absence of any such details, one may refer to guidelines issued by SEBI.

Sources of Funds for Redemption of Debentures:

So, far as sources of funds for the redemption of debentures are concerned, the company may choose any one of following courses:

1. Redemption of Debentures out of Capital:

Under this method the company may dispose off some fixed asset and may use the sale proceeds for redemption of debentures. However, it is a very unusual source of finance and is rarely followed. Again the company may utilize its working capital to redeem the debentures. This adversely affects the working capital of the company. In either case, the assets of the company are reduced. However, in view of the legal provisions with regard to creation of DRR, redemption of debentures purely out of capital is not possible. In this case, the basic entries for redemption of debentures are passed.

They are as follows:

1 Debiture a/c                      Dr

To Debiture Holder a/c

2 Debiture Holder a/c              Dr

To Bank a/c

## 2. Redemption of Debentures out of Profits:

Redemption of debenture out of profits implies that an amount equal to the face value of the debentures redeemed is transferred to DRR. Thus, a part of the profits of company are withheld from distribution to shareholders.

Accounting entries in this case are as follows:

1 Debiture a/c                      Dr

To Debiture Holder a/c

2 Debiture Holder a/c              Dr

To Bank a/c

3 Profit & loss Appropriation a/c Dr

To Debiture Redemption Reserve a/c

Debiture redemption reserve account appears on the liabilities side of the balance sheet. The balance in Debiture Redemption Reserve a/c increases with each redemption. When all the debentures are redeemed, the DRR is closed by transferring its balance to general reserve.

## Methods of Redemption of Debentures:

Debentures may be redeemed in a number of ways. Procedure for redemption of debentures is laid down at the time of issue of debentures and it is in accordance with the provisions of articles of association.

The following are the main methods of redemption of debentures:

I. Redemption of debentures in lump-sum at maturity

II. Redemption of debentures by draw of lots

III. Redemption of debentures by purchasing them in the open market

#### IV. Redemption of debentures by conversion

##### I. Redemption of Debentures in Lump-sum at Maturity:

In this case, debentures are redeemed in one lump-sum at the end of stipulated period.

The basic accounting entries for redemption of debentures are:

1 Debiture a/c                      Dr

To Debenture Holder a/c

2 Debenture Holder a/c          Dr

To Bank a/c

Debentures may be redeemed at par, at premium or at a discount. When debentures are redeemed at par, the above two entries are passed. When debentures are redeemed at premium, the following accounting entries are passed.

    Debenture a/c                      Dr

    Premium on redemption on debenture Dr

    To Debenture Holder a/c

It may be noted here that ‘premium on redemption of debentures a/c’ may have opened and credited at the time of issue of debentures. If so, then premium payable on redemption of debentures has only to be transferred to debenture holders account as per first entry. If it has not been opened earlier, it will be debited now and later closed by transferring it to securities premium a/c or profit and loss account.

Debentures may be redeemed at discount though it is an unreal situation and not found in practice.

However, in such a case the following entries are passed:

1 Debiture a/c                      Dr

To Debenture Holder a/c

To profit on redemption of debentures

Profit on redemption of debentures is a capital profit. It is used to write-off discount on issue of debentures/shares; otherwise it will be transferred to capital reserve.

Debentures may be redeemed out of capital or out of profits. Prudent companies make arrangements for the redemption of debentures from the very beginning. They set aside a certain sum of money out of profits every year and invest an equivalent amount in first class securities so that necessary funds are available for redemption of debentures at the appropriate time.

For investing funds outside the business, the company may follow any of the following two methods:

(a) Sinking fund method/debenture redemption fund method

(b) Insurance policy method

(a) Sinking Fund Method/Debenture Redemption Fund Method:

Under this method every year the company sets aside a certain part of profits and credits the same to debenture redemption fund. To collect the required funds at the time of redemption, it invests the same in first-class securities. The interest earned in the investments is also invested when the debentures fall due for redemption; investments are sold and sale proceeds utilized for redeeming the debentures.

Instead entry for sale of investment and redemption of debentures will be passed which are as follows:

Bank a/c                                      Dr

To DRF Investment a/c

(Being sale of investment)

DRF Investment a/c                      Dr

To DRF a/c

(Being profit on sale transferred to DRF a/c)

For loss on sale of investments reverse entry will be passed. On redemption of debentures, the following entries will be passed.

1 Debenture a/c                              Dr

To Debenture Holder a/c

2 Debenture Holder a/c                  Dr

To Bank a/c



The credit balance in DRF a/c will be transferred to general reserve account. It may be noted here that profit on sales of investment which was earlier transferred to DRF account will be transferred to capital reserve from DRF, these facts are recorded by means of following accounting entry.

Debenture redemption fund a/c      Dr

To General reserve a/c

To capital reserve a/c (profit)

(b) Insurance policy method:

Under this method, the company instead of purchasing investments takes an insurance policy for an amount which would be adequate for the redemption of debentures.

Accounting entries, under these methods are as follows:

First year and subsequent years (including last year)

1. Debenture redemption fund a/c      Dr

To Bank a/c

(Being payment of premium)

2. Profit & loss appropriation a/c      Dr

To Debenture redemption fund a/c

(Being appropriation of profit to DR fund)

In the last year, when policy amount is realized and debentures are redeemed, the following accounting entries are passed.

Bank a/c                                      Dr

To DRF policy a/c

(Being the amount of policy realized)

2 Debenture a/c                              Dr

To Debenture Holder a/D

(Being the amount of debenture transferred to d. holder a/c)

3 Debenture Holder a/c                      Dr



To Bank a/c

(Being payment made to D. holder)

4. DRF Policy a/c                      Dr

To DRF a/c

(Being profit on policy transferred to policy a/c)

5. DRF fund a/c                      Dr

To General reserve a/c

(Being the balance of DRF a/c transferred to general reserve a/c)

## II. Redemption of Debentures by Draw of Lots:

Under this method, the company redeems debentures each year. The debentures to be redeemed are selected by draw of lots. Accounting entries for redemption of debentures are the same as passed in case debentures are redeemed out of profits.

They are as follows: 1 Debenture a/c                      Dr

To Debenture Holder a/c

2 Debenture Holder a/c                      Dr

To Bank a/c

3. P&L appropriation a/c                      Dr

To debenture redemption reserve a/c

When all the debentures are redeemed, the balance in DRR account will be transferred to general reserve.

## III. Redemption of Debentures by purchasing them in the Open Market:

Sometimes the company purchases the debentures in the open market at its convenience and redeems them. The company may purchase the debentures at par or at premium or at discount.

Accounting entries for the purchase of debentures at par will be as follows:

Debenture a/c                      Dr

To Bank a/c



Accounting entry will be:

1. Debiture a/c Dr  
 To own debenture a/c  
 To profit on cancellation of own debenture a/c
2. profit on cancellation of own debenture a/c Dr  
 To capital reserve

However, if price paid on own debentures is more than the face value of debentures, company will make a loss on cancellations of own debentures.

Accounting entry will be as under:

- Debiture a/c Dr  
 Loss on cancellation of own debenture a/c Dr  
 To own debenture a/c

Loss on cancellation of own debentures will be transferred to P&L account.

#### IV. Redemption of Debentures by Conversion:

Sometimes a company redeems debentures by converting them into a new class of shares or debentures. If new debentures are issued in place of old debentures, the accounting entry will be

- Debiture a/c Dr  
 To debenture a/c( new)

In case debentures are redeemed by converting them into equity shares, the entry will be

- Debiture a/c Dr  
 To equity share capital a/c

If the debentures are converted into equity shares at a premium the accounting entry will be

- Debiture a/c Dr

To equity share capital a/c

To securities premium a/c

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### 1.13 Ex-Interest and Cum-Interest Quotations:

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Sometimes debentures are purchased in the open market on a date other than the date of payment of interest on debentures. In such a case, distinction must be made between capital and revenue parts of the price paid for debentures. Of the price paid for the debenture, what is capital part and what is revenue part will depend upon the quotation made for the debentures.

Quotation price of the debentures may be cum-interest or ex-interest. If the price quoted is cum-interest, it means price quoted for the debentures includes interest for the expired period. If the quotation is ex-interest, it means price of the debenture does not include interest for the expired period and, therefore, the buyer in addition to the quotation price, has to pay interest for the expired period. At the time of passing entries for the purchase of own debentures, capital part of the price are debited to 'own debentures account' and revenue part of the price is debited to interest account.

Example:

X Co. Ltd. buys its own 9 per cent debentures of the nominal value of Rs. 40,000 at Rs. 97 on March 31, 2002. Record the transaction in the books of the company if quotations price is:

(i) Cum-interest

(ii) Ex-interest.

Company pays interest on debentures on June 30, and Decem-ber 31.

1 Cum-interest own debenture a/c      Dr 37,900

Interest a/c                                      Dr     900

To bank a/c                                      38,800

(Being purchase of own debenture at cum interest)

2 Ex-interest own debenture a/c      Dr 38,800

Interest a/c                                      Dr     900

To bank a/c                                      39,700

(Being purchase of own debenture at ex interest)

Note:

Interest for the expired period = Rs. 40,000 x 9 x 3/100 x 100 x 12 = Rs. 900

Non-Convertible Debentures (NCD) with Detachable Warrants:

A recent innovation in the Indian stock market is the issue of non-convertible debentures with detachable warrants attached to them. These warrants can be exchanged by the investors for equity shares of the company. The number of equity shares that would be allotted to the investors against the warrants and the time period within which the option is to be exercised by the investors is specified by the company at the time of issue of the non-convertible debentures.

When the time for exercising the option comes, the holders of these warrants who wish to exchange them for shares should pay the specified price and will be allotted the specified number of shares. The dividend warrants are intended to act as sweeteners to the NCD issue, and are considered beneficial to the investors because of the potential increase in the market prices of the company's shares. For instance, Mangalore Refineries and Petrochemicals Ltd. came out with a large issue in May 1992 comprising the issue of equity shares, PCDs and NCDs with detachable warrants.

The terms of the issue of NCDs aggregating Rs. 500 crore were as follows:

NCDs—Rs. 200 each

Rate of interest—17.5%

Redemption—5-9 years

Detachable equity warrants carrying the right to apply for one equity share of Rs. 10 at par between eighteen to twenty four months from the date of allotment.

The accounting entries would be as follows:

When the application money of Rs. 50 and the call money of Rs. 150 are received, the 17.5% non-convertible debentures account would show a credit balance of Rs. 500 crore. This would carry interest at 17.5 per cent and would be debited only on redemption between the fifth and the ninth year.

Between eighteen to twenty-four months, the NCD holders who are entitled to apply for equity shares will have to pay up Rs. 10 per share. Assuming that the holders of 2 crore NCDs of Mangalore Refineries exercise such option, the company would pass the following entry:



Bank a/c                      Dr     20,000  
To equity share capital                      20,000

(Being option on detachable equity warrants exercised by NCD holders)

Recognition of the Liability under the Equity Warrant Exercisable by the Investor:

The entries given above are under the assumption that the equity liability on the warrants is recognized in the company's books only when the option for the same is exercised by the debenture holders. However, an International Accounting Standard on 'Financial Instruments' has been formulated wherein a different treatment is suggested for the equity options.

The IAS accounting standard requires a company to recognize the financial liability under the warrant option at the time of issuing the compound instrument (i.e., the financial instrument consisting of the debentures, and the equity option) itself.

The liability under the option may be determined by some options valuation model that are available. It is also required that the liability under the debentures and the equity option have to be segregated and shown separately—the debenture liability along with such similar bond instruments and that under the equity option under share capital.

However, since there is no such legal or accounting standard requirement in India and the equity warrants themselves are new instruments, it is yet to be seen how companies actually account for the same and whether they make any disclosure regarding the equity options in their balance sheets.

It is most desirable, however, that even if companies do not account for the equity options until such options are exercised, specific disclosures as to the number of such warrants issued, the price that is to be paid for converting them into shares and the time within which such options are to be exercised, etc. are given by way of a note to the Balance Sheet in order to facilitate analysis and future projections of the company's prospects and commitments.

Introduction to Redemption of Debentures:

Debentures are invariably redeemable. The Companies Act has not laid down any conditions for the redemption of debentures. Of course, the terms laid down for the redemption of the debentures in the prospectus at the time of issue of the debentures will have to be complied with by the company.

Debentures may be redeemed in one of the following three ways:

(i) In one lot:

All the debentures may be redeemed in one lot at the end of a specified period of time or even before the expiry of the specified period of time by serving a notice to debenture-holders

(ii) In instalments by draw of lots:

The debentures may be redeemed in instalments. For example one-tenth of the total debentures may be redeemed every year for ten years by draw of lots. Lot will have to be drawn every year to determine which particular debentures have to be redeemed in that particular year.

(iii) By purchase of debentures in the open market:

A company may reserve the right to buy its debentures in the open market. If the company cancels the debentures so purchased, it will amount to redemption of these debentures.

Cancellation of debentures may take place in one of the two ways:

(a) Immediate cancellation:

The company may cancel the debentures immediately after their purchase in the open market.

(b) Cancellation after holding them for some time as ‘Own Debentures’:

The company may hold the debentures purchased in the open market for some time as investments in ‘Own Debentures’. It is done when the company wants to keep open its option of reselling the debentures. But after some time, it may decide to cancel the debentures held. After cancellation, the debentures stand redeemed and cannot be resold.

The company may redeem only a part of the debentures by purchase in the open market. The remaining debentures may be redeemed at the expiry of the stipulated period of time.

When a company redeems its debentures in one lot at the expiry of a specified period of time or in instalments by draw of lots, the debentures may be redeemed either at par or at a premium according to the terms of issue. But if the company redeems debentures by purchase in the open market the debenture may be redeemed at a premium, at par or even at a discount.



Debentures will be redeemed at a discount when the company is able to buy the debentures in the open market at a price lower than the face value of the debentures. Before redemption starts, there must be a balance of at least 50% of the amount of debentures issued in the Debenture Redemption Reserve.

By the terms of issue, the debentures may be redeemable at a premium and the company may, at the time of allotment of debentures, credit Premium on Redemption of Debentures Account with the amount of the premium payable at the time of debentures.

The company may reserve the right of redeeming any of these debentures by purchase in the open market.

If the company redeems any of such debentures by purchasing them in the open market and then cancelling them, while passing entries on cancellation, Debentures Account will be debited with face value of debentures cancelled and Premium on Redemption of Debentures Account will be debited with premium agreed to be paid on redemption according to the terms of the issue.

Profit or loss on cancellation will be calculated by comparing the purchase price of debentures cancelled with this face value plus the premium payable on redemption according to the terms of the issue. Illustration :X Co. Ltd issued 10 percent debentures for Rs 6,00,000 on January 1, 2012. Debentures were to be redeemed after four years from the date of issues, i.e., on December 31, 2016. Company decided to create a debenture redemption fund for the purpose and purchased earning interest @5 percent p.a. Sinking fund table show that .232012 invested annually at amount to Re 1 in four years. On the due date investment were sold for Rs 4,40,000 debentures were redeemed. Pass necessary journal entries to record the above instructions for , prepare necessary accounts. Bank balance before redemption on the due date was

Solution: The annual investment (excluding interest) required is  $6,00,000 \times .232012 = 1,39,207.20$

### Journal Entries



Date	Particulars	Amount Rs.	Amount Rs.
	Bank a/c .....Dr. 10% debenture a/c (Being the issue of 10% debentures a/c)	6,00,000	6,00,000
	Profit and loss appropriation a/c .....Dr. To debenture redemption fund a/c (Being the amount of profit credited to DRF a/c)	1,39,207.20	1,39,207.20
	Debenture redemption fund investment a/c .....dr. To bank a/c (Being the purchase of investment)	1,39,207.20 6,960.36	1,39,207.20 6,960.36
	Bank a/c .....Dr. To Interest on DRF investment a/c (being interest received debentures)	6,960.36	6,960.36
	Interest on DRF investment a/c .....Dr. To DRF a/c (Being interest received on DRF investment transferred to DRF a/c)	1,39,207.20	1,39,207.20
	P&L appropriation a/c .....Dr. To DRF a/c (Being amount of profit transferred to DRF a/c)	1,46,167.56	1,46,167.56
	DRF investment a/c .....Dr. To bank a/c (Being the purchase of investments)		

Date	Particulars	Rs	Date	Particulars	
	To balance c/d	6,00,000	2014 Jan. 1	By balance b/d	6,00,000
	To debenture holders	6,00,000	2015 Jan. 1	By balance b/d	6,00,000

**Debenture redemption fund a/c**

Date	Particulars	Rs	Date	Particulars	Rs
2012 Dec. 31	To balance c/d	13,920.20	2012 Dec.31	By P&L appropriate a/c	13,920.20
2013 Dec. 31	To balance c/d	2,85,374.76	2013 Jan. 1	By balance b/d	1,39,207.20
			2013 Dec. 31	By interest on DRF	6,960.36
			2013 Dec.31	By P&L appropriation a/c	6,960.36
					2,85,374.76
		2,85,374.76			
2014 Dec. 31	To balance c/d	4,38,850.70	2014 Jan. 1	By balance b/d	2,85,374.76
			2014 Dec.31	By interest on DRF investment a/c	14,268.76
			2014 Dec. 31	P&L appropriation a/c	13,920.20
		4,38,850.70			4,38,850.70
2015 Dec. 31	To G. Reserve a/c	6,00,000.43	2015 Jan. 1	By balance b/d	4,38,850.70
	To capital reserve a/c	1,149.30	2015 Dec. 31	By interest on DRF investment	21,942.53
			2015 Dec. 31	BY P&L appropriation a/c	1,39,207.20
			2015 Dec. 31	By DRF investment a/c	1,149.30
		6,01,149.73			6,01,149.73

**Debenture redemption Fund investment a/c**

Date	Particulars	Rs	Date	Particulars	Rs
2012 Dec. 31	To bank a/c	1,39,207.20	2012 Dec. 31	By balance c/d	1,39,207.20
2013 Jan. 1	To balance b/d	1,39,207.20	2013 Dec. 31	By balance c/d	
2013 Dec. 31	To bank a/c	1,46,167.56			
		2,85,374.76			2,85,374.76
2014 Jan. 1	To balance b/d	2,85,374.76	2014 Dec. 31	By balance c/d	
2014 Dec. 31	To bank a/c	1,53,475.94			
2015		4,38,850.70	2015		4,38,850.70

### Debenture Redemption Fund Policy a/c

Date	Particulars	Rs	Date	Particulars	Rs
2012 Jan. 1	To bank (Premium)	6,50,000	2012 Dec. 31	By balance c/d	6,50,000
2013 Jan. 1	To balance	6,50,000	2013 Dec. 31	By balance c/d	13,00,000
Jan.1	b/d	6,50,000			13,00,000
	To bank	13,00,000			
2014 Jan. 1		13,00,000	2014 Dec. 31	By bank a/c	20,00,000
Jan. 1	To balance	6,50,000			
Dec. 31	b/d	50,000			
	To bank	20,00,000			
	To DRF fund				
		20,00,000			20,00,000

**Illustration :** ABC Co. Ltd. had issued 9 percent Rs 5,00,000 debentures divided into 5,000 debentures of Rs 100 each redeemable at any time by the company after giving three month's issue. Under the terms of issue, the company had the power to purchase its own debentures and after resell them or cancel them. On Jan. 1, 2012 the following were the balances in the relevant accounts in the books of company.

	Rs		Rs
Debentures issued	4,50,000	Debenture redemption fund a/c	3,00,000
To debentures a/c (Par value Rs 5,000)	4,300	Debenture redemption fund investment a/c	2,80,000

During the year 2012, the following were the transactions relating to the above:

- Purchased 'own' debentures of par value Rs3,000 at Rs 3,200
- Resold own debentures held at the beginning of the year for Rs 5,000
- Interest received on DRF investments, 2 Rs 8,000
- Annual appropriation to debenture redemption fund a/c - Rs 50,000
- Purchased investments - Rs 7 5,000
- Own debentures held on 31.12.2004 were cancelled

Show ledger accounts relating to above

**Solution:**

**9% Debentures a/c**

	Rs		Rs
To own debentures a/c	3,000	By balance b/d	4,50,000
To balance c/d	4,47,00		
		By balance b/d	4,50,000
			4,47,00

**Own Debenture a/c**

	Rs		Rs

**Debenture holders a/c**

Date	Particulars	Rs	Date	Particulars	Rs
2015 Dec. 31	To bank a/c	6,00,000	2015 Dec. 31	By 10% debenture a/c	6,00,000

**Bank a/c**

Date	Particulars	Rs	Date	Particulars	Rs
2015 Dec. 31	To balance b/d	2,45,000.00	2015 Dec. 31	By 10% debenture a/c	
Dec. 31	To interest DRF investment a/c	21,942.53		By balance c/d	
Dec. 31	To DRF investment	4,40,000.00			
		7,06,942.53			7,06,942.53

**Illustration:**

A company issued 20,000 9 percent debentures of Rs 100 each on Jan. 2012 redeemable after 3 years. The company took an insurance policy of Rs 20,00,000 redemption debenture and paid Rs 6,50,000 as annual premium. At the end of the third year, policy amount received and debenture were redeemed. Prepare necessary ledger account.



Solution:

**9% Debentures a/c**

Date	Particulars	Rs	Date	Particulars	Rs
2012 Dec. 31	To balance c/d	20,00,000	1012 Jan. 1	By bank	20,00,000
2013 Dec. 31	To balance c/d	20,00,000	2013 Jan. 1	By balance b/d	20,00,000
2014 Dec.31	To debenture holders a/c	20,00,000	2014 Jan. 1	B balance b/d	20,00,000

**Debenture Holders a/c**

Date	Particulars	Rs	Date	Particulars	Rs
2012 Dec. 31	To bank a/c	20,00,000	2012 Dec. 31	By 9% Debenture	20,00,000

**Debenture Redemption fund a/c**

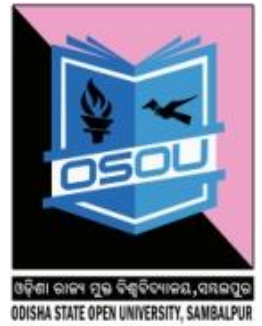
Date	Particulars	Rs	Date	Particulars	Rs

Date	Particulars	Rs	Rs
	Bank a/c .....Dr, To interest on DRF investment a/c (Being interest on investment received)		
	Interest on DRF investment a/c .....Dr. To DRF a/c (Being interest credited to DRF a/c)		
	Profit and loss appropriation account Dr. To DRF a/c (Being amount of profit credited to DRF a/c)		
	DRF investment a/c .....Dr. To bank a/c (Being the purchase of investment)		

<p>Bank a/c .....Dr.</p> <p>To interest on DRF a/c (Being interests on investment)</p> <p>Interest on DRF investment a/c .....Dr.</p> <p>To DRF a/c (Being interest on DRF investment a/c transferred on DRF a/c)</p> <p>Profit and loss appropriation a/c .....Dr.</p> <p>To DRF a/c (Being amount of profit credited DRF a/c)</p> <p>Bank a/c .....Dr.</p> <p>To DRF investment a/c (Being the sale of investment)</p> <p>DRF investment a/c .....Dr.</p> <p>To DRF investment a/c (Being the profit and sale of investment credited DRF a/c)</p> <p>10% Debenture a/c .....Dr.</p> <p>To debenture holders a/c (Being debentures transferred to debenture holders a/c)</p>	
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**Sum up:** A debenture is a way of borrowing money at a fixed or floating rate of interest without assigning any assets of the company as security. Various features of a debenture are the requirement of the trust indenture, payment of coupon interest rate, tax benefit, certain date of maturity, various redemption choices, security, convertibility into equity, mandatory credit rating and claims on profits and assets in case of default. A debenture is an important source of raising money for long-term financial needs of the company. Though it raises a considerable proportion of the capital, it is not the only source. Bank loans, equity shares, and bonds are also used by companies to raise money. A company should understand the differences between the various sources of long-term debt and decide the most suitable one after a complete consideration

Keywords: Debenture , Debenture holder, Own debenture, Detachable equity warrants, N.C.D., cum-interest, ex- interest, debenture redemption fund, sinking fund, redemption of debenture, cancellation of debenture, collateral security ,SEBI.



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### Self Assessment Questions:

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Problem: GangadharLtd. took over the assets of Rs.5, 00,000 and liabilities of 50,000 of ABCLtd. For an agreed purchase consideration of Rs.4, 50,000 to be paid by the issue of 10% debenture of Rs.100 each at a discount of 10%. Show the necessary journal entries in the book of Gangadhar Ltd.

Problem: Asutosh Ltd issue 40,000 10% debentures of Rs.100 each As collateral security to a commercial bank against a loan of Rs.7,00,000. On 1st September, 2016

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### Model Questions:

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1. What is debenture? What are the features of it?
2. State the procedures of issuing debenture.
3. Distinguish between share and debenture.
4. Describe the advantages and disadvantages of debenture.
5. Discuss the methods and sources of redemption Of Debenture.
6. What is cum-interest and ex- interest how does it calculate?
7. Highlights the process of cancellation of debenture.
8. What is collateral security how debenture is used as collateral security?

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### Further Readings:

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1. Modern Accountancy: Hanif and Mukherjee, volume –I, Tata Mcgrewhill.
2. Higher secondary Accounting: Biswal and Sharma.
3. Financial Accounting: P.C. Tulsian, Pearson.
4. An Introduction to Accountancy: S.N. Maheshwari, S.K. Maheshwari. Vikas.

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