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DIPLOMA IN ACCOUNTING

DIA-5
COMPANY ACCOUNTING

Block

2

Unit-I
Issue of Debenture

Unit-II
Redemption of Debenture

EXPERT COMMITTEE

DIPLOMA IN ACCOUNTING

Course Writer
Dr. Rajesh Sain
HOD , Deptt.of IMBA
BJB (Auto) College
Bhubaneswar

Course Editor
Dr. Anam Charan Raul
Assistant Professor in Commerce
M.P.C. (Auto.) College
Baripada, Mayurbhanja

Material Production

Dr. Jayanta Kar Sharma
Registrar
Odisha State Open University, Sambalpur

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Unit – I
Issue of Debenture

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, cancellation of debenture, conversion of debenture, how to calculate ex interest and cum interest.

Structure:

1.1 Introduction

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 indebtness. Debentures are issued in the same manner in which shares are issued. The company issues a prospectus inviting applications along with a sum of money called application money. After scrutiny, the Board of Directors makes allotment of debentures.

1.2 Meaning of Debenture

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.

1.3 Features of Debenture

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.

1.4 Classification of Debentures

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.

1.5 Advantages and Disadvantages of Issue of Debenture

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.

1.6 Procedures to Issue Debentures Under the Companies Act, 2013

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.

1.7 Difference between Share and Debenture

Sl. No.	Share	Debenture
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.

B. 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.

C. 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.

D. Difference between a Debenture and a Debenture stock:

- Debenture need not be fully paid whereas debenture stock must be fully paid
- Debenture can be transferred wholly whereas debenture stock can be transferred in fraction also.
- Debentures are identified by their district number whereas no such distinct numbers in case of debenture stock.

1.8 Issue of Debenture

The procedure and process o 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 installment:

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

   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

Accounting Entries when Lump Sum Amount is Received :

A company may get the full amount of debentures at the time of application. The following entries are passed in this case.

(a) For application money received:

Bank A/c Dr.

To Debenture Application A/c

(Being money received on application)

(b) For Allotment of Debentures:

Debenture Application A/c Dr.

To Debenture A/c

(ii) Issue of Debentures at Discount:

When debentures are issued by company at a price less than its nominal value (face value) it is said to be issued at discount. It is important to note that the Companies Act has not put any restriction on the maximum limit of discount. For example, if a debenture of Rs. 1,000 is offered to public at Rs. 950, it is issue at a discount. Here Rs. 50 on each debenture is loss to the company. As a principle of equity, it is desirable to write off this loss.

Accounting Treatment :

The Requisite Entries to be Passed are as Follows:

(a) When allotment money becomes due

Debenture allotment a/c--------Dr

Discount on issue of debenture a/c-------Dr

To Debentures a/c

(b) When allotment money is received

Bank a/c--------Dr

To Debenture allotment a/c

(c) To Write off Discount

Profit & Loss A/c--------Dr

To Discount on Issue of Debenture A/c

(iii) Issue of Debentures at Premium:

If debentures are issued at a price more than its nominal value (face value) such an issue is called issue at a premium. For example, if a debenture of Rs. 1000 is offered at 1,050, it is a case of issue of debentures at premium. The excess of issue price over face value is premium.The premium is a capital gain for company so it is to be credited to 'Securities Premium Reserve A/c'. The amount of premium on debentures should not be transferred to profit and loss account because it is not a profit arising from the normal operations of the company. Since it is a gain, it is shown on the liabilities side of balance sheet under the head 'Reserves and Surplus'.

Accounting Treatment:

The debenture premium may be called by the company on application or on allotment.

(a) If premium is received on application :

(i) Bank A/c Dr.

To Debenture Application A/c

(ii) Debenture Application A/c Dr.

To Debenture A/c

To Securities Premium Reserve A/c

(b) If premium is to be received on allotment:

(1) Allotment Due:

Debenture Allotment A/c Dr.

To Debenture A/c

To Securities Premium Reserve A/c

(ii) Allotment Received:

Bank A/c Dr.

To Debenture Allotment A/c

Issue of debenture for consideration other than cash:

Debentures can also be issued for consideration other than cash. Generally, companies follow this route with their vendors. So, instead of paying the cash for the assets purchased from the vendor, the companies issue debentures for consideration other than cash. In this case, also, the debentures can be issued at a par, premium or discount and are accounted for in the similar fashion.

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

2. Expenses on Issue of Debentures Account:

Discount on Issue of Debentures Account and Loss on Issue of Debentures Account may be transferred to Cost of Issue of Debentures Account by means of the following journal entry:

Cost of Issue of Debentures Account Dr

To Expenses on Issue of Debentures Account

To Discount on Issue of Debentures Account

To Loss on Issue of Debentures Account

Cost of Issue of Debentures Account, Expenses on Issue of Debentures Account, Discount on Issue of Debentures Account and Loss on Issue of Debentures Account represent capital losses and their balances are shown as a deduction from Reserves and Surplus in the balance sheet.

According to the provisions of the Companies Act, the amount of such a loss need not be written off. But sound principles of accountancy demand that the loss should be gradually and suitably written off over the life span of debentures in respect of which the loss has been incurred. Alternatively, the loss may be wholly or partly be transferred to Securities Premium Account.

Premium on Issue of Debentures Account represents a capital profit and should be transferred to Capital Reserve. Premium on Redemption of Debentures Account is a personal account. At the time of redemption of debentures, Premium on Redemption of Debentures Account is transferred to Sundry Debenture-holders Account.

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%)			

1.9 Issue of Debenture as Collateral Security

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. The debentures can be issued as a collateral security to the lenders. This happens when the lenders insist on additional assets as security in addition to the primary security. The additional assets may be used if the complete amount of loan cannot be realized from the sale of the primary security. Therefore, the companies tend to issue debentures to the lenders in addition to some other physical assets already pledged. The lenders may redeem or sell the debentures on the open market if the primary assets do not pay for the complete loan.

The issue of debenture as collateral :

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. 0n 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 20,000 10% debenture of Rs.50 each. (Issued at collateral Security) Loan from bank (Secured by debenture)	10,00,000 8,00,000	Miscellaneous expenditure Debenture suspense	10,00,000

1.10 Own Debentures

Sometimes the company may purchase its debentures from the market and, instead of cancelling them, may keep them as investments. In such a case, the cost price of debentures purchased is debited to a new account known as 'own debentures account'. Own debentures may be utilized for reissue when needed afterwards.

Accounting entries for own debentures are:

Own debenture A/c Dr

To Bank A/c

On Cancellation of Own Debentures :

When the actual price paid on purchase of own debentures is less than the face value of debentures, there will profit on cancellation of own debentures.

Accounting entry will be :

1. Debenture 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:

Debenture 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

Debenture a/c Dr

To debenture a/c(new)

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

Debenture 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

Debenture a/c Dr

To equity share capital a/c

To securities premium a/c

1.11Ex-Interest and Cum-Interest Quotations

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

1.12 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

1.13 Keywords

Debenture, Debenture holder, Own debenture, Detachable equity warrants, N.C.D., cum-interest, ex- interest, SEBI.

1.14 Self Assessment Questions

Q1. Highlight the process of cancellation of debenture.
Ans :

Q2What is collateral security how debenture is used as collateral security?
Ans :

Q3. Gangadhar Ltd took over the assets of Rs.5, 00,000 and liabilities of 50,000 of ABC Ltd 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.

Ans :

Q 4. 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. 0n 1st September, 2016 Show the necessary journal entries in the book of Gangadhar Ltd.

Ans :

1.15 Model Questions

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. What is cum-interest and ex- interest how does it calculate?

1.16 Further Readings

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.

Unit-II
Redemption of Debenture

Learning Objectives

After studying this lesson, you will be able to know: what is redemption of debenture, several ways of redemption of debenture, diverse sources of fund **for** redemption of debenture, numerous methods of redemption of debenture, conversion value of premium on redemption, convertible debenture and its features, nonconvertible debenture, cancellation of debenture and etc.

Structure:

2.1 Introduction

Redemption of debenture is the discharge of debenture liability. It can be done either by repaying the money to debenture holders or converting the debenture into shares. The conditions of redemption are clearly stated at the time of issue of debenture in the prospectus. Debentures can be redeemed at par, premium or discount as per the terms of issue. The period of maturity, redemption amount, yield on redemption etc. will be mentioned in the prospectus. In case the non convertible debentures proposed to be rolled over (repayment extended for an additional period), a compulsory option should be given to the debenture holders who wish to withdraw from the debenture programme, as per the guidelines issued by SEBI.

2.2 Meaning of Redemption of Debentures

Redemption of debentures means the repayment of the amount of debentures to debenture holders. In other words redemption refers to discharge of an obligation arising out of the contractual obligations created on account of debenture trust deed. The redemption of debenture is made by the company in accordance with the terms and conditions of issue which are clearly stated in the debenture certificate.

2.3 Ways to Redeem Debentures

Debenture can be redeemed in various ways by a company. It can pay a lump sum on the date of maturity or may pay in annual installments. A company can also purchase it from the open market or convert to an equity share in case of convertible debentures. Innovative ways like call or put option can also be utilized. The company may exercise a call option or the investor may utilize put option for redemption.

Redeeming a debenture means paying back the principal amount to the debenture holder. To speak in company's language, discharge off the debt liability of debentures. Debenture redemption generates a set of questions in mind with specifications like an amount of money to be required, sources from where to manage the fund, etc. A company is also relieved of a big liability after this and decrease its leverage ratios.
There are various ways of redeeming a debenture which is discussed below:

Lump sum payment on a fixed date:

This is the simplest option of redeeming the debentures. The debenture holders are paid their promised sum on the fixed date. The lump sum is the total amount of principal of all the debentures if they are not redeemed at premium or discount. The fixed date is nothing but the maturity date mentioned on the agreement of debenture. The company may choose to pay the debentures before maturity also which is at the option of the company. The amount of payment and the date is known to the company in advance and therefore, they can manage the resources accordingly.

Payment in annual installment:

This kind of redemption is similar to the redemption of a term loan. A term loan is normally redeemed in monthly, quarterly, biannual, or annual installments. In this method, the company pays some part of the principal every year to the debenture holders till the time of maturity. The total principal is divided by a number of years for which they are borrowed which becomes the installment to be paid at the end of every year.

Debenture redemption reserve / sinking fund:

Debenture redemption reserve is a very well known term in the reference of debentures. This reserve is built by transferring some part of the profits in this reserve every year. It is always easy to arrange smaller fund every year than arranging a lot of funds at a particular point of time for payment to debenture holders. In many countries, a law has made it compulsory to maintain a debenture redemption reserve or a sinking fund. The primary objective is to protect an interest of the debenture holders.

Buy from open market:

If the debentures are traded on a regulated exchange, the company can opt to purchase them from the open market. It will reduce a lot of administrative, paperwork and efforts of manpower.

Conversion into shares:

There is a type of debentures called convertible debentures which contain a clause of conversion into ordinary equity shares of the company. As per the agreed terms and time period, the convertible debenture is converted into ordinary equity share and at that point of conversion, the liability of debenture is discharged.

Call and put option:

A company may issue debenture with the call option or put option for the redemption purpose. A call option is exercised by the company whereby it can opt to purchase the debentures on or before the date of maturity at a price which is arrived at according to the terms and conditions mentioned at the time of issue. Similarly, a put option is exercised by the debenture holder whereby he has the right to sell the debenture to the company at some agreed price on or before the maturity date. It is an innovative way redeeming the debentures. A call option gives the company a freedom to get away from the burden at the time it wished to do so and vice versa is the case of investors.

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.

2.4 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.

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.

2.5 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:

1st Method Redemption Out of Profit

In this method, we repay the money of debentures out of profit. Now, understand, how is it possible? Suppose, you have estimated that you will get Rs 1,00,0000 profit in march 2017 and in same month, you have to redeem Rs10,000 debentures. Now, one side, you will pay Rs 10000 through your cash or bank account and other side, you will deduct same Rs 10000 from your profit and loss account by making redemption reserve account. Following entry will be passed :

A) Transfer of Profit to debenture redemption reserve account

Profit and loss appropriation account Dr. 10000

To Debentures Redemption account 10000

B) Redemption of Debentures

Debentures account Dr. 10000

To Bank account. 10000

2nd Method of Redemption of Debentures - Redemption Out of Capital

It means we directly repay the debentures out of capital. We just pass following entry after repay of debentures by cheque.

Debentures account Dr.

To Bank account .

This entry's effect on our capital and it will reduce by same amount. There is no need to transfer of profit to redemption reserves in this method.

3 th Method of Redemption of Debentures - Redemption by Buying Own Debentures

In this method, directors go to debenture market and for redemption of debentures, they have bought own debentures. For this, following entry will be passed.

Own Debenture or investment in own debentures account Dr.

To Bank account .

Investment in own debentures account or simply own debentures account will be shown on the assets side of the balance sheet. Debentures will continue to be shown on the liabilities side of the balance sheet. Here, it is assumed that the debentures are purchased immediately after the payment of interest. As and when the company wants to cancel investment in own debentures, the following entry is done.

Debentures account Dr.

Loss on redemption of debentures account Dr.

To Own debentures account .

To Profit on redemption of debentures account .

4th Method of Redemption of Debentures - Redemption by Making Provision
In this method, we create provision for redemption of debentures when we issue debentures. To making provision for redemption is good method to repay the amount of debenture on the time. We keep a small amount of provision and invest in good scheme. At the time of redemption, we liquidate our provision and repay the amount of debentures, it has two sub-methods.

(A) Sinking Fund for Redemption Method

(B) Insurance Policy Method

In this method, we invest provision for redemption of debentures in insurance company, we pay premium of insurance annual. When we have to redeem the debentures, we collect all the money of insurance policy. After this, we repay the debenture amount.

5th Method of Redemption of Debentures - Redemption by Conversion

Company can also redeem the old debentures by conversion these into new debentures or equity or pref. shares. At that time, we will pass following entry Old Debentures account Dr.

To New Debentures account /Equity Share capital account/Pref. Share capital account.
Let us make an in-depth study about the redemption of debentures by conversion into shares/new debentures. After reading this article to learn about:

1. Convertible Debentures

2. Features of Convertible Debentures

3. Conversion Ratio

4. Conversion Price.

Convertible Debentures:

Convertible Debentures are those which can be converted into equity shares at the option of the holder. The most significant feature of issuing these debentures is that it gives a fixed income to the holder along with a chance of having equity shares if the holder exercises his conversion option to the company as capital gains.In other words, a convertible debenture/security is one that can be converted at the option of the holder into a security of the same firm but of another type. This convertible debenture is called Hybrid Security since it gives a fixed income by way of interest and capital gains by way of equity shares.A company can also issue convertible preference shares like convertible debentures. A holder of a convertible debenture gives up his position as creditor to become an owner.

The said principle can be illustrated with the help of the following example:

X Ltd. issued 1,00,000, 16% convertible debentures of Rs. 100 each. After two years they can be converted into two equity shares of Rs. 50 each from the date of allotment but within 4 months after the period. Naturally, when the debentures are issued, the company receives Rs. 1, 00,000 after deducting flotation cost. It is needless to say here that the holder of each debenture will get a fixed income of Rs. 16 per debenture. After two years, the holder of each debenture of Rs. 100 each may convert into 2 equity shares of Rs. 50 each. Now, if all the debenture-holders opt for conversion the company must issue 2, 00,000 equity shares of Rs. 50 each and the convertible debentures were redeemed. There will be a change in the capital structure in the company’s Balance Sheet. The benefit enjoyed by the company is that it does not require any cash for redemption of such debentures although the debentures-are redeemed, i.e., rather, they are converted into equity shares. The debenture-holders are converted into equity shareholders and will get dividend like other equity shareholders instead of interest they got earlier. Convertible Securities always include a call feature whereby the issuer, at his option, can call the issue for redemption. However, the purpose of the call feature usually is not to force redemption but to force conversion. When the value of the common shares into which the security is convertible exceed the call price, the holders would opt to convert rather than to redeem. Convertibles usually are issued with the expectation that they will convert. The call features provide the issuer some control over the timings of the conversion.

Features of Convertible Debentures:

It has been stated above that when a company issues convertible debentures it clearly states the terms and conditions and timing of conversion. Moreover, it also states the rate of conversion (i.e., how much equity shares will be converted for each debenture), the price at which the debentures will be converted, and the time period (i.e., at what time the conversion procedure will take place).

Conversion Ratio:

It indicates the number of equity shares a holder will get in exchange of his convertible debentures. In short, the number of equity shares per convertible debenture is known as Conversion Ratio. In the previous example, the ratio was 1: 2, i.e., the holder of one convertible debenture of Rs. 100 each would be allotted two equity shares of Rs. 50 each. Hence, the ratio of conversion is 1: 2.

Conversion Price:

The price so paid at the time of conversion from debentures to equity shares is called conversion price. If both the prices of each debenture and each equity share are known the same can be easily found out. In the example stated above, the Conversion price of each equity share was Rs. 50 and of debenture Rs. 100.

Thus, the ratio is calculated as:

$$\text{Conversion Ratio} = \frac{\text{Per Value of Convertible Debenture}}{\text{Conversion Price}}$$

In the above example it was = Rs. 100/Rs.50 = 2.

However, in our country, the companies usually present both the conversion ratio and the conversion price so that the conversions can be done easily. It is very interesting to note that the conversion price differs in case of a developed country like USA and a developing country like India. The conversion price in USA is fixed at about 20% in excess of the market price of each equity share when the issue was made. In India, however, the conversion price is fixed at par below the market price of each equity share. Practically, in our country, rules regarding the convertible debentures have been changed with the implication of Capital Issue Control Act and the guidelines framed by SEBI in 1992. The provisions relating to convertible debentures were issued in June 1992.

As per the guidelines, the convertible debentures are of two types— Fully Convertible Debentures (FCDs) and Partially Convertible debentures (PCDs) and the provisions are:

(a) Both FCDs and PCDs are optional if the conversion of debentures happens between 18 months and 30 months from the date of allotment of such debentures;

(b) If the conversion period of FCDs exceeds 18 months, compulsory credit rating must be done;

(c) Until and unless the conversion is done optional with “Put” and “Call” options, a conversion period of more than 36 months is not allowed;

(d) In the prospectus of the company, the conversion timing and premium must be predetermined.

However, from the above guidelines framed by SEBI, it becomes clear that there are three types of convertible debentures:

(a) The convertible debentures which are compulsorily converted must be converted within 18 months;

(b) Those which are optional must be converted within 36 months; and

(c) Those which are converted after 36 months will carry "Put" and "Call" options.

Objectives of issuing convertible debenture:

(a) Sweetening Fixed Income Securities:

Since the convertible debentures are very much attractive to the fixed income group for the fixed rate of interest/income along with the benefit of capital gains, it may be termed as **"Sweetening Fixed Income Securities",** rather, the convertibility features make the debenture 'sweety'.

Moreover, the convertibility features help the company to save the amount of interest to be paid in cash, rather, they pay dividend (or Bonus Shares), after the debentures are converted into equity shares.

(b) Lower Cost of Capital:

We know that every firm needs financing—both for long-term as well as for short-term—for its various activities including promotional expansion and development at its different phases, and in most of the cases the needs are satisfied by equity financing. But, instead of issuing equity, if a firm issues convertible debentures it will be less costly as interest on debentures is tax deductible at its initial stages.Obviously, when the purpose of having loans will be completed, i.e., during prosperity, instead of redeeming the debentures the company may convert them into equity shares and they will take part in the share of the profit by way of dividend. At the same time, no cash is required to redeem such debentures.

(c) Deferred Equity Financing:

It has been stated above that a company, after issuing Convertible Debentures, is practically issuing equity shares of a future date. This is particularly done by a company when the current market price of a share is below the face value of a share, although the shares are issued at a higher price.In other words, this technique can successfully be implemented by increasing the Conversion Price than the prevailing market price of an equity share.

(d) Dilution of Earnings:

Dilution of earnings can be avoided if a firm issues convertible debentures. Usually, a firm cannot increase the number of equity shares till its investment pattern is found to be suitable, rather, it will prefer to issue fixed interest securities just to take its benefits.

2.6 Conversion Value of Premium

Needless to say that the conversion value of a convertible debenture or security is nothing but the conversion ratio of the security times the market price per share of the equity share. It has already been stated earlier in the above paragraph that convertible debentures or securities help the potential investors with a fixed return from a debenture as interest or a fixed amount of dividend from the preference shares. Moreover, the investor receives an option to convert his debentures/pref. shares into equity shares and comes under capital gains. Due to the above, a company usually sells the convertible securities at a lower yield than it would have to pay on a convertible debenture or preference share. At the time of issue, the convertible debentures are priced higher than its conversion value, the difference between the two represents the Conversion Premium. The Conversion Premium is expressed as a percentage.

The Conversion Premium is calculated as:

$$\text{Conversion Premium} = \frac{\text{Market Value} - \text{Conversion / Investment Value}}{\text{Conversion/ Investment Value}} \times 100$$

Redemption by Conversion of Debentures into Shares/New Debentures:

Sometimes a company may issue convertible debentures, i.e., the debentures which may be converted into shares. Practically, it provides the debenture holders the right to exercise the option to convert their debenture into shares within a stipulated period at a stipulated rate. Issue of such convertible debentures must be authorized by special resolution of the company which must also be approved by the Central Government. Generally, this conversion is affected at a discount on the market price of the shares but at a premium on the face value of shares. The debenture holders will exercise their option if it becomes beneficial to them; otherwise they will be repaid in cash. When the debenture holder exercise option for conversion, the entry will be:

Illustration 1:

The authorised capital of a company consists of 4,00,000 equity shares of Rs. 10 each. Out of these, 1,20,000 shares have been issued as fully paid:The company has an outstanding 6% Debenture loan of Rs. 1,20,000 redeemable at 102 per cent and interest has been paid up to date on Dec. 31.2008. On that date, the balance of the Debenture Redemption Reserve Account is Rs. 10,00,000 and that of corresponding Investment Account Rs. 10,00,000 (at cost) of which the market value is Rs. 9,00,000.The directors resolved to redeem the debentures on Jan. 1, 2008 and the holders are given an option to receive payment—either wholly in cash or wholly in fully paid equity shares—@ 8 shares for every Rs. 100 of debentures.75% of the holders decide to exercise the option for taking shares in repayment and cash for the rest is procured by realising an adequate amount of investment at the prevalent market value.Draw up the journal entries (including Cash Book Entries) to give effect to the above transactions.

Notes:1. As the nominal value of debentures redeemed in cash is less than Rs. 9,42,000, additional amount which is transferred to General Reserve from P & L (App.) A/c is not necessary.

2. Balance of Sinking Fund Investment transferred to general investment.

Conversion into New Debentures and Pref. Shares:

Redemption of Debentures by Conversion (Accounting Entries)

The debentures may be redeemed by converting them into equity shares as per the terms of their issue. The Companies Act prohibits any non-convertible portion of the debentures to be redeemed by conversion. This implies that the debentures will be redeemed by conversion only if they were issued as such and no cash outflow will take place and hence, there is no requirement of creating Debenture Redemption Reserve. Whenever the debentures are redeemed by conversion, the debenture holders have to apply for the same.

For conversion a company records the following entries:

(A) When Debentures are redeemed at Par:

(i) For Amounts due to Debenture holders:

Debentures A/c Dr.

To Debenture holders A/c

(ii) When debentures are converted into share at par:

Debentures a/c Dr. (With nominal value of debentures)

To Share capital a/c

(iii) When debentures are converted into shares —At discount:

Debenture holders a/c Dr. (Nominal value)

Discount on issue of shares a/c Dr. (With amount of discount)

To Share capital a/c (With nominal value of shares)

(iv) When debentures are converted into shares —At premium:

Debenture holders a/c Dr. (Nominal value of debentures)

To Share capital a/c (Nominal value of shares issued)

To Securities premium reserve a/c (With difference)

(B) When Debentures are redeemed at Premium, through conversion in to shares:

(i) For amount due to Debenture holders :

Debentures A/c Dr. (with N.V)

Premium on Redemption A/c Dr. (With premium on redemption)

To Debenture holders A/c

(ii) For discharging of debentures by issue of shares at par:

Debenture holders A/c Dr.

To Equity share capital A/c

(iii) For discharging of Debentures by issue of shares at premium:

Debenture holders A/c Dr.

To Equity share capital A/c

To Securities Premium Reserve A/c

2.7 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 ate 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.

2.8 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 installments 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.

2.9 illustrations

Illustration I: 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 is6, 00,000 × .232012 = 1, 39,207.20

Journal Entries

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

Debenture A/c

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
			Dec. 31	By interest on DRF	6,960.36
			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
			Dec.31	By interest on DRF investment a/c	14,268.76
			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	Dec. 31	By interest on DRF investment	21,942.53
			Dec. 31	BY P&L appropriation a/c	1,39,207.20
			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	To bank a/c		2012	By balance	
Dec. 31		1,39,207.20	Dec. 31	c/d	1,39,207.20
2013	To balance		2013		
Jan. 1	b/d	1,39,207.20	Dec. 31	By balance	
Dec. 31	To bank a/c	1,46,167.56		c/d	
		2,85,374.76			2,85,374.76
2014			2014		
Jan. 1	To balance	2,85,374.76	Dec. 31		
Dec. 31	b/d	1,53,475.94		By balance	
	To bank a/c			c/d	
2015			2015		
		4,38,850.70			4,38,850.70

Debenture Redemption Fund Policy a/c

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

(a) Purchased ‘own’ debentures of par value Rs3, 000 at Rs 3,200

(b) Resold own debentures held at the beginning of the year for Rs 5,000

(c) Interest received on DRF investments Rs 8,000

(d) Annual appropriation to debenture redemption fund a/c - Rs 50,000

(e) Purchased investments - Rs 7 5,000

(f) 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		
			4,50,000
		By balance b/d	4,47,00

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			7,06,942.5 3

Illustration iii:

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

Journal

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)		

Bank a/c ....Dr. To interest on DRF a/c (Being interests on investment) Interest on DRF investment a/c ....Dr. To DRF a/c (Being interest on DRF investment a/c transferred on DRF a/c) Profit and loss appropriation a/c ....Dr. To DRF a/c (Being amount of profit credited DRF a/c) Bank a/c ....Dr. To DRF investment a/c (Being the sale of investment) DRF investment a/c ....Dr. To DRF investment a/c (Being the profit and sale of investment credited DRF a/c) 10% Debenture a/c ....Dr. To debenture holders a/c (Being debentures transferred to debenture holders a/c)		

2.10 Sum Up

Debentures can be redeemed at par, premium or discount as per the terms of issue. The period of maturity, redemption amount, yield on redemption etc. will be mentioned in the prospectus. Redemption refers to discharge of an obligation arising out of the contractual obligations created on account of debenture trust deed. The redemption of debenture is made by the company in accordance with the terms and conditions of issue which are clearly stated in the debenture certificate. A company can also purchase it from the open market or convert to an equity share in case of convertible debentures. Innovative ways like call or put option can also be utilized. The company may exercise a call option or the investor may utilize put option for redemption.

2.11 Keyword

Redemption, Debenture redemption reserve, Securities premium reserve, Debenture holder, Premium on redemption, Convertible debenture, Debenture trust deed, Sweetening fixed income securities, Conversion ratio.

2.12 Self Assessment Questions

Illustration 1:

AB Ltd. purchased assets worth Rs. 6, 80,000 and took over liabilities of Rs. 80,000. It was agreed to pay the purchase price of Rs. 6,40,000 by issuing debentures valued Rs. 4,40,000 of Rs. 100 each at a premium of 10% and balance in cash. Journalize the transaction in the books of purchasing company.

Illustration 2:

B.K. Ltd. issued at Rs 1, 00,000 10% Debenture at 95%. Subscriptions are payable as to Rs 20,000 on application and balance on allotment. Expenses of the issue are Rs 500.Show the journal entries and the Balance Sheet of the Company.

Illustration 3:

In the Balance Sheet of a Company, the discount on debentures shows a debit balance of Rs 15,000. Every year Rs 5,000 is charged off to Profit and Loss Account. How will you show the Discount on Debentures Account at the end of the First Year and Second Year in the Balance Sheet of the Company?

Illustration 4:

A Company issued Rs 2, 00,000 10% Debentures of Rs 100 each at par, repayable at the end of 5 years at a premium of 5%. In terms of the Trust Deed, a Sinking Fund was to be created for the purpose of accumulating sufficient funds for the purpose. Investments were made yielding 5% interest received at the end of each year. All investments, including reinvestments of interest received, were made at the end of the year. All the investments were sold in the fifth year for Rs 1, 63,805.You are required to show for 5 years the journal entries and ledger accounts.

2.13 Model Questions

1. What do you mean by debenture? State the various ways to redeem the debenture.
2. Discuss the diverse sources of redemption of debenture.
3. Describe the numerous methods of redemption of debenture.
4. What is cancellation of debenture? What are the different types of it?
5. What is convertible debenture? State the feature and types of it.

2.14 Further Readings

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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