



Accountancy Notes PDF

On

*Issue and Redemption of
Debentures*

Meaning of Debenture: The term, 'debenture' has been derived from the Latin word "debre" which means "to borrow". Thus, it is a written document acknowledging a debt under the common seal of the company and containing a contract for the repayment of the principal sum at a specified date and for the payment of interest (usually half-yearly) at a fixed rate percent until the principal sum is repaid.

"Debenture includes debenture stock, bonds and any other securities of a company whether constituting a charge on the assets of the company or not."- Section 2(12) of the Companies Act, 1956.

Bond: Bond, like debenture, is an acknowledgment of debt issued under the seal of a company and signed by an authorized signatory.

Charge: It means securing the loan by encumbering a specific part of assets towards the loan. It means, if the company fails to meet its obligation, the lender can secure his payment from the assets mortgaged or in case of winding up of the company from the official liquidator.

The Companies Act, 1956) requires that all the charges be registered with the Registrar of Companies. Section 125 (4) of the Companies Act, 1956 requires that a charge when created on the following be got registered:

For the purpose of securing any issue of debentures.

- On uncalled share capital of the company.
- On calls made but not paid.
- On any book debts of the company.
- On any immovable property, wherever situated, or any interest therein.
- On a ship or any share in the ship.
- On goodwill, on a patent or a license under a patent, on a trademark or on the copyright or a license under copyright.

TYPES OF DEBENTURES

There are two types of debentures :

- **Convertible debentures**, which can be converted into equity shares of the issuing company after a predetermined period of time. These may be Partly Convertible Debentures (PCD): A part of these instruments are converted into Equity shares in the future at notice of the issuer. The issuer decides the ratio for conversion. This is normally decided at the time of subscription.
- **Fully convertible Debentures (FCD):** These are fully convertible into Equity shares at the issuer's notice. The ratio of conversion is decided by the issuer. Upon conversion the investors enjoy the same status as ordinary shareholders of the company.
- **Non-convertible Debentures**, which are simply regular debentures, cannot be converted into equity shares. These are debentures without the convertibility feature, these usually carry higher interest rates than their convertible counterparts.

On basis of Security, debentures are classified into:

- **Secured Debentures:** These instruments are secured by a charge on the fixed assets of the issuer company. So if the issuer fails to pay off either the principal or interest amount, its assets can be sold to repay the liability towards debenture holders.
- **Unsecured Debentures:** These instruments are unsecured in the sense that if the issuer defaults on payment of the interest or principal amount, the investor is treated like other unsecured creditors of the company.

From Redemption point of view

- **Redeemable Debentures:** Redeemable debentures are those which are redeemed or paid off after the termination of fixed term. The amount paid off includes the principal amount and the current year's interest. The company always has the option of either to redeem a specific number of debentures each year or redeem all the debentures at a specified date.
- **Irredeemable or Perpetual Debentures:** Irredeemable debentures are those debentures which do not have any fixed date of redemption. They are redeemed either in the event of winding up or at a very remote period of time. Irredeemable or perpetual debenture holders can never force the company to redeem their debentures.

Distinguish Between a Share and Debenture

Basis	Share	Debenture
Ownership	Shareholders are the owners of company	Debenture holders are the lenders of company
Form of return	Dividend	Interest
Security	Not secured	Secured by a charge on assets
Voting right	Equity shareholders have the voting right	No voting right in normal course of business
Risk	More risk as compared to Debentures	Risk Free due to secured Debentures

Issue of Debentures:

Debentures can be issued in following ways:

1. for cash
2. for consideration other than cash
3. As collateral security

Terms of Issue

Debentures can be issued in following ways:

1. Issue of Debentures at Par
2. Issue of Debenture at Premium
3. Issue of Debentures at Discount.

Debenture Payable in Installments

1. First installment paid along with the application is called application money.
2. Second installment paid on allotment is called allotment money.
3. Subsequent installments paid are called as call money calls can be more than one and called First call, second call or as the case may be.

Issue of Debentures for Cash

(a) When Debentures amount received in lump sum with the application

On receipt of application money	Bank A/c Dr. To Debenture Application and Allotment A/c	With the application money received
On acceptance of application money	Debenture Application and Allotment A/c Dr. To X% Debentures A/c To Bank A/c	With Amount of application money on allotted debentures, and Excess amount refunded.

(B) When Debentures amount received in installments.

In this case accounting entries will be same as at the time of issue of shares in instalments with small change in the name of term like-the share capital word replaced with the X% Debentures A/c, and Share word replaced with Debentures e.g. Equity share capital into 8% Debentures, Equity share application into Debentures Application and follows on.

AT Par: means debentures are issued at face value.

Issue of Debentures for Consideration other than Cash

When Debentures are issued for purchase of asset

When Debentures Issued for purchases Asset at par	Sundry Asset A/c Dr. To Vendor	With the purchases consideration
	Vendor Dr. To Debenture Account	
When Debentures are issued for purchases of asset at premium	Sundry Assets A/c Dr. To Vendor	With the purchases Consideration No. of debentures par value No. of debentures x premium
	Vendor Dr. To Debenture A/c To Security Premium Reserve A/c	

When business is Purchased	<p>When Purchase consideration is equal to net value of assets Sundry Assets A/c Dr. To Sundry Liabilities A/c To Vendor</p> <p>When Purchases consideration more than net value of assets Goodwill Account Dr. To Sundry Liabilities A/c To Vendor</p>	Value of asset Value of liabilities Purchases consideration Excess of Purchase Value (B/F) Value of Liabilities Purchases Consideration
	<p>When Purchase Consideration is less than net value of asset Sundry Assets Account Dr. To Sundry Liabilities A/c To Capital Reserve To Vendor</p>	Value of Asset Value of liabilities Difference (B/F) Purchases Consideration

Collateral Security: Collateral security means security provided to the lender in addition to the principal security. It is a subsidiary or secondary security. Whenever a company takes a loan from a bank or from any financial institution it may issue its debentures as secondary security which is in addition to the principal security. Such an issue of debentures is known as 'issue of debentures as collateral security'. The lender will have a right over such debentures only when the company fails to pay the loan amount and the principal security is exhausted. In case the need to exercise the right does not arise, debentures will be returned back to the company. No interest is paid on the debentures issued as collateral security because the company pays interest on loan.

In the accounting books of the company issue of debentures as collateral security can be credited in two ways :

1. First method : No Journal entry to be made in the books of accounts of the company for debentures issued as collateral security. A note of this fact is given in this case.
2. Second method : Entry to be made in the books of accounts of the company.

A journal entry is made on the issue of debentures as a collateral security, Debentures Suspense Account is debited because no cash is received for such an issue.

Following journal entry will be made

Date	Particulars	LF.	Debit (Rs.)	Credit (Rs.)
	Debenture Suspense A/c Dr. To % Debentures A/c (Being the issue of Debentures of Rs.... each issued as collateral security)			

INTEREST ON DEBENTURES

Interest on Debentures is calculated at a fixed rate on its face value and is usually payable half yearly & is paid even if the company is suffering from loss because it is charged on profit.

Income Tax is deducted from interest before payment to debenture holders. It is called T.D.S. (Tax deducted at source).

JOURNAL ENTRIES

1.	When interest is Due	
	Debentures Interest A/c Dr.	(Gross Interest)
	To Debentures holder A/c	(Net Interest)
	To Income Tax Payable A/c	(Income Tax Deducted)
2.	When Interest is paid	
	Debentures Holder A/c Dr.	(With Interest)
	To Bank A/c	
3.	On payment of Income Tax to Government	
	Income Tax Payable A/c Dr.	(Amount of Income)
	To Bank A/c	
4.	On Transfer of Interest on Debenture to statement of profit and Loss A/c	(Tax deducted at source)
	Statement of Profit and Loss Dr.	
	To Debenture Interest A/c	(Amount of Interest)

Redemption of Debentures:

Redemption of debentures means repayment of the loan due on debentures to debenture holders. According to Section 117 C (3) of the Companies Act 1956, the debentures should be redeemed in accordance with the terms and conditions of their issue/ offer documents. The date, the terms, and the conditions are generally stated in the debenture certificate itself or in the trust deed.

On the due date or happening of the circumstances so specified, the company becomes liable to pay the principal amount to the debenture holder. A company may purchase its own debenture which then stands canceled. In other words, the redemption of debentures means repayment of the number of debentures by the company. There are three aspects that a company should bear in mind regarding redemption, namely the time of redemption, the amount to pay, and the sources from which redemption will have to be carried out.

Methods of the Redemption of Debentures:

The various methods of redemption of debentures are as under:

1. Payment in Lump-Sum
2. Payment in Installments
3. Purchase in Open Market
4. Conversion of existing Debenture into Shares or New Debentures.

1. Payment in Lump Sum: It means debentures can be redeemed by paying the debenture holders in one lump sum at the expiry of the agreed time or earlier at the option of the company. In this case, the time of repayment is known in advance and thus the company can plan its financial resources accordingly.

2. Payment in Installments: It means the redemption is made in annual installments. The amount of installment is worked out by dividing the total amount of debentures by the number of years it is to last. The number of debentures to be redeemed each year are selected by lottery. Thus, it is also known as drawing by lottery or draw of lots.

3. Purchase in Open Market: A company, if authorized by its Articles of Association, can purchase its own debenture in the open market. Debentures so purchased may be canceled and it means the debentures have been paid.

4. Conversion of Existing Debentures into Shares or New Debentures: It means the debenture holder can exchange their debenture either for shares or new debentures of the company and the debentures which carry such rights are called convertible debentures.

Sources of funds for Redemption of Debentures: The redemption of debentures can be done either out of capital or out of profits.

(a) Redemption of Debenture out of Capital: In this case, profits of the company are not utilized for the redemption of debentures, so the assets of the company are reduced by the amount paid. Normally the profits are transferred to Debenture Redemption Reserve for redemption. In case no profits have been transferred to Debenture Redemption Reserve and debentures are redeemed on the due date, it is regarded as redemption out of the capital. It is, however, presumed that the company has adequate funds to redeem the debentures.

Accounting Treatment:

(a) If debentures are to be redeemed at par

1. On debentures becoming due

Debentures A/c Dr.
 To Debenture- holder A/c

2. On Redemption

Debenture Holder A/c Dr.
 To Bank A/c

(b) If debentures are to be redeemed at a premium

1. On debentures becoming due

Debentures A/c Dr.
Premium on Redemption of Debenture A/c Dr.
 To Debenture holder A/c

2. On Redemption

Debenture holder A/c Dr.
 To Bank A/c

(b) Redemption of Debentures out of Profits: Redemption of debentures out of profits means the amount equal to that utilized for repayment to debenture holders is transferred from Profit and Loss Appropriation A/c to a newly opened A/c called 'Debenture Redemption Reserve A/c' (DRR). The portion of the profits set aside may either be retained in the business or maybe invested.

The Companies Act (Amendment), 2000 has introduced Section 117 C which provides as under:

(a) Where company-issued debentures after the commencement of this act, it shall create a DRR for the redemption of such debentures, to which an adequate amount shall be credited, from out of its profits every year until such debentures are redeemed.

(b) The amount credited to the DRR shall not be utilized by the company except for the purpose of the redemption of debentures.

SEBI's Guidelines:

Securities and Exchange Board of India (SEBI) has provided some guidelines for the redemption of debentures. The focal points of these guidelines are:

1. Every company shall create a venture Redemption Reserve in case of issue of debenture redeemable after a period of more than 18 months from the date of issue.
2. The creation of Debenture Redemption Reserve is obligatory only for non-convertible debentures and a non-convertible portion of partly convertible debentures.
3. A company shall create a Debenture Redemption Reserve equivalent to at least 50% of the amount of debenture issue before starting the redemption of the debenture.
4. Withdrawal from Debenture Redemption Reserve is permissible only after 10% of the debenture liability has already been reduced by the company.

Exemption:

SEBI guidelines would not apply under the following situations:

(a) Infrastructure company (a company wholly Engaged in the business of developing, maintaining, and operating infrastructure facilities.)

(b) A company issuing debentures with a maturity period of not more than 18 months.

Clarifications regarding Debenture Redemption Reserve:

The Department of Company Affairs, Government of India, vide their circular No. 9/2002, dates 18.04.2002 has issued the following clarifications regarding the creation of Debenture Redemption Reserve (DRR):

(a) No DRR is required for debentures issued by All India Financial Institutions, by RBI and, Banking Companies for both public as well as privately placed debentures.

(b) No DRR is required in case of privately placed debentures.

(c) Section 117c will apply to debentures issued and pending to be redeemed and, therefore, DRR will also be created for debentures issued prior to 13.12.2000 and pending redemption.

(d) Section 117c will apply to the non-convertible portion of debentures issued whether they are fully or partly paid.

Journal Entries:

Debenture A/c

 To Debentureholders A/c

Debenture holder A/c

 To Bank A/c

Profit and Loss Appropriation A/c
 To Debenture Redemption Reserve A/c

Debenture Redemption Reserve A/c appears on the liability side of the Balance Sheet, under the head "Reserves and Surplus". The balance in Debenture Redemption Reserve A/c increases with each redemption. When all the debentures are redeemed, the Debenture Redemption Reserve A/c is closed by transferring its balance to General Reserve A/c.

Redemption by Purchase in the Open Market: A company, if authorized by its Articles of Association, can redeem its own debenture by purchasing them in the open market.

If a company purchases its own debenture for the purpose of immediate cancellation, the purchase and cancellation of such debenture are called, redemption by purchase in the open market.

Advantages:

1. A company can redeem the debentures at its convenience whenever it has surplus funds.
2. A company can save money by purchasing its own debenture when they are available in the market at discount.

Accounting Treatment:

(In case of Profits)

(a) On purchase of own debentures for immediate cancellation

Debenture A/c Dr.
 To Bank A/c
 To Profit on Cancellation of Debenture A/c

(b) On transfer of Profit on Redemption

Profit on Cancellation of Debenture A/c Dr.
 To Capital Reserve A/c

(In case of Loss)

(a) On purchase of own debenture for immediate cancellation.

Debenture A/c Dr.
 Loss on Cancellation of Debenture A/c Dr.
 To Bank A/c

(b) On transfer of Loss on Redemption

Profit and Loss A/c Dr.
 To Loss on Cancellation of Debenture A/c

Redemption by Conversion: Sometimes, at the time of issue of debentures, a company gives the convertible debenture holders the privilege that they can get their debentures converted into shares or new debentures after the expiry of a specified period. Whenever debenture is redeemed by conversion, the debenture holders have to.; apply for the same. The new shares or debentures may be issued at par, discount, or a premium.

No Debenture Redemption Reserve is required in case of convertible debentures because no funds are required for redemption.

If debentures to be converted were issued at discount, the issue price of the share must be equal to the amount actually received from debentures. If this rule is not followed, it would be a violation of section 79 of the Companies Act, 1956.

Accounting Treatment:

(i) For the amount due to debenture holders

(a) If Redemption at par

Debentures A/c Dr.
 To Debentureholder A/c

Or

If Redemption at a premium

Debentures A/c Dr.
Securities Premium A/c Dr.
 To Debentureholder A/c

(b) For discharging obligation by issuing shares or debentures

Debenture Holder A/c Dr.
 To Equity Share Capital

Or

 To Debentures A/c (New)

If the new shares/debentures are issued at a premium, the Securities Premium A/c is credited or new shares/debentures are issued at a discount, the Discount on Issue of Shares/Debentures A/c is debited in the above-mentioned entry (b).

Sinking Fund Method: The amount required for the redemption of debentures is generally large and the date of redemption is known to the company. Thus, it is prudent for a company to make arrangements to ensure the availability of adequate funds for the redemption of debenture at the end of the stipulated period for which debentures are issued. Hence, it is better for the company to set aside every year a part of divisible profits and to invest the same outside the business in marketable securities.

This is done by creating a Sinking Fund. The company adopts the method of Debenture Redemption Sinking Fund. An appropriate amount calculated by referring to Sinking Fund Factors, depending upon the interest rate on investments and the number of years for which investments are made, is set aside.

Debenture Redemption Sinking Fund A/c will be created every year to provide means for the redemption of debentures. The company sets aside every year a certain sum of money out of its profits and invests the same along with the interest that may be earned on an investment. The investment is sold when debentures fall due for redemption. The amount available from the sale of investment is utilized for the redemption of debentures.

Accounting Treatment:

1. At the end of First Year

(a) For setting aside the amount out of Profit

Profit & Loss		[With the amount
Appropriation A/c	Dr.	of profit set aside]
To Debenture Redemption Fund A/c		

(b) For Investing the amount set aside

Debenture Redemption Fund		[With the amount of investment made]
Investment A/c	Dr.	
To Bank A/c		

2. At the end of the second year and subsequent years other than the last year.

(a) For Receiving the Interest on Investments made

Bank A/c		[With the amount of Interest received]
To Interest on Debentures Redemption Fund		
Investment A/c	Dr.	

(b) For the transfer of Interest on Debenture Redemption Fund Investment to Debenture Redemption Fund A/c

Interest of Debenture Redemption Fund Investment A/c Dr.
To Debenture Redemption Fund A/c

(c) For Setting aside the number of profits

Profit and Loss Dr. [With the amount Appropriation A/c of Profit set aside]
To Debenture Redemption Fund A/c

(d) For Investing the amount set aside along with interest • received.

Deb. Red. Fund Investment A/c Dr.
To Bank A/c

3. At the end of last year

(a) For Receiving the Interest on Investment made

Bank A/c Dr.
To Interest on Deb. Red. Fund Investment A/c

(b) For the transfer of Interest on Deb. Red. Fund Investment to DRF A/c

Interest in Deb. Red. Fund Investment A/c Dr.
To Deb. Red. Fund A/c

(c) For setting aside the number of profits

Profit & Loss Appropriation A/c Dr.
To Deb. Red. Fund A/c

(d) For Realising the Investment made

Bank A/c Dr. [With the sale To Deb. Red. Fund proceeds]
To Investment A/c

(e) For the transfer of profit/loss on realization of Deb. Red. Fund Investments

In case of Profit
Deb. Red. Fund Investment A/c Dr. [With the amount of profit]
To Deb. Red. Fund A/c

Or

In case of Loss
Deb. Red. Fund A/c Dr. [With the amount of Loss]
To Deb. Red. Fund Investment A/c

(f) For the amount due to debenture holders

Debenture A/c Dr.
To Debenture holders A/c

(g) For redemption

Debenture holders A/c
To Bank A/c

(h) For the transfer of the balance, if any, Discount on Issue of Debentures A/c/Loss on Issue of Debenture A/c

Deb. Red. Fund. A/c Dr.
To Discount on Issue of Debentures A/c,
To Loss on Issue of Debentures A/c

1. For the transfer of an amount from the Deb. Red. Fund A/c to General Reserve:**(a) If some of the Debentures are redeemed**

Deb. Red. Fund A/c Dr. [With the nominal value of Debentures redeemed]
To Deb. Red. Reserve

(b) If all the Debentures are redeemed

Deb. Red. Fund A/c Dr. [With the balance left in Deb. Red. Fund A/c]
To General Reserve A/c

[Follow on Facebook](#)[Follow on Instagram](#)[Join us on Telegram](#)