Class-12 Accountancy
Chapter 8 – Issue of Debentures

Introduction

A debenture is a document that either creates a debt or acknowledges it. In corporate finance, the term is used for a medium- to long-term debt instrument used by large companies to borrow money. In some countries the term is used interchangeably with bond, loan stock or note. A debenture is thus like a certificate of loan or a loan bond evidencing the fact that the company is liable to pay a specified amount with interest and although the money raised by the debentures becomes a part of the company's capital structure, it does not become share capital.

Note : Debenture is instrument that is not secured by physical asset or col ateral
In case of bond interest is not declared. Debentures are general y freely transferable by the debenture holder.

Debenture holders have no rights to vote in the company's general meetings of shareholders,The interest paid to them is a charge against profit in the company's financial statements.

Types of debentures

Convertibility point of view : there are two types of debentures: Convertible debentures, which are 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 normal y decided at the time of subscription.
Fully convertible Debentures (FCD): These are ful y 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 of the liable company. They are debentures without the convertibility feature, they usual y 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 on payment of the principal or interest amount, his assets can be sold to repay the liability to the investors.
Unsecured Debentures: These instrument are unsecured in the sense that if the issuer defaults on payment of the interest or principal amount, the investor is treated like along 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 al the debentures at 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.

Meaning of Bond

Bonds and debentures are same, both in terms of contents and texture. In the earlier days, Bonds had been issued by the government, but these days bonds are also being issued by the Government, Semi-government and non-government organizations as an acknowledgment of debt.

Zero Coupon Bonds
Zero Coupon Bonds are issued at a discount and redeemed at par. No interest payment is made on such bonds at periodic intervals before maturity.

Meaning of Charge
A charge does not involve the transfer of ownership of the secured property. Charge includes any security for repayment of a debt as well as other securities. Specific portion of the assets is mortgaged by the company to meet the obligation under the trust deed it is known as Charge. Charge may be fixed or floating.

Debenture Trust Deed
Before offering the debentures for public subscription a document regarding the Trust Deed should be created by the company which is known as Debenture Trust Deed.
The main purpose of appointment of Trustees is to protect the interest of debenture holders.

Issue of Debentures :
Debentures can be issued in two ways
1 for cash
2. for consideration other than cash
3. As colateral security

Terms of issue of: Debentures can be issued in two ways
1 .Issue of Debentures at Par
2. Issue of Debentures at Premium

Debentures payable in Instalments
1. First instalment paid along with application is called as application money
2. Second instalment paid on allotment is called as allotment money

3. Subsequent instalments 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 at par: this means shares are issued at face value.

Distinction between Share and Debenture

Basis	**Share**	**Debenture**
Meaning	Share means share capital of the company. Share Capital is the Internal Liability of the firm.	Debenture means Loan or debt of the company. Debenture is the external liability of the firm
Status of Holder	Share Holders are treated as the owners of the company	Debenture Holders are the Creditors of the company
Dividend Vs Interest	Dividend is paid to the Shareholders. It is an appropriation of Profit	Interest is paid to the Debenture Holders at a fixed rate. It is charge against the profit
Voting Rights	Shareholders enjoy voting rights and take part in the management.	Debenture Holders do not have voting right and they are not entitled to take part in the management.
Security	Shares are not secured	Generally debentures are secured by fixed or floating charge over the assets.
Convertibility	Shares are non-convertible	Debentures are convertible
Forfeiture	Shares are forfeited when amount due on allotment or calls is not paid by the shareholder	Debentures are not forfeited by the company
Repayment	Amount of Shares is not repayable during the life of the company. At the time of winding up, It is paid after meeting all other obligations	Repayment is made after a fixed period for which debentures were issued.

Distinction between Shareholders and Debenture holders

Basis	Shareholders	Debenture holders
Ownership	Shareholders are considered as the owners of the company	Debenture holders are considered as Creditors of the company
Participation in Management	They are entitled to take part in the management	They are not entitled to take part in the management
Share of Profit	They enjoy the share of profit as dividend	They get interest and are not entitled to share the profits
Risk Taker	Shareholders are the Risk Taker	Debenture holders are safe in comparison of shareholders (for secured debentures)
Voting Rights	They have right to vote	They don't have right to vote
Option of Convertibility	Shareholders can not convert their shares in debentures	Debenture holders can convert their debentures in Equity Shares

Journal Entries at the time of Issue of Debentures

The Process of issuing debentures is same as the issue of shares. Debentures can also be issued at par, Premium, and Discount. Debentures can be issued for consideration other than cash as well as collateral security. A Company may call the lump sum amount on application or in installments.

When full amount is called on Application	When full amount is called in two or More Installments
Bank A/c Dr. **To Debenture Application & Allotment A/c** (Being Application money Received) **Debenture Application & Allotment A/c Dr.** **To Debentures A/c** (Being Deb.Application money adjusted)	**Bank A/c Dr.** **To Debenture Application A/c** (Being Application money Received) **Debenture Application Dr.** **To Debentures A/c** (Being Deb. Application money adjusted) **Debenture Allotment A/c Dr.** **To Debentures A/c** (Being Allotment money due) **Bank A/c Dr.** **To Debenture Allotment A/c** (Being Allotment money received)

	Debenture First Call A/c Dr. **To Debentures A/c** (Being First call money due) **Bank A/c Dr.** **To Debenture First Call A/c** **(Being First Call money Received)** **Note:** in the same way entries for Second and Final call (if any) will be recorded.

Issue of Debentures at Par

When a company issues its debenture at the face value (Original price) it is known as debenture issued at Par. For example if the Face value of a Debenture is Rs.1,000 and the issue price of debenture is also Rs.1,000.

Issued of Debentures at Premium

When a company issues its debenture at a price which is more than the face value (Original price) it is known as debenture issued at Premium. For example if the Face value of a Debenture is Rs.1,00 and the issue price of debenture is also Rs.120.

Issued of Debentures on Discount

When a company issues its debenture at a price which is less than the face value (Original price) it is known as debenture issued at Discount. For example if the Face value of a Debenture is Rs.100 and the issue price of debenture is also Rs.95.

Oversubscription of Debentures

When excess applications are received by the company for the subscription of debentures it is known as oversubscription. In such a case there are three options available :

1. **Reject the Excess Applications:** in this case directors may reject the excess applications and excess application money received will be paid back to the applicants.
2. **Allotment on Pro-rata basis:** The directors may allot the Debentures on pro-rata basis. For example Ram has applied for 1000 Debentures but company has issued only 800 debentures on pro-rata basis and money of 200 debentures will be adjusted on the allotment. (In this case applicants do not get the full debentures applied by them)
3. **Combination of above two alternatives:** This is combination of first two methods where some of the excess applications are rejected by the company and pro-rata allotment is made to the remaining applicants. Options available in this case are :

- Some of the excess applications may be rejected
- Some applicants may get full allotment
- Some Applicants may get allotment on pro-rata basis

Issue of debentures for consideration other than cash

When Debentures are issued for purchase of asset

When Debentures are issued for purchase of asset at par	Sundry Asset Account To Vendor	Dr.	With the purchase consideration
	Vendor To Debenture Account	Dr.	
When Debentures are issued for purchase of asset at premium	Sundry Assets Account To Vendor	Dr.	With the purchase Consideration
	Vendor To Debenture Account To Security Premium Account	Dr.	No. of debentures x par value No. of debentures x premium
When business is purchased and debentures issued	When Purchase consideration is equal to net value of assets		
	Sundry Assets Account To Sundry Liabilities Account To Vendor	Dr.	Value of asset Value of liability Purchase consideration
	When Purchase consideration more than net value of assets		
	Sundry Asset Account	Dr.	Value of asset
	Goodwill account	Dr.	Excess of purchase value
	To Sundry Liabilities Account		
	To Vendor		Purchase Consideration
	When Purchase consideration is less than net value of asset		
	Sundry Assets Account To Sundry Liabilities Account To Capital Reserve To Vendor		Value of asset Value of liability Excess liabilitiy Purchase consideration

Collateral Security (issue of debentures)

Collateral security means security provided to lenderin addition to the principal security. It is a subsidiary or secondary security. Whenever a company takes loan from bank or 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 company fails to pay the loan amount and the principal security is exhausted. In case the need to excercise the right dose not arise debentures will be returned back to the company. No interest is paid on the debentures issued as collateral security because company pays interest on loan. This is used when there are no assets to mortgage.

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

(i) First method : No Journal entry to be made in the books of accounts of the company. Debentures are issued as collateral security. A note of this fact is given;

(ii) On the liability side of the balance sheet under the heading Long term borrowings

An Extract of Balance Sheet
As at…………………

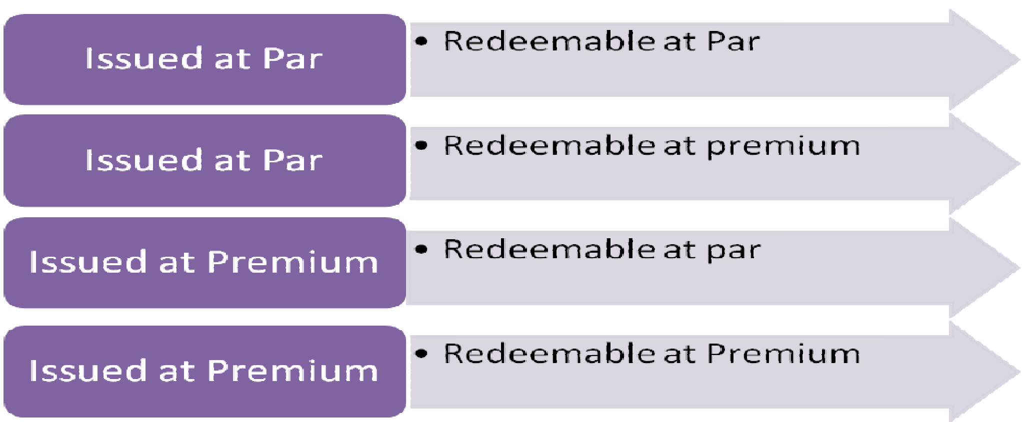
Liabilities	Amount	Assets	Amount
Non Current Liabilities **(a) Long Term Borrowings**	**xxxx**		

Second Method: Under this method following entries are recorded in the books of accounts:

Debenture Suspense A/c Dr.
To % Debentures A/c

VARIOUS CASES FROM THE POINT OF VIEW OF REDEMPTION

Debentures can be redeemed at Par or at Premium. Conditions of issue and conditions of redemptions are given below:



Journal entries in the different situations:

Issued at Par, redeemable at Par	Issued at Par, redeemable at Premium
Bank A/c Dr. **To Deb. Application A/c** (App. Money received) **Deb. Application A/c Dr.** **To Debentures A/c** (Being App. Money transferred to Deb. A/c)	**Bank A/c Dr.** **To Deb. Application A/c** (App. Money received) **Deb. Application A/c Dr.** **Loss on issue of Deb. A/c** **To Debentures A/c** **To Premium on Redemption of Deb. A/c** (Being Deb. Issued at par redeemable at premium)

Issued at Premium, redeemable at Par	Issued at Premium, redeemable at Premium
Bank A/c Dr. **To Deb. Application A/c** (App. Money received) **Deb. Application A/c Dr.** **To Debentures A/c** **To Securities Premium A/c** (Deb. Issued at Premium redeemable at par)	**Bank A/c Dr.** **To Deb. Application A/c** (App. Money received) **Deb. Application A/c Dr.** **Loss on issue of Deb. A/c** **To Debentures A/c** **To Securities premium A/c** **To Premium on Redemption of Deb. A/c** (Being Deb. Issued at premium redeemable at premium)

<u>Interest on Debentures</u>

Interest on debentures is paid periodically and it is the charge against the profit. Students must remember that the TDS collected by the company should be deposited to the Government (Income Tax Authorities). Following Journal entries are recorded for this purpose:

Interest due to Debenture holders	Interest Paid to Debenture holders	Income Tax paid to Government	Interest transferred to Statement of P/L
Deb. Interest A/c Dr. **To Deb. Holders A/c** **To Income Tax Payable A/c**	**Deb. Holders A/c Dr.** **To Bank/Cash A/c**	**Income Tax Payable A/c Dr.** **To Bank A/c**	**Statement of P/L Dr.** **To Deb. Interest A/c**

CBSE Quick Revision Notes and Chapter Summary
Class-12 Accountancy
Chapter 9 – Redemption of Debentures

Introduction

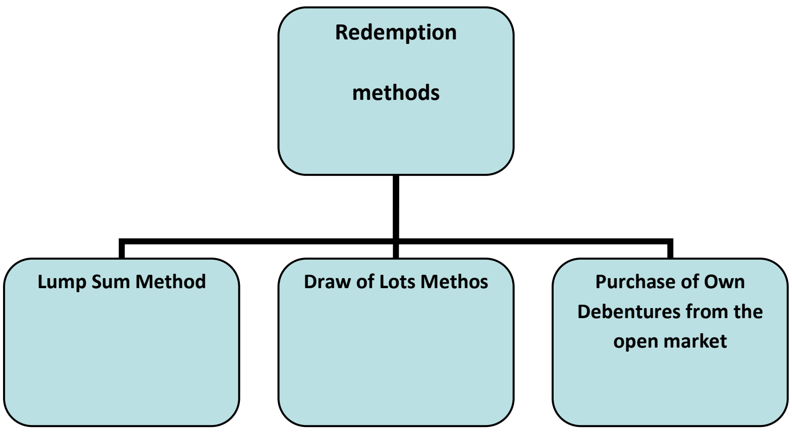
Meaning : Redemption of debentures means repayment of the due amount of debentures to the debenture holders. It may be at par or at premium.

Time of redemption :

(a) At maturity : when repayment is made at the date of maturity of debentures which is determined at the time of issue of debentures.

(b) Before maturity: If articles of association and terms of issue mentioned in prospectus allows, then a company can redeem its debentures before maturity date.

Redemption methods :



(1) Redemption by Lump-sum :- When redemption is made at the expiry of a specific period, as per the terms of issue.

(2) Redemtion by draw of lots :- In this method a certain proportion of debentures are redeem each year, the debenture for which repayment is to be made is selected by draw.

(3) **Redemtion by purchase in open market :-** if articles of association of a company authorize, it may purchase its own debentures from open market i.e. stock exchange. Advantage of this method :

1. When market price of own debentures is low than the redeemable value.
2. Decrease the amount of interest payable to outsiders.
3. if term of issue is provided that debentures are to be redeemed at premium then such premium can be decrease.

Sometimes company can purchase the debentures at more than the redeemable value due to the following reasons :

1. To maintain the solvency ratio.
2. To utlize the surplus money or funds which are lying idle with the company.
3. When rate of interest on debentures is more than the current market rate of interest on debentures in the industry.

Journal Entries When Debentures are purchased from the open market

1. **When Debentures are purchased for immediate cancellation**
   Own Debentures A/c Dr.
   To Bank A/c
   (Being own debentures purchased)

2. **For cancellation of own debentures**
   Debentures A/c Dr.
   To Own Debentures A/c
   To Gain on Cancellation of Debentures
   (Being own debentures cancellation)

3. **Transfer of Gain to Capital Reserve**
   Gain on Cancellation of Debentures Dr.
   To Capital Reserve
   (Being Gain on cancellation of debentures transferred to capital reserve)

4. **Providing Interest on Debentures**
   Interest on Debentures A/c Dr.
   To Debentureholders A/c
   (Being interest on debentures due)

5. **Payment of Interest on Debentures**
   Debentureholders A/c Dr.
   To Bank A/c
   (Being Payment of interest on Debentures)

6. **Transfer of Interest in Statement of P/L**
   Statement of P/L Dr.
   To Interest on Debentures
   (Being Interest transferred to Statement of P/L)

Sources of Redemption of debentures

1. Proceeds from fresh issue of share capital or debenture holders.

2. From accumulated profits.

3. Proceeds from sale of fixed assets.

4. A company may purchases its own debentures out of its surplus funds.

Two terms which are used in the redemption of debentures

1. **Redemption out of capital :** When a company not used its reserve or accumulated profit for redemptionof its debentures. It is called redemption out of capital. Socompany using this method are not transfer it profit to DRR A/c. But as per SEBI guidelines it is necessary for a company to transfer 50% amount of nominal value of debentures to be redeemed in DRR A/c before redemption of debentures commence.

2. **Redemption out of profit :** Redemption out of profit means that adequate amount of profits are transferred to DRR A/c from Statement of P/L before the redemption of debenture commences. This reduce the amount availablefor dividends toshareholders.

NOTE : If it is mentioned in question that redemption is out of capital then DRR should also created with 50% of the nominal value of debentures.
If it is mentioned that redemption is out of profit then DRR should be created with the 100% of the nominal value of debentures.
If nothing is mention about the source of redemption than as per SEBI guidelines 50% of nominal value of debentures is to be transferred to DRR A/c.
If in any particular question DRR is already existed with more than 50% amount of nominal value of debentures, then in this case total 100% of nominal value of debentures is to be transferred to DRR A/c

Clarifications regarding creation of Debenture Redemption Reserve (DRR)

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

a. No DRR is required for debentures issued by All India Financial Institutions, regulated 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 non-convertible portion of debentures issued whether they are Fully or partly paid.

Debenture Redemption Reserve : Debenture redemption reserve is a reserve representing retentions out of profit made for the purpose of redemption of debentures. **Amount of DRR to be created :** Section 117 (c) of the Indian Companies Act 1956 requires that, an adequate amount of profit should be transferred to DRR beforeredemption commences. However the adequate amount is not specified by the companies Act.

SEBI has issued guidlines for the redemption of debentures whereby :

An amount equivalent to 50% of the amount of debentures issue must be transferred to DRR before redemption of debentures commences.

This provision is applicable for non-convertible debentures or non-convertible part of party convertible debentures.

After all the debentures are redeemed, this account is closed by transferring to general reserve account.

Exception to the creation of DRR as per SEBI guidlines :

1. All infrastructure companies, wholly engaged in the business related to development maintenance and operation of infrastructure facilities.
2. A company issuing debentures maturity period of not more than 18 months.
3. Debentures issued by Banking Companies.
4. Companies issuing privately placed debentures.

The above types of companies are exempted by SEBI from creating DRR. However the above types of companies can create DRR (at it option) for the redemption of debentures.