

**CHAPTER-7**

**ISSUE AND REDEMPTION OF DEBENTURES**

**Meaning of Debentures**

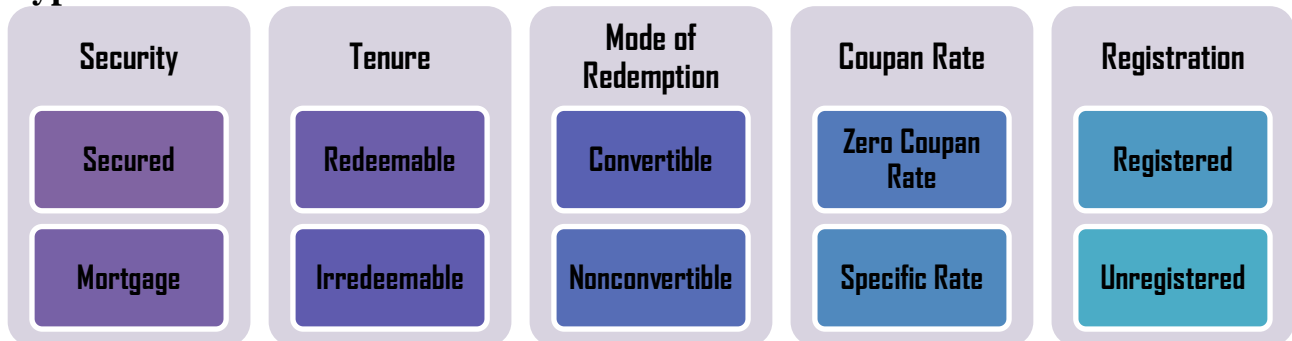
The word ‘debenture’ has been derived from a Latin word ‘debere’ which means to borrow. Debenture is a written instrument acknowledging a debt under the common seal of the company.

**BOND:** Bond is also an instrument of acknowledgement of debt. Traditionally, the Government issued bonds.

**Distinction between Shares and Debentures**

Basis	Shares	Debentures
Ownership	Ownership Capital	Borrowed Capital
Return	Dividend	Interest
Repayment	Not returned during the life of the company	Returned only after the completion of specific period.
Voting Rights	Have voting rights	Do not have voting right.
Security	Not Secured	Secured by assets of company
Convertibility	Can not be converted into Debentures	Can be converted into shares.

**Types of Debenture/Bond**



**ISSUE OF DEBENTURES**

**Issue of Debentures for Cash**

**On Application**

- On opening account in scheduled bank  
Bank A/c Dr.  
    To Debenture Application A/c  
(Amount received on application for — Debenture @ Rs. \_\_\_\_\_ per Debenture)
- For Transfer of Application Money  
Debenture Application A/c Dr.

To Debenture Capital A/c  
(Application money on \_\_\_\_\_ Debenture allotted/transferred to Debenture Capital)

3. For Money refunded on rejected application

Debenture Application A/c Dr.

To Bank A/c

(Application money returned on rejected application for \_\_\_\_ Debenture)

### **On Allotment**

4. For Amount Due on Allotment

Debenture Allotment A/c Dr.

To Debenture Capital A/c

5. For Adjustment of Excess Application Money

Debenture Application A/c Dr.

To Debenture Allotment A/c

(Application Money on \_\_ Debenture @ Rs\_\_per Debenture adjusted to the amount due on allotment).

6. For Receipt of Allotment Money

Bank A/c Dr.

To Debenture Allotment A/c

(Allotment money received on \_\_\_\_ Debenture @ Rs. — per Debenture Combined Account)

### **On Receipt of Call Money**

7. For Call Amount Due

Debenture Call A/c Dr.

To Debenture Capital A/c

(Call money due on \_\_\_\_ Debenture @ Rs. \_\_\_\_\_ per Debenture)

8. For Receipt of Call Amount

Bank A/c Dr.

To Debenture Call A/c

(Call money received)

### **Issue of Debentures at a Discount**

Debenture is issued at a price below its nominal value.

It is a capital loss and can be written-off either by debiting it to profit and loss.

12% Debenture Allotment A/c Dr.

Discount on Issue of Debentures A/c Dr.

To 12% Debenture A/c

(Allotment money due on debentures)

### **Issue of Debentures at Premium**

The price charged is more than its nominal value. Amount of premium is credited to securities premium account and is shown on the liabilities side of the balance sheet under the head reserves and surpluses.

10% Debenture Allotment A/c Dr.  
 To 10% Debentures A/c  
 To Securities Premium A/c  
 (Allotment money due on debentures)

### **Over Subscription**

The number of debentures applied for is more than the number of debentures offered to the public.

### **Issue of Debentures for Consideration other than Cash**

1. Asset A/c Dr.

To Vendor

(Asset purchased)

2. When debentures are issued at par

Vendors A/C Dr.

To debentures Capital A/c

(debentures issued at par)

3. When debentures are issued at Discount

Vendors A/C Dr.

Discount on Issue of debentures A/c Dr.

To debentures Capital A/c

(debentures issued at discount)

4. When debentures are issued at premium

Vendors A/C Dr.

To debentures Capital A/c

To Securities Premium A/c

(debentures issued at premium)

### **Issue of Debentures as a Collateral Security**

Any security in addition to primary security is called 'collateral security'. The amount of debentures will be transferred to debenture suspense account.

Debenture Suspense A/c Dr.

To 19% Debentures A/c

For cancellation of 19% debentures as collateral security on repayment of bank loan.

19% Debentures A/c Dr.

To Debenture Suspense A/c

### **TERMS OF ISSUE OF DEBENTURES**

#### **1. Issue at par and redeemable at par**

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

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

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

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

(b) Debenture Application & Allotment A/c Dr.  
Discount on Issue of Debentures A/c Dr.

    To Debentures A/c  
(Allotment of debentures at a discount)

## 3. Issue at premium and redemption at par

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

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

## 4. Issue at par and redeemable at premium

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

(b) Debenture Application & Allotment A/c Dr.  
Loss on Issue of Debentures A/c Dr. (with premium on redemption)

    To Debentures A/c (with nominal value of debenture)  
    To Premium on Redemption of Debenture A/c (with premium on redemption)  
(Allotment of debentures at par and redeemable at a premium)

## 5. Issue at discount and redemption at premium

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

Debenture Application & Allotment A/c Dr.  
Loss on Issue of Debentures A/c Dr. (with discount on issue plus premium on redemption)

    To Debentures A/c (with nominal value of debenture)

To Premium on Redemption of Debentures A/c (with premium on redemption)

(Allotment of debentures at a discount and redeemable at premium)

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

Bank A/c Dr.

To Debenture Application & Allotment A/c

(Receipt of application money)

Debenture Application & Allotment A/c Dr.

Loss on Issue of Debentures A/c Dr. (with premium on redemption)

To Debentures A/c (with nominal value of debenture)

To Securities Premium A/c (with premium on issue)

To Premium on Redemption of Debentures A/c (with premium on redemption)

### INTEREST ON DEBENTURES

Interest at fixed percentage will be paid periodically until debentures are repaid. According to Income Tax Act 1961, a company must deduct income tax at a prescribed rate from the interest payable on debentures if it exceeds the prescribed limit.

1. When interest is due

Debenture Interest A/c Dr.

To Income Tax payable A/c

To Debentureholders A/c

(Amount of interest due on debenture and tax deducted at source )

2. For payment of interest to debentureholders

Debentureholders A/c Dr.

To Bank A/c

(Amount of interest paid to debentureholders)

3. On transfer debenture Interest Account to statement of Profit and Loss

Profit and Loss A/c Dr.

To Debenture Interest A/c

(Debenture interest transferred to profit and loss A/c)

4. On payment of tax deducted at source to Government

Income Tax Payable A/c Dr.

To Bank A/c

(Payment of tax deducted at source on interest on debentures)

### Writing-Off Discount/Loss On Issue Of Debentures

The discount/loss on issue of debentures is a capital loss or a fictitious asset.

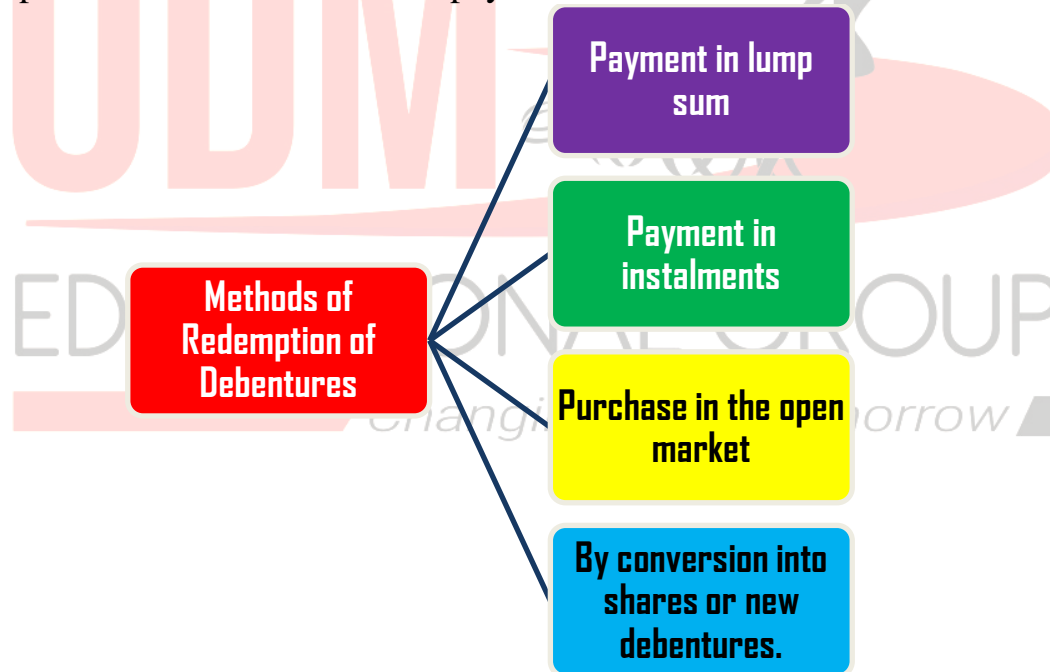
Profit and Loss A/c Dr.

To Discount/Loss on Issue of Debentures A/c

(Discount/loss on issue of debentures written-off)

## REDEMPTION OF DEBENTURES

Redemption of debentures means repayment of the amount of debentures.



### Redemption by Payment in Lump Sum

1. If debentures are to be redeemed at par
  - (a) Debentures A/c      Dr.  
        To Debentureholders
  - (b) Debentureholders      Dr.  
        To Bank A/c
2. If debentures are to be redeemed at premium
  - (a) Debentures A/c      Dr.  
        Premium on Redemption of Debentures A/c Dr.  
                To Debentureholders
  - (b) Debentureholders      Dr.  
        To Bank A/c

The Debenture Redemption Reserve account appears on the liability side of the Balance sheet under the head “Reserves and Surpluses.” When the debentures are redeemed, the requisite amount of Debenture Redemption Reserve is transferred to General Reserve.

### Redemption by Payment in Instalments

1. If redeemed out of profits
  - (a) Statement of profit and loss      Dr.  
        To Debenture Redemption Reserve A/c

- (b) Debentures A/c Dr.  
     To Debentureholders
- (c) Debentureholders Dr.  
     To Bank A/c
2. If redeemed out of capital
- (a) Debentures A/c Dr.  
     To Debentureholders
- (b) Debentureholders A/c Dr.  
     To Bank A/c

### Redemption by Purchase in Open Market

Debentures are purchased from the market at a discount and cancelled

1. On purchase of our debentures for immediate cancellation

Debentures A/c Dr.  
     To Bank A/c  
     To Profit on Redemption of Debentures A/c

2. On transfer of Profit on Redemption

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

The debentures are purchased from the market at a price which is above the nominal value of debenture

1. Debentures A/c Dr.

Loss on Redemption of Debentures A/c Dr.

    To Bank A/c

2. Statement of profit and loss Dr.

    To Loss on Redemption of Debentures A/c

### Redemption by Conversion

The debentures can also be redeemed by converting them into Shares or new debentures.

### Sinking Fund Method

To meet the redemption of debentures, the company may decide to create a sinking fund and invest adequate amount in marketable securities or bonds of other business entities. Normally, a company ensures that an equal amount is set aside every year to arrange the necessary funds at the time of redemption. This is called Sinking Fund method.

#### **1. At the end of First Year**

- (a) For setting aside the fixed amount of profit for redemption

    Statement of profit and loss Dr.

        To Debenture Redemption Fund A/c

- (b) For investing the amount set aside for redemption

Debenture Redemption Fund Investment A/c Dr.

To Bank A/c

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

(a) For receipt of interest on Debenture Redemption Fund Investments

Bank A/c Dr.

To Interest on Debenture Redemption Fund Investment A/c

(b) For transfer of Interest on Debenture Redemption Fund Investment to Debenture Redemption Fund Account

Interest on Debenture Redemption Fund Investment A/c Dr.

To Debenture Redemption Fund A/c

(c) For setting aside the fixed amount of profit for redemption

Statement of profit and loss Dr.

To Debenture Redemption Fund A/c

(d) For investments of the amount set aside for redemption and the interest earned on DRFI

Debenture Redemption Fund Investment A/c Dr.

To Bank A/c

**3. At the end of last year**

(a) For receipt of interest

Bank A/c Dr.

To Interest on Debenture Redemption Fund Investment A/c

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

Interest on Debenture Redemption Fund Investment A/c Dr.

To Debenture Redemption Fund A/c

(c) For setting aside the fixed amount of profit for redemption

Statement profit and loss Dr.

To Debenture Redemption Fund A/c

(d) For encashment of Debenture Redemption Fund Investments

Bank A/c Dr.

To Debenture Redemption Fund Investment, A/c

(e) For the transfer of profit/loss on realization of Debenture Redemption Fund Investments

**In case of Profit**

Debenture Redemption Fund Investment A/c Dr.

To Debenture Redemption Fund A/c

**In case of Loss**

Debenture Redemption Fund A/c Dr.

To Debenture Redemption Fund Investment, A/c



(f) For amount due to debentureholders on redemption

Debenture A/c Dr.

To Debentureholders A/c

(g) For payment to debentureholders

Debentureholders A/c Dr.

To Bank A/c

(h) For transfer of Debenture Redemption Fund Account balance to  
General Reserve

Debenture Redemption Fund A/c Dr.

To General Reserve A/c

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