

Chapter 2 - Issue And Redemption Of Debentures

Short Answer Questions

Question 1:

What is meant by a Debenture?

Answer:

The word Debenture is derived from a Latin word '*debere*' which means to borrow. A debenture is issued in the form of a certificate under the seal of a company and containing a contract for the repayment of the principal sum after a fixed period of time and payment of interest at regular intervals, generally half yearly. Debentures are issued by a company for acquiring long-term borrowings.

Question 2:

What does a Bearer Debenture mean?

Answer:

When a company does not maintain any record of the debenture holders and the debenture is transferable mere by delivery, then the type of the debenture held by the holders is termed as Bearer Debenture. Interests on such debentures are paid to the persons who produce the interest coupons that are attached with these debentures in a specified bank.

Question 3:

State the meaning of 'Debentures issued as a Collateral Security'.

Answer:

The term collateral security means additional or secondary security in addition to the primary security. Sometimes, when a company takes loan from a financial institution, then besides the primary security, the company may issue debenture for additional security (as collateral security). The lender who receives debenture as collateral security is not entitled for interest on these debentures. If any default is made by the company in paying back the principal amount (i.e. the loan amount) or interest on the loan, then the lender has the full

right to recover his/her dues from the sale of primary security. But, if the primary security is not sufficient to recover the amount of the debt, then the debentures issued as collateral may be used for recovery of the remaining amount.

Question 4:

What is meant by 'Issue of debentures for Consideration other than Cash'?

Answer:

If a company purchases assets from its suppliers or vendors, then instead of paying them in cash the company issues debentures to them. This is known as issue of debenture for consideration other than cash. The issue of debenture for consideration other than cash serves the purpose of both the vendor as well as of the purchaser (company). From the purchaser's point of view, purchasing an asset against the issue of debentures requires no additional cost for raising loans or arranging funds immediately. On the other hand, the vendor gets interest on the amount of debentures received. In this case, payment is deferred by issue of debentures and interest is paid for time lag payment. Debentures may be issued at par, premium or discount to the vendor.

Accounting treatment for Issue of Debentures for Consideration other than Cash

1. For purchase of Assets:

Assets A/c	Dr.
To Vendor A/c	
(Asset Purchased)	

2. For Issue of Debentures

a. If debentures are issued at Par:

Vendor A/c	Dr.
To Debentures A/c	

(Debenture issued to Vendor at par)

b. If debentures are issued at Premium

Vendor A/c Dr.

To Debentures A/c

To Securities Premium A/c

(Debenture issued to Vendor at premium)

c) If debentures are issued at Discount

Vendor A/c Dr.

Discount on Issue of Debentures Dr.

To Debentures A/c

(Debenture issued to Vendor at discount)

Question 5:

What is meant by 'Issue of debenture at discount and redeemable at premium?'

Answer:

When debentures are issued below its par value (or the face value) but are redeemed at price higher than its par value, then it is termed as issue of debenture at discount and redeemable at premium. The difference between the issue price and the redemption price is treated as loss on issue of debenture.

Example:

A 10% debenture of Rs 1,000 is issued at 5% discount and is redeemed at 10% premium.

Bank A/c	Dr.	950	
Discount on Issue of Debenture A/c	Dr.	50	
Loss on Issue of Debenture A/c	Dr.	100	
To Debenture A/c			1,000
To Debenture Redemption Premium A/c			100

(Debenture issued)

Total loss = Payment made at redemption – Amount received on issue of debenture
 $1,100 - 950 = \text{Rs } 150$

Question 6:

What is 'Capital Reserve'?

Answer:

Capital Reserve is a reserve that is created out of capital profits i.e. gains or profits arising from other than the normal activities of business operations i.e. activities other than sale or purchase of goods and services. This reserve is utilised to meet future capital losses, if any, and to issue bonus shares. It cannot be distributed as dividend among the share holders.

The Capital Reserve is generated out of the following activities:

- i. Premium on issue of shares.
- ii. Premium on issue of debentures.
- iii. Profit on redemption of debentures.
- iv. Profit on sale of fixed assets.

v. Profit on reissue of forfeited shares.

vi. Profit prior to incorporation, etc.

Question 7:

What is meant by an 'Irredeemable Debenture'?

Answer:

Irredeemable Debentures are those debentures that are not repayable or redeemable by a company during its life time. These are repayable only at the time of winding up of the company. These are also known as Perpetual Debentures that means debentures having indefinite life. In India, now days, no company can issue irredeemable debentures.

Question 8:

What is a 'Convertible Debenture'?

Answer:

Convertible Debentures are those debentures that can be converted into equity shares after a specified period of time. These are of following two types:

i. **Fully Convertible Debentures:** When the whole amount of a debenture is convertible into equity shares worth of equivalent amount, then these debentures are called Fully Convertible Debentures. There is no need to maintain Debenture Redemption Reserves for such debentures.

ii. **Partly Convertible Debentures:** When only a part of the amount of a debenture is convertible into equity share, then these debentures are called Partly Convertible Debentures. In this regards, the Debenture Redemption Reserve is maintained only for the non-convertible part of the debenture.

Question 9:

What is meant by 'Mortgaged Debentures'?

Answer:

Mortgaged Debentures are those debentures that are secured against asset/s of a company. These are also known as secured debentures. If the debentures are secured against a particular asset, then it is called fixed charge whereas, if the debentures are secured against all the assets of a company, then it is called floating charge. In case the company fails to pay back the principal amount of debenture or fails to meet its interest obligations on the due date, then the debenture holders have the right to sell the mortgage asset in order to realise their amount due to the company.

Question 10:

What is discount on issue of debentures?

Answer:

When the debentures are issued at a price below its par value or face value, then it is said that the debentures are issued at discount. The difference between the issue price and the face value of the debenture is regarded as a capital loss.

As per the Revised Schedule VI of the Companies Act, Discount on Issue of Debentures is shown in the Notes to Accounts:

1. With the amount that is to be written off *within 12 months* from the date of Balance Sheet - Shown under *Other Current Assets*
2. With the amount that is to be written off *after 12 months* from the date of Balance Sheet - Shown under *Other Non-Current Assets*

Question 11:

What is meant by 'Premium on Redemption of Debentures'?

Answer:

When the debentures are redeemed at a price more than its face value or the par value, then it is said that the debentures are redeemed at premium. The difference between the redeemed price and the par value is regarded as a capital loss and this loss is written off till the redemption of the debentures. The Premium on Redemption of Debenture is shown in the Notes to Accounts under the sub-head of 'Other Long-term Liabilities'. The final balance is shown under the main head of 'Non-Current Liabilities' on the Equity and Liabilities side of the Company's Balance Sheet.

Accounting Treatment for Premium on Redemption on Debentures:

1. *At the time of the Issue of Debenture:*

Bank/Debenture Allotment A/c

Dr.

Loss on Issue of Debenture A/c

Dr.

To Debenture A/c

To Premium on Redemption

(Debenture issued with the term of redemption at premium)

2. At the time of Redemption of Debentures:

Debenture A/c

Dr.

Premium on Redemption A/c

Dr.

To Debentureholder A/c

(Amount of debentures due to debentureholders)

Question 12:

How are debentures different from shares? Give two points.

Answer:

Basis of Comparisons	Debentures	Shares

1. Meaning	Debentures are a part of loan, therefore, the debenture holders are the creditors of a company.	Shares form a part of capital, hence, share holders are the owner of a company.
2. Voting Rights	These do not carry any voting rights for their holders.	These carry voting rights for their holders.

Question 13:

Name the head under which 'discount on issue of debentures' appears in the Balance Sheet of a company.

Answer:

Discount on Issue of Debentures is regarded as a capital loss. As per the Revised Schedule VI of the Companies Act, Discount on Issue of Debentures is shown in the Notes to Accounts:

1. With the amount that is to be written off ***within 12 months*** from the date of Balance Sheet - Shown under ***Other Current Assets***

2. With the amount that is to be written off ***after 12 months*** from the date of Balance Sheet - Shown under ***Other Non-Current Assets***

Question 14:

What is meant by redemption of debentures?

Answer:

Redemption of debenture means repayment of debentures by the company to the debenture holders. In other words, it implies the discharge of liabilities by repaying the

amount due to the debenture holders as per the terms and conditions determined at the time of issue of debentures. Debentures may be redeemable at par, premium or discount, but, nowa days, these are mostly redeemable at par or premium. The redemption can be done out of profits or from the fresh issue of debentures or shares. Redemption of debentures may be done by the following methods:

1. In lump sum at the time of maturity,
2. In instalments by draw of lots at the end of each year,
3. By purchase in open market whenever price is below its face value,
4. By converting debentures into shares or new debentures.

Question 15:

Can the company purchase its own debentures?

Answer:

Yes, a company can purchase its own debentures provided it is authorised by its Article of Association. As per the Company Act, if a company is authorised by its Article of Association, only then it may purchase its own debentures from the open market. The main purposes of such purchase are as follows:

1. For immediate cancellation of debenture liability, if the interest rate on its debenture is higher than the market rate of interest.
2. A company may also purchase its own debentures with the motive of investment and sell them at higher price in future and thereby earn profit.

Question 16:

What is meant by redemption of debentures by conversion?

Answer:

When a debenture holder can convert his/her debentures into shares or new debentures after the expiry of a specified period of time, then it is known as redemption of debentures by conversion. As the company do not need to pay any funds for the redemption, so there is

no need to maintain the Debenture Redemption Reserve (DRR). The new shares or debentures may be issued at par, premium or at discount.

Question 17:

How would you deal with 'Premium on Redemption of Debentures'?

Answer:

When the debentures are redeemed at a price more than its face value or the par value, then it is said that the debentures are redeemed at premium. The difference between the redeemed price and the par value is regarded as a capital loss and this loss is written off till the redemption of the debentures. The Premium on Redemption of Debenture is shown in the Notes to Accounts under the sub-head of 'Other Long-term Liabilities'. The final balance is shown under the main head of 'Non-Current Liabilities' on the Equity and Liabilities side of the Company's Balance Sheet.

Accounting Treatment for Premium on Redemption on Debentures:

1. *At the time of the Issue of Debenture:*

Bank/Debenture Allotment A/c	Dr.
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Loss on issue of Debenture A/c	Dr.
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To Debenture A/c

To Premium on Redemption

(Debenture issued with the term of redemption at premium)

2. *At the time of Redemption of Debentures:*

Debenture A/c	Dr.
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Premium on Redemption A/c	Dr.
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To Debenture Holder A/c

(Amount of debentures due to debenture holders)

Question 18:

What is meant by 'Redemption out of Capital'?

Answer:

When debentures are redeemed out of capital and no profits are utilised for redemption, then such redemption is termed as redemption out of capital. In such a situation, no profits are transferred to the Debenture Redemption Reserve.

As per the guideline laid down by Securities and Exchange Board of India (SEBI) and the Section 117C of Company Act of 1956, the creation of Debenture Redemption Reserve is mandatory (DRR). Therefore, it is not possible to redeem debentures purely out of capital, as it reduces the value of assets. The following companies are exempted from the creation of DRR.

1. Infrastructure companies (i.e. those companies that are engaged in the business of developing, maintaining and operating infrastructure facilities)
2. A Company that issues debentures with a maturity up to 18 months

The following are the necessary Journal entries that need to be passed, in case the debentures are redeemed out of capital.

a. If debentures are redeemed out of capital at Par

Debenture A/c

Dr.

To Debenture holder A/c

(Amount of debentures due to debenture holders)

Debenture holder A/c Dr.

To Bank A/c

(Amount of debentures paid to debenture holders)

b. If debentures are redeemed out of capital at Premium

Debenture A/c Dr.

Premium on Redemption A/c Dr.

To Debenture holder A/c

(Amount of debentures due to debenture holders)

Debenture holder A/c Dr.

To Bank A/c

(Amount of debentures paid to debenture holders)

Question 19:

What is meant by redemption of debentures by 'Purchase in the Open Market'?

Answer:

According to the Company Act, if a company is authorised by its Article of Association, only then it may purchase its own debentures from the open market. The main purpose of such purchase is as follows:

1. For immediate cancellation of debenture liability, if the interest rate on its debenture is higher than the market rate of interest.
2. A company may also purchase its own debentures with the motive of investment and sell them at higher price in future and thereby earn profit.

Question 20:

Under which head is the 'Debenture Redemption Reserve' shown in the Balance Sheet?

Answer:

As per the Revised Schedule VI, Debenture Redemption Reserve (DRR) is shown in the Notes to Accounts of Reserve and Surplus. The final balance after adding DRR, is shown as the sub-head 'Reserves and Surplus' under the main head of Shareholders' Funds on the Equity and Liabilities side of the Company's Balance Sheet.

Long Answer Questions

Question 1:

Explain the different types of debentures?

Answer:

Debentures are issued by a company for acquiring long-term borrowings.

They can be classified on the following basis.

1. On the basis of Security

a. **Secured Debentures**- Mortgaged Debentures are those debentures that are secured against asset/s of a company. These are also known as secured debentures. In case the company fails to pay back the principal amount of debenture or fails to meet its interest obligations on the due date, then the debenture holders have the right to sell the mortgaged asset in order to realise their amount due to the company.

b. **Unsecured Debentures**- These debentures are treated as unsecured creditors. They do not have any security. These are uncommon now days.

2. On the basis of Tenure

- a. **Redeemable Debenture-** These debentures are payable after the expiry of a specific period. These debentures can be redeemed at par or premium either in lump sum or in installment. Generally all debentures are redeemable.
- b. **Irredeemable Debenture-** Irredeemable Debentures are those debentures that cannot be repayable or redeemable by a company during its life time. These are repayable only at the time of winding up of the company. These are also known as Perpetual Debentures that means debentures having indefinite life. In India, now days, no company can issue irredeemable debentures.

3. On the basis of Mode of Redemption

- a. **Convertible Debentures-** Convertible Debentures are those debentures that can be converted into equity shares after a specified period of time. These are of following two types:
 - i. *Fully Convertible Debentures:* When the whole amount of a debenture is convertible into equity shares of equivalent amount, then these debentures are called Fully Convertible Debentures. There is no need to maintain Debenture Redemption Reserves for such debentures.
 - ii. *Partly Convertible Debentures:* When only a part of the amount of a debenture is convertible into equity shares, then these debentures are called Partly Convertible Debentures. In this regards, the Debenture Redemption Reserve is maintained only for the non-convertible part of the debenture.
- b. **Non-Convertible Debenture-** These debentures cannot be converted into shares. Generally debentures are non convertible.

4. On the basis of Coupon Rate

- a. **Zero Coupon Rate-** These debentures do not contain a specific rate of interest and can be issued at discount. The excess of the face value of the debenture over its issue price is considered as interest amount.
- b. **Specific Rate-** These debentures carry a specific rate of interest which may be fixed or floating.

5. On the basis of Registration

- a. **Registered Debenture-** While issuing such debentures, the company maintains a record regarding name, address and number of holding of debentures in the Register of Debenture Holders of the company.
- b. **Bearer Debentures-** When a company does not maintain any record of the debenture holders and the debenture is transferable mere by delivery, then the type of the debenture held by the holders is termed as Bearer Debenture. Interests on such debentures are paid to the persons who produce the interest coupons that are attached with these debentures in a specified bank.

Question 2:

Distinguish between a debenture and a share. Why is debenture known as loan capital? Explain.

Answer:

Basis of Difference	Shares	Debenture
1. Owner or Creditor	Share holders are the owners since shares forms a are part of owned capital	Debenture holder are Creditors since debentures are a part of loan
2. Voting Rights	Share holders have the voting rights	Debenture holders do not have any voting rights.
3. Returns	Share holders are entitled for returns in the form of dividend.	Debenture holders are entitled for returns in the form of interest.
4. Rate of Return	The rate of dividend is not fixed and varies from year to year.	The rate of interest is fixed and do not vary from year to year.
5. Obligations of Return	Dividend is appropriation of profit. Dividend will not be paid if losses are incurred by the company	Interest is charged against profit, interest is payable even if there is no profit.

6. Repayment of Amount	The amount of share is not returned during the life time of the company	The amount of debenture is returned according to the term of issue.
7. Issue	The issue of shares at discount need adherence to the restrictions imposed by the Section 79 of the Company Act.	There are no such restrictions for issuing debentures on discount.
8. Conversion	Shares cannot be converted into debentures.	Debentures can be converted into shares.
9. Risk	Shares are more risky than debenture as these are unsecured.	If debentures are secured against asset, the risk involved is the minimal.
10. Repayment Priority	Payment to the share holders is made after settlement of all external liabilities, i.e. after debenture holders.	Payment to the debenture holders is made before the share holders.

Issue of debentures implies incurring long-term indebtedness. Generally, a company issues debentures for acquiring long-term borrowings to achieve its long-run targets and growth. Like the owner's capital, interest is also payable on the principal amount of the debenture. The interest paid is regarded as an expense for the company and is deductible under Income Tax Act. Therefore, debentures are also known as loan capital because they are redeemable after a long period of time.

Question 3:

Describe the meaning of 'Debenture Issued as Collateral Securities'. What accounting treatment is given to the issue of debentures in the books of accounts?

Answer:

The term collateral security means additional or secondary security in addition to the primary security. Sometimes, when a company takes loan from a financial institution, then besides the primary security, the company may issue debenture for additional security (as collateral security). The lender who receives debenture as collateral security is not entitled for interest on these debentures. If any default is made by the company in paying back the principal amount (i.e. the loan amount) or interest on the loan, then the lender has the full right to recover his/her dues from the sale of primary security. But, if the primary security is not sufficient to recover the amount of debt, then the debentures issued as collateral may be used for recovery of the remaining amount.

Accounting Treatment

There are two ways to record issue of debentures as collateral security:

1. No Entry

As no liability has been created so no Journal entry is recorded in the books of account. As per the Revised Schedule-VI of the Companies Act, the issue of debenture as collateral security is shown as a Long-Term Borrowings under the heading of Non-Current Liabilities on the Equity and Liabilities side of the Balance Sheet. In the Notes to Accounts of Long-Term Borrowings, the Loan so taken is shown. And in the Notes to Accounts of Cash and Cash Equivalents, the amount of loan so received (in cash) is shown. This can be better understood with the help of the below explained example.

Example- Suppose Best Bus Ltd. issued 4,000 9% Debentures of Rs 100 each as collateral security to NBP bank for a loan of Rs 3,00,000.

Best Bus Ltd.**Balance Sheet**

Particulars	Note No.	Amount (Rs)
I. Equity and Liabilities		
1. Shareholders' Funds		

2. Non-Current Liabilities		
a. Long-Term Borrowings	1	3,00,000
3. Current Liabilities		
Total		3,00,000
II. Assets		
1. Non-Current Assets		
2. Current Assets		
a. Cash and Cash Equivalents	2	3,00,000
Total		3,00,000

NOTES TO ACCOUNTS

Note No.	Particulars	Amount (Rs)
1	Long-Term Borrowings	

	Loan (Secured by issue of 9% Debentures of Rs 4,00,000 as Collateral Security)	3,00,000
2	Cash and Cash Equivalents	
	Cash at Bank	3,00,000

2. *By Making Entry*

In order to record the issue of debentures as collateral security, the following necessary Journal entries are made in the books of account.

At the time of Issue of Debentures as Collateral Security

Debenture Suspense A/c Dr.

To Debenture A/c

(Debentures issued as collateral security)

In this case, as per the Revised Schedule VI of the Companies Act, Debentures so issued as collateral security will be shown as Long-Term Borrowings under the head of Non-Current Liabilities of the Equity and Liabilities side of the Company's Balance Sheet. Unlike Method-1, in this method, Debentures Suspense Account is deducted from the Debentures Account in the Notes to Accounts of Long-Term Borrowings.

Best Bus Ltd.

Balance Sheet

Particulars	Note No.	Amount (Rs)
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I. Equity and Liabilities 1. Shareholders' Funds 2. Non-Current Liabilities a. Long-Term Borrowings 3. Current Liabilities	1	3,00,000
Total		3,00,000
II. Assets 1. Non-Current Assets 2. Current Assets a. Cash and Cash Equivalents	2	3,00,000
Total		3,00,000

NOTES TO ACCOUNTS

Note No.	Particulars	Amount (Rs)
1	Long-Term Borrowings <i>Secured:</i> Loan (Secured by issue of 9% Debentures of Rs 4,00,000 as Collateral Security)	3,00,000
	9% Debentures (Issued as Collateral Security to Bank against loan)	4,00,000
	<i>Less:</i> Debenture Suspense Account	(4,00,000)
		3,00,000
2	Cash and Cash Equivalents Cash at Bank	3,00,000

Question 4:

How is 'Discount on Issue of Debentures' treated in the books of accounts? How will you deal with the 'discount in issue of debentures' when the debentures are to be redeemed in instalments?

Answer:

When the debentures are issued at a price below its par value or face value, then it is said that the debentures are issued at discount. The difference between the issue price and the face value of the debenture is regarded as a capital loss. As per the Revised Schedule VI of the Companies Act, Discount on Issue of Debentures is shown in the Notes to Accounts:

1. With the amount that is to be written off *within 12 months* from the date of Balance Sheet - Shown under *Other Current Assets*

2. With the amount that is to be written off *after 12 months* from the date of Balance Sheet - Shown under *Other Non-Current Assets*

Accounting Treatment

For example, if a company has issued 10% debentures of Rs 6,00,000 at 5% discount redeemable annually by Rs 2,00,000 each year. The total amount of discount on Rs 6,00,000 debentures @ 5% is Rs 30,000, i.e. $(6,00,000 \times 5/100 = \text{Rs } 30,000)$. The accounting treatment for discount on issue of debentures(if it is to be written-off in 5 years) is:

Year 1: Amount to be written-off each year =

$30,000 \times$

1

5

$= 6,000$

$30,000 \times 5 = 6,000$ - Shown in **Statement of Profit and Loss**

Amount to be written-off in the next year = 6,000 - Shown as *Other Current Asset* under **Current Assets**

Remaining Amount to be written-off after next year =

$30,000 - 6,000 - 6,000 = 18,000$

$30,000 - 6,000 - 6,000 = 18,000$ - Shown as *Other Non-Current Asset* under **Non-Current Assets**

<p style="text-align: center;">Statement of Profit and Loss <i>for year ended...</i></p>

S. No.	Particulars	Note No.	Amount
I	Revenue from Operations		
II	Other Income		
III	Total Revenue (I + II)		
IV	Expenses:		
	Amortisation Expenses (Discount on issue of debentures written-off)		6,000

Extract of Balance Sheet as on March 31, 2013		
Particulars	Note No.	Amount (Rs)
II. Assets		
1. Non-Current Assets		
(e) Other Non-Current Assets	1	18,000
2. Current Assets		
(f) Other Current Assets	2	6,000

NOTES TO ACCOUNTS

Note No.	Particulars	Amount (Rs)
1	Other Non-Current Assets	
	Discount of Issue of Debentures	18,000
2	Other Current Assets	
	Discount of Issue of Debentures	6,000

Year 2

Amount to be written-off =

30,000 ×

5

=6,000

$30,000 \times 15 = 6,000$ - Shown in **Statement of Profit and Loss**

Amount to be written-off in the next year = 6,000 - Shown as *Other Current Asset* under **Current Assets**

Remaining Amount to be written-off after next year =

$18,000 - 6,000 = 12,000$

$18,000 - 6,000 = 12,000$ - Shown as *Other Non-Current Asset* under **Non-Current Assets**

At the end of Year 5, the amount of discount on issue of debentures will be completely written off.

Question 5:

Explain the different terms for the issue of debentures with reference to their redemption.

Answer:

The different terms for the issue of debentures with reference to their redemption can be the combinations of at par, at premium and at discount. Normally, the debentures are not redeemable at discount. The permutation and the combination of the various terms of issue and redemption of debentures give rise to following six situations:

1. Issue at Par, Redeemable at Par.
2. Issue at Premium, Redeemable at Par.
3. Issue at Discount, Redeemable at Par.
4. Issue at Par, Redeemable at Premium.
5. Issue at Premium, Redeemable at Premium.
6. Issue at Discount Redeemable at Premium.

1. **Issue at Par and Redeemable at Par-** When the debentures are issued and are redeemed at their face value, then the following Journal entry is passed.

Bank A/c

Dr. (with the amount received)

To Debenture Application A/c

(with the face value)

(Debenture Application money received)

Debenture Application A/c

Dr.

To Debenture A/c

(Application money transferred to Debenture Account)

2. Issue at Premium and Redeemable at Par- When the debentures are issued at premium and are redeemable at par, then the following Journal entry is passed. As premium is a gain for a company so it is credited in the Journal entry.

Bank A/c

Dr.

To Debenture Application A/c

(Debenture Application money received)

Debenture Application A/c

Dr.

To Debenture A/c

To Securities Premium A/c

(Debentures issued at premium and redeemable at par)

3. Issue at Discount and Redeemable at Par- When the debentures are issued at discount and are redeemable at par, then the following Journal entry is passed. As discount is a loss for a company so it is debited in the Journal entry.

Bank A/c Dr.

To Debenture Application A/c

(Debenture Application money received)

Debenture Application A/c Dr.

Discount on Issue of Debenture A/c Dr.

To Debenture A/c

(Debentures issued at discount and redeemable at par)

4. Issue at Par and Redeemable at Premium- When debentures are issued at par and redeemable at premium, then the following Journal entry is passed. In such case, the company did not suffer any loss at the time of issue but there will be loss at the time of redemption.

Bank A/c Dr.

To Debenture Application A/c

(Debenture Application money received)

Debenture Application A/c	Dr.
Loss on Issue of Debenture A/c	Dr. (with the amount of premium on redemption)
To Debenture A/c	(with the face value of the debentures)
To Premium on Redemption of Debenture A/c	(with the amount of premium on redemption)

(Debentures issued at par and redeemable at premium)

5. Issued at Premium and Redemption at Premium- When the debentures are issued and redeemable at premium, then the following Journal entry is passed.

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

(Debenture Application money received)

Debenture Application A/c	Dr.
Loss on Issue of Debenture A/c	Dr. (with the amount of premium on redemption)
To Debenture A/c	(with the face value of the debentures)
To Securities Premium A/c	(with the amount of premium on issue)

To Premium on Redemption of
Debenture A/c

(with the amount of premium on redemption)

(Debentures issued at premium and
redeemable at
premium)

6. Issue of Discount and Redemption at Premium- When the debentures are issued at discount and redeemable at premium, then the following Journal entry is passed.

Bank A/c

Dr.

To Debenture Application A/c

(Debenture Application money received)

Debenture Application A/c

Dr.

Loss on Issue of Debenture A/c

Dr. (with the amount of discount on issue *plus* amount
of premium on redemption)

To Debenture A/c

(with the face value of the debentures)

To Premium on Redemption of
Debenture A/c

(with the amount of premium on redemption)

(Debentures issued at discount and
redeemable at
premium)

Question 6:

Differentiate between redemption of debentures out of capital and out of profits.

Answer:**Redemption of Debentures Out of Capital**

When debentures are redeemed out of capital and no profits are utilised for redemption, then such redemption is termed as redemption out of capital. In such a situation, no profits are transferred to the Debenture Redemption Reserve (DRR).

As per the guideline laid down by Securities and Exchange Board of India (SEBI) and the Section 117C of Company Act of 1956, the creation of DRR is mandatory (DRR). Therefore, it is not possible to redeem debentures purely out of capital, as it reduces the value of assets. The following companies are exempted from the creation of DRR.

1. Infrastructure companies (i.e. those companies that are engaged in the business of developing, maintaining and operating infrastructure facilities)
2. A Company that issues debentures with a maturity up to 18 months

Redemption of Debenture Out of Profits

When debentures are redeemed out of profit then no capital is utilised for redemption. Before redeeming the debentures profits are transferred to DRR from Profit and Loss Appropriation Account. The creation of DRR is mandatory as per the guidelines laid down by Securities and Exchange Board of India (SEBI). SEBI mandates transferring amount equal to 50% of debentures issued to DRR before redeeming debentures. In this method, as profits are transferred to the DRR Account, thereby reducing the total amount of profits, therefore this method is termed as Redemption of Debentures Out of Profits. In this method, first of all, the required profits are transferred from Statement of Profit and Loss to the DRR Account. The working of which is shown in the Notes to Accounts of Reserves and Surplus (as prescribed in Revised Schedule VI). The final balance (after considering DRR) is shown as the sub-head 'Reserves and Surplus' under the main head of Shareholders' Funds on the Equity and Liabilities side of the Company's Balance Sheet. Lastly, when all the debentures are redeemed, then DRR account is closed by transferring its amount to the General Reserve.

Question 7:

Explain the guidelines of SEBI for creating Debenture Redemption Reserve.

Answer:

The following are the main points of SEBI's guidelines for creation of Debenture Redemption Reserve (DRR).

1. Every company that issues debentures with a maturity of more than 18 months shall create DRR.
2. An amount equal to 50% of debenture issued shall be transferred to DRR before starting redemption of debentures.
3. Creation of DRR is applicable only for Non-Convertible Debentures and for non-convertible part of Partly Convertible Debentures.
4. Any withdrawal from DRR is allowed only after 10% of debentures are redeemed.

Thus, as per the SEBI's guidelines, 50% of the debentures issued should be redeemed out of the profits that are transferred to DRR and the remaining 50% of the debentures issued can be redeemed either out of profits or out of capital. Hence, no company can redeem all the debentures issued purely out of the capital.

As per the SEBI's guidelines the following companies are exempted from the creation of DRR.

1. Infrastructure companies (i.e. those companies that are engaged in the business of developing, maintaining and operating infrastructure facilities)
2. A Company that issues debentures with a maturity up to 18 months

Question 8:

Describe the steps for creating Sinking Fund for redemption of debentures.

Answer:

The various steps involved in the creation of Sinking Fund for redemption of debentures can be better understood by the help of the example explained below.

A Company issued 10% Debentures of Rs 5,00,000 for 3 years. The investment is expected to earn 6% p.a. The Sinking Fund table shows that 0.31411 invested annually at 6% amount to Rs 1 in 3 years.

Step 1: Calculate the amount of instalment to be required every year for investment with the help of the Sinking Fund table. Like in the example Rs 1,57,055 (i.e. $0.31411 \times 5,00,000$) is required every year.

Step 2: The amount of instalment calculated in the above step is transferred to the Debenture Redemption Fund (Sinking Fund) by debiting from Profit and Loss Appropriation Account.

Step 3: In the first year, the above instalment is invested to yield amount required for redemption of debenture by debiting Debenture Redemption Fund Investment Account.

Step 4: The interest on investment is received on half yearly or annual basis. In the

example, the interest of Rs 9,423 is received on annual basis. $\left(1,57,055 \times \frac{6}{100} = \text{Rs } 9,423\right)$

Step 5: The total amount of investment, i.e. interest plus instalment is invested in the subsequent year. In the example, Rs 1,66,478 (i.e. Rs 1,57,055 + Rs 9,423) is invested in the next year.

Step 6: Repeat the Step 2, 3, 4 for each subsequent years up to the end of the life of the debenture. In the year of redemption, the instalment (i.e. the last instalment) will be debited to the Profit and Loss Appropriation Account but will not be invested.

Step 7: In the year of redemption, the investment is sold off.

Step 8: The profit (loss) on the sale of the investment is transferred by debiting (crediting) Debenture Redemption Fund Investment Account to the Debenture Redemption Fund Account.

Step 9: The payment to the debenture holder is made.

Step 10: The balance of Debenture Redemption Fund Account *if any*, is transferred to the General Reserve.

Question 9:

Can a company purchase its own debentures in the open market? Explain.

Answer:

Yes, a company can purchase its own debentures provided it is authorised by its Article of Association. As per the Company Act, if a company is authorised by its Article of Association, only then it may purchase its own debentures from the open market. The main purposes of such purchase are as follows:

1. For immediate cancellation of debenture liability, if the interest rate on its debenture is higher than the market rate of interest.
2. A company may also purchase its own debentures with the motive of investment and sell them at higher price in future and thereby earn profit.

A company may purchase its own debentures at discount or at premium for cancellation.

1. If Debentures are purchased at Discount for Cancellation

When the company purchases its own debentures at discount for cancellation, then the following Journal entries are recorded.

Own Debentures A/c

Dr.

To Bank A/c

(Own debentures purchased)

Debentures A/c

Dr. (with the face value)

To Own Debentures A/c

(with the amount paid)

To Profit on Cancellation of Own
Debentures A/c

(with the difference between the face value
and amount paid)

(Own debentures cancelled)

Profit on Cancellation of Own Debentures A/c Dr.

 To Capital Reserve A/c

(Profit on Cancellation of Own Debentures transferred to
Capital Reserve)

2. If Debentures are Purchased at Premium for Cancellation

Own Debentures A/c Dr.

 To Bank A/c

(Own debentures purchased)

Debentures A/c Dr. (with the face value)

Loss on Redemption of Debentures A/c (with the difference between Amount paid
and face value)

 To Own Debentures A/c

(Own Debentures cancelled)

Question 10:

What is meant by conversion of debentures? Describe the method of such a conversion.

Answer:

When a debenture holder can convert his/her debentures into shares or new debentures after the expiry of a specified period of time, then it is known as redemption of debentures by conversion. As the company does not need to pay any funds for the redemption, so there is no need to maintain Debenture Redemption Reserve (DRR). The new shares or debentures may be issued at par, premium or at discount.

If a debenture holder exercises the conversion option, then the issue price of shares must be equal to or less than the amount actually received from debentures.

Accounting Treatment**1. For amount due to debenture holders**

Debenture A/c

Dr.

To Debenture holders A/c

(Debentures redeemed)

2. For discharging liability to the debenture holders

Debenture holders A/c

Dr.

To Shares/Debentures (New) A/c

(Debenture holder amount discharged)

Numerical Questions

Question 1:

G.Ltd. issued 75,00,000, 6% Debenture of Rs 50 each at par payable Rs 15 on application and Rs 35 on allotment, redeemable at par after 7 years from the date of issue of debenture. Record necessary entries in the books of Company.

Answer:**Book of G. Ltd.****Journal**

Date	Particulars	L.F.	Debit Amount Rs	Credit Amount Rs
	Bank A/c Dr. To 6% Debenture Application A/c (Application money @ Rs 15 each received for 75,00,000 debentures)		11,25,00,000	11,25,00,000
	6% Debenture Application A/c Dr. To 6% Debenture A/c		11,25,00,000	11,25,00,000

(Application money of 75,00,000 debentures transferred to 6% Debentures Account)			
6% Debenture Allotment A/c	Dr.	26,25,00,000	
To 6% Debenture A/c			26,25,00,000
(Allotment money @ Rs 35 each due for 75,00,000 debentures)			
Bank A/c	Dr.	26,25,00,000	
To 6% Debenture Allotment A/c			26,25,00,000
(Allotment money received @ Rs 35 each on 75,00,000 debentures)			

Question 2:

Y.Ltd. issued 2,000, 6% Debentures of Rs 100 each payable as follows: Rs 25 on application; Rs 50 on allotment and Rs 25 on First and Final call.

Answer:

Books of Y Ltd.

Journal

Date	Particulars	L.F.	Debit Amount Rs	Credit Amount Rs
	Bank A/c Dr. To 6% Debentures Application A/c (Application money @ Rs 25 each received for 2,000 6% Debentures)		50,000	50,000
	6% Debenture Application A/c Dr. To 6% Debenture A/c (Application money on 2,000 debentures transferred to 6% Debentures Account)		50,000	50,000

<div>6% Debenture Allotment A/c</div> <div>Dr.</div> <div>To 6% Debenture A/c</div> <div>(Debenture Allotment money @ Rs 50 each due on 2,000 6% Debentures)</div>	1,00,000	1,00,000
<div>Bank A/c</div> <div>Dr.</div> <div>To 6% Debenture Allotment A/c</div> <div>(Allotment money for 2,000 6% Debentures received)</div>	1,00,000	1,00,000
<div>6% Debenture First and Final Call A/c</div> <div>Dr.</div> <div>To 6% Debenture A/c</div> <div>(Debenture First and Final Call @ 25 each due on 2,000 6% Debentures)</div>	50,000	50,000
<div>Bank A/c</div> <div>Dr.</div>	50,000	

	To 6% Debenture First and Final Call A/c			50,000
	(First and Final Call for 2,000 6% Debentures received)			

Question 3:

A.Ltd. issued 10,000, 10% Debentures of Rs 100 each at a premium of 5% payable as follows:

Rs 10 on Application;

Rs 20 along with premium on allotment and balance on First and Final call. Record necessary Journal Entries.

Answer:

Books of A. Ltd.

Journal

Date	Particulars	L.F.	Debit Amount	Credit Amount

			Rs	Rs
	<p>Bank A/c Dr.</p> <p>To 10% Debentures Application A/c</p> <p>(Application money received for 10,000, 10% Debenture Application @ Rs 10 each)</p>		1,00,000	1,00,000
	<p>10% Debentures Application A/c Dr.</p> <p>To 10% Debenture A/c</p> <p>(Application money @ Rs 10 each transferred to 10% Debenture Account)</p>		1,00,000	1,00,000
	<p>10% Debenture Allotment A/c Dr.</p> <p>To 10% Debentures A/c</p> <p>To Securities Premium A/c</p> <p>(Allotment due @ Rs 25 each including premium Rs 5 on 10,000, 10% Debentures)</p>		2,50,000	2,00,000 50,000

Bank A/c	Dr.	2,50,000	
To 10% Debenture Allotment A/c			2,50,000
(Allotment money received on allotment @ Rs 25 each for 10,000 10% Debentures)			
10% Debenture First and Final Call A/c	Dr.	7,00,000	
To 10% Debenture A/c			7,00,000
(First and Final Call @ Rs 70 each on 10,000 10% Debentures due)			
Bank A/c	Dr.	7,00,000	
To 10% Debenture First and Final Call A/c			7,00,000
(Debenture First and Final Call received @ Rs 70 each for 10,000 10% Debentures)			

Question 4:

A. Ltd. issued 90,00,000, 9% Debenture of Rs 50 each at a discount of 8%, redeemable at par any time after 9 years. Record necessary entries in the books of A. Ltd.

Answer:**Books of A. Ltd.****Journal**

Date	Particulars	L.F.	Debit Amount Rs	Credit Amount Rs
	Bank A/c Dr.		41,40,00,000	
	Discount on Issue of Dr. Debenture A/c		3,60,00,000	
	To 9% Debenture A/c			45,00,00,000
	(Money received for 90,00,000 9% Debentures @ Rs 50 each at discount of 8%)			

Alternative Method:

	Bank A/c Dr. To 9% Debentures Application A/c (Debenture Application money received @ Rs 46 each on 90,00,000 9% Debentures)		41,40,00,000	41,40,00,000
	9% Debentures Application A/c Dr. Discount on issue of Debentures A/c Dr. To 9% Debenture A/c (9% Debentures application money transferred to 9% Debenture Account)		41,40,00,000 3,60,00,000	4,50,00,000

Question 5:

A. Ltd. issued 4,000, 9% Debentures of Rs 100 each on the following terms:

Rs 20 on Application;

Rs 20 on Allotment;

Rs 30 on First call; and

Rs 30 on Final call.

The public applied for 4,800 Debentures. Applications for 3,600 Debentures were accepted in full. Applications for 800 Debentures were allotted 400 Debentures and applications for 400 Debentures were rejected.

Answer:**Books of A Ltd.**

Date	Particulars	L.F.	Debit Amount Rs	Credit Amount Rs
	Bank A/c Dr.		96,000	
	To 9% Debenture Application A/c			96,000

<p>(9% Debenture Application money received on 4,800 Debentures @ 20 each)</p>			
<p>9% Debenture Application A/c Dr.</p> <p style="padding-left: 40px;">To 9% Debenture A/c</p> <p style="padding-left: 40px;">To 9% Debenture Allotment A/c</p> <p style="padding-left: 40px;">To Bank A/c</p> <p>(9% Debenture Application money of 4000 debentures transferred to Debentures Account, 400 debentures rejected returned and remaining amount adjusted on allotment)</p>		<p>96,000</p>	<p>80,000</p> <p>8,000</p> <p>8,000</p>
<p>9% Debenture Allotment A/c Dr.</p> <p style="padding-left: 40px;">To 9% Debenture A/c</p> <p>(9% Debenture Allotment due on 4,000 Debentures @ Rs 20 each)</p>		<p>80,000</p>	<p>80,000</p>

Bank A/c	Dr.	72,000	
To 9% Debenture Allotment A/c			72,000
(9% Debenture Allotment money received)			
9% Debenture First Call A/c	Dr.	1,20,000	
To 9% Debenture A/c			1,20,000
(9% Debenture First Call due on 4000 debentures @ Rs 30 each)			
Bank A/c	Dr.	1,20,000	
To Debenture First Call A/c			1,20,000
(9% Debenture first call received for 4000 debentures @ Rs 30 each)			
9% Debenture Final Call A/c	Dr.	1,20,000	
To 9% Debenture A/c			1,20,000

	(9% Debenture Final Call due on 4000 debentures @ Rs 30 each)			
	Bank A/c Dr.		1,20,000	
	To 9% Debenture Final Call A/c			1,20,000
	(9% Debenture Final Call received on 4000 debentures @ Rs 30 each)			

Question 6:

T. Ltd. offered 2,00,000, 8% debenture of Rs 500 each on June 30, 2014 at a premium of 10% payable as Rs 200 on application (including premium) and balance on allotment, redeemable at par after 8 years. But application are received for 3,00,000 debentures and the allotment is made on pro-rata basis. All the money due on application and allotment is received. Record necessary entries regarding issue of debentures.

Answer:

Books of T. Ltd. Journal

Date	Particulars	L.F.	Debit Amount (₹)	Credit Amount (₹)

2014				
Jun. 30	Bank A/c	Dr.	6,00,00,000	
	To 8% Debenture Application A/c			6,00,00,000
	(8% Debenture application money received for 3,00,000 debentures @ ₹200 each)			
Jun. 30	8% Debenture Application A/c	Dr.	6,00,00,000	
	To 8% Debenture A/c			3,00,00,000
	To 8% Debenture Allotment A/c			2,00,00,000
	To Securities Premium A/c			1,00,00,000
	(8% Debenture Application money of 2,00,000 debentures @ ₹200 each including ₹50 premium transferred to Debenture Account and rest of the amount adjusted on allotment)			
	8% Debenture Allotment A/c	Dr.	7,00,00,000	
	To 8% Debenture A/c			7,00,00,000
	(8% Debenture allotment on 2,00,000 debentures @ ₹350 due)			

Bank A/c	Dr.	5,00,00,00 0	
To 8% Debenture Allotment A/c			5,00,00,00 0
(8% Debenture Allotment money received)			

Question 7:

X.Ltd. invites application for the issue of 10,000, 14% debentures of Rs 100 each payable as to Rs 20 on application, Rs 60 on allotment and the balance on call. The company receives applications for 13,500 debentures, out of which applications for 8,000 debentures are allotted in full, 5,000 only 40% and the remaining rejected. The surplus money on partially allotted applications is utilised towards allotment. All the sums due are duly received.

Answer:

Books of X. Ltd.

Journal

Date	Particulars	L.F.	Debit Amount Rs	Credit Amount Rs
	Bank A/c	Dr.	2,70,000	

<p>To 14% Debenture Application A/c</p> <p>(14% Debenture application money for 13,500 debentures @ 20 each received)</p>			2,70,000
<p>14% Debenture Application A/c Dr.</p> <p>To 14% Debenture A/c</p> <p>To 14% Debenture Allotment A/c</p> <p>To Bank</p> <p>(14% Debenture Application money of 10,000 @ Rs 20 each transferred to 14% Debentures Account and 500 debentures were rejected and returned and rest of the amount adjusted on allotment)</p>		2,70,000	
<p>14% Debenture Allotment A/c Dr.</p> <p>To 14% Debenture A/c</p>		6,00,000	6,00,000

<p>(14% Debenture Allotment money due on 10,000 debentures @ Rs 60 each)</p>			
<p>Bank A/c Dr.</p> <p>To 14% Debenture Allotment A/c</p> <p>(14% Debenture Allotment money received)</p>		<p>5,40,000</p>	<p>5,40,000</p>
<p>14% Debenture First and Final Call A/c Dr.</p> <p>To 14% Debenture A/c</p> <p>(14% Debenture First and Final Call money due on 10,000 debentures @ 20 each)</p>		<p>2,00,000</p>	<p>2,00,000</p>
<p>Bank A/c Dr.</p> <p>To 14% Debenture First and Final Call A/c</p>		<p>2,00,000</p>	<p>2,00,000</p>

	(14% Debenture First and Final Call money received on 10,000 debentures @ Rs 20 each)			
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Question 8:

R.Ltd. offered 20,00,000, 10% Debenture of Rs 200 each at a discount of 7% redeemable at premium of 8% after 9 years. Record necessary entries in the books of R. Ltd.

Answer:

Books of R.Ltd.

Journal

Date	Particulars	L.F.	Debit Amount Rs	Credit Amount Rs
	Bank A/c Dr.		37,20,00,000	
	To 10% Debenture Application & Allotment A/c			37,20,00,000

(Debenture Application and Allotment money received for 20,00,000 10% Debentures @ Rs 200 each)				
10% Debenture Application and Allotment A/c	Dr.	37,20,00,000		
Loss on Issue of Debenture A/c	Dr.	3,20,00,000		
Discount on Issue of Debentures A/c	Dr.	2,80,00,000		
To 10% Debenture A/c				40,00,00,000
To Premium on Redemption of Debentures A/c				3,20,00,000
(Allotment of 20,00,000 debenture @ Rs 200 each at 7% discount with the term of 8% premium on redemption)				

Question 9:

M.Ltd. took over assets of Rs 9,00,00,000 and liabilities of Rs 70,00,000 of S.Ltd. and issued 8% Debenture of Rs 100 each. Record necessary entries in the books of M. Ltd.

Answer:

Books of M. Ltd.

Journal

Date	Particulars	L.F.	Debit Amount Rs	Credit Amount Rs
	Sundry Assets Dr. To Sundry Liabilities A/c To S.Ltd. (Assets and liabilities of S. Ltd. taken over)		9,00,00,000	70,00,000 8,30,00,000
	S. Ltd. Dr. To 8% Debenture A/c (8,30,000 8% debentures @ 100 each issued to S Ltd. in consideration of assets and liabilities)		8,30,00,000	8,30,00,000

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Question 10:

B.Ltd. purchased assets of the book value of Rs 4,00,000 and took over the liability of Rs 50,000 from Mohan Bros. It was agreed that the purchase consideration, settled at Rs,3,80,000, be paid by issuing debentures of Rs 100 each.

What Journal entries will be made in the following three cases, if debentures are issued: (a) at par; (b) at discount; (c) at premium of 10%? It was agreed that any fraction of debentures be paid in cash.

Answer:

Case (a)

Book of B. Ltd.

Journal

Date	Particulars	L.F.	Debit Amount Rs	Credit Amount Rs
	Sundry Assets A/c Dr.		4,00,000	
	Goodwill A/c Dr.		30,000	

	To Sundry Liabilities A/c			50,000
	To Mohan Bros.			3,80,000
	(Assets and liabilities of Mohan Bros. taken over)			
	Mohan Bros. Dr.	3,80,000		
	To Debenture A/c			3,80,000
	(3,800 debentures of 100 each issued to Mohan Bros. in consideration of assets and liabilities)			

Case (b)

	Sundry Assets A/c Dr.	4,00,000		
	Goodwill A/c Dr.	30,000		
	To Sundry Liabilities A/c			50,000
	To Mohan Bros.			3,80,000

(Assets and liabilities of Mohan Bros. taken over)				
Mohan Bros.	Dr.	3,80,000		
Discount on Issue of Debenture A/c	Dr.	42,222		
To Debenture A/c				4,22,200
To Bank A/c				22
(Issued 4,222 debentures of Rs 100 each at 10% discount and balance paid in cash)				

Case (c)

Sundry Assets A/c	Dr.	4,00,000		
Goodwill A/c	Dr.	30,000		
To Sundry Liabilities A/c				50,000
To Mohan Bros.				3,80,000
(Assets and liabilities of Mohan Bros. taken over)				

	Mohan Bros	Dr.	3,80,000	
	To Debentures A/c			3,45,400
	To Securities Premium A/c			34,540
	To Bank A/c			60
	(Issued of 3,454 debentures at 10% premium and balance paid in cash)			

Question 11:

X.Ltd. purchased a Machinery from Y for an agreed purchase consideration of Rs 4,40,000 to be satisfied by the issue of 12% debentures of Rs 100 each at a premium of Rs 10 per debenture. Journalise the transactions.

Answer:

Books of X. Ltd.

Journal

Date	Particulars	L.F.	Debit Amount Rs	Credit Amount Rs
	<div>Machinery A/c Dr.</div> <div>To Y</div> <div>(Machinery purchased from Y)</div>		4,40,000	4,40,000
	<div>Y Dr.</div> <div>To 12% Debentures A/c</div> <div>To Securities Premium A/c</div> <div>(Allotted 4,000 debentures of Rs 100 each at a premium of Rs 10 per debenture in consideration of Machinery purchased)</div>		4,40,000	4,00,000 40,000

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Question 12:

X.Ltd. issued 15,000, 10% debentures of Rs 100 each. Give journal entries and the Balance Sheet in each of the following cases:

- (i) The debentures are issued at a premium of 10%;
- (ii) The debentures are issued at a discount of 5%;
- (iii) The debentures are issued as a collateral security to bank against a loan of Rs 12,00,000; and
- (iv) The debentures are issued to a supplier of machinery costing Rs 13,50,000.

Answer:

(i)

Books of X. Ltd.

Journal

Date	Particulars	L.F.	Debit Amount Rs	Credit Amount Rs
	Bank A/c Dr.		16,50,000	
	To 10% Debentures A/c			15,00,000

	To Securities Premium A/c			1,50,000
	(Issued 15,000, 10% debentures of Rs 100 each at 10% premium)			

X Ltd.

Balance Sheet

Particulars	Note No.	Amount (Rs)
I. Equity and Liabilities		
1. Shareholders' Funds		
a. Reserves and Surplus	1	1,50,000
2. Non-Current Liabilities		
a. Long-Term Borrowings	2	15,00,000

3. Current Liabilities		
Total		16,50,000
II. Assets		
1. Non-Current Assets		
2. Current Assets		
a. Cash and Cash Equivalents	3	16,50,000
Total		16,50,000

NOTES TO ACCOUNTS

Note No.	Particulars	Amount (Rs)
1	Reserves and Surplus	
	Securities Premium	1,50,000

2	Long-Term Borrowings	
	10% Debentures (Secured)	15,00,000
3	Cash and Cash Equivalents	
	Cash at Bank	16,50,000

(ii)

Bank A/c	Dr.	14,25,000	
Discount on Issue of Debentures A/c	Dr.	75,000	
To 10% Debentures			15,00,000
(Issued 15,000 10% Debenture of Rs 100 each at 5% discount)			

X Ltd.

Balance Sheet

Particulars	Note No.	Amount (Rs)
I. Equity and Liabilities		
1. Shareholder's Funds		
2. Non-Current Liabilities		
a. Long-Term Borrowings	1	15,00,000
3. Current Liabilities		
Total		15,00,000
II. Assets		
1. Non-Current Assets		
a. Other Non-Current Assets	2	75,000

2. Current Assets		
a. Cash and Cash Equivalents	3	14,25,000
Total		15,00,000

NOTES TO ACCOUNTS

Note No.	Particulars	Amount (Rs)
1	Long-Term Borrowings	
	10% Debentures (Secured)	15,00,000
2	Other Non-Current Assets	
	Discount on Issue of Debentures	75,000
3	Cash and Cash Equivalents	
	Cash at Bank	14,25,000

(iii) No entry will be passed for issuing debentures as a collateral security

X Ltd.

Balance Sheet

Particulars	Note No.	Amount (Rs)
I. Equity and Liabilities		
1. Shareholders' Funds		
2. Non-Current Liabilities		
a. Long-Term Borrowings	1	12,00,000
3. Current Liabilities		
Total		12,00,000
II. Assets		
1. Non-Current Assets		
2. Current Assets		
a. Cash and Cash Equivalents	2	12,00,000
Total		12,00,000

NOTES TO ACCOUNTS

Note No.	Particulars	Amount (Rs)
1	Long-Term Borrowings Bank Loan (Secured against issue Debentures of Rs 12,00,000)	12,00,000
2	Cash and Cash Equivalents Cash at Bank	12,00,000

Alternative Method

	Debenture Suspense A/c	Dr.	15,00,000	
	To 10% Debentures A/c			15,00,000
	(Issued 15,000 10% Debentures of Rs 100 each as collateral security to bank against a loan of Rs 12,00,000)			

X Ltd.

Balance Sheet

Particulars	Note No.	Amount (Rs)
I. Equity and Liabilities		
1. Shareholders' Fund		
2. Non-Current Liabilities		
a. Long-Term Borrowings	1	12,00,000
3. Current Liabilities		
Total		12,00,000
II. Assets		
1. Non-Current Assets		
2. Current Assets		
a. Cash and Cash Equivalents	2	12,00,000
Total		12,00,000

NOTES TO ACCOUNTS

Note No.	Particulars	Amount (Rs)
1	Long Term Borrowings	
	<i>Secured:</i>	
	Bank Loan	12,00,000
	10 % Debentures (Secured against issue of Debentures of Rs 12,00,000)	15,00,000
	<i>Less:</i> Debenture Suspense Account	15,00,000
		-
		12,00,000
2	Cash and Cash Equivalents	
	Cash at Bank	12,00,000

(iv)

	Machinery A/c	Dr.	13,50,000	
	To Vendor A/c			13,50,000

	(Machinery purchased from vendor)			
	Vendor A/c Dr.	13,50,000		
	Discount on Issue of Debentures A/c Dr.	1,50,000		
	To 10% Debenture A/c			15,00,000
	(15,000 10% Debentures @ Rs 100 each issued at 10% discount to the vendor in consideration of Machinery of Rs 13,50,000)			

X Ltd.

Balance Sheet

Particulars	Note No.	Amount (Rs)
I. Equity and Liabilities		
1. Shareholders' Funds		
2. Non-Current Liabilities		

a. Long Term Borrowings	1	15,00,000
3. Current Liabilities		
Total		15,00,000
II. Assets		
1. Non-Current Assets		
a. Fixed Assets		
i. Tangible Assets	2	13,50,000
b. Other Non-Current Assets	3	1,50,000
2. Current Assets		
Total		15,00,000

NOTES TO ACCOUNTS

Note No.	Particulars	Amount (Rs)
1	Long Term Borrowings	

	10% Debentures (Secured)	15,00,000
2	Tangible Assets	
	Plant and Machinery	13,50,000
3	Other Non-Current Assets	
	Discount on Issue of Debentures	1,50,000

Question 13:

Journalise the following:

- (i) A debenture issued at Rs 95, repayable at Rs 100;
- (ii) A debenture issued at Rs 95, repayable at Rs 105; and
- (iii) A debenture issued at Rs 100, repayable at Rs 105;

The face value of debenture in each of the above cases is Rs 100.

Answer:

S.No.	Particulars	L.F.	Debit Amount	Credit Amount Rs

			Rs	
(i)	Bank A/c Dr.		95	
	Discount on Issue of Debenture A/c Dr.		5	
	To Debenture A/c			100
	(Debenture of Rs 100 issued at Rs 5 discount with the term repayable at Rs 100)			
(ii)	Bank A/c Dr.		95	
	Loss on Issue of Debenture A/c Dr.		10	
	To Debenture A/c			100
	To Premium on Redemption of Debentures			5
	(Debenture of Rs 100 issued at a discount of Rs 5 and with the term repayable at Rs 105)			
(iii)	Bank A/c Dr.		100	

Loss on Issue of Debenture A/c	Dr.		5	
To Debenture A/c				100
To Premium on Redemption of Debenture A/c				5
(Debenture of Rs 100 issued with the term repayable at Rs 105)				

Question 14:

A.Ltd. issued 50,00,000, 8% Debenture of Rs 100 at a discount of 6% on April 01, 2009 redeemable at premium of 4% by draw of lots as under:

20,00,000 Debentures on March, 2011

10,00,000 Debentures on March, 2013

20,00,000 Debentures on March, 2014

Compute the amount of discount to be written-off in each year till debentures are paid. Also prepare discount/loss on issue of debenture account.

Answer:

Loss on issue of debenture = 6% (discount on issue) + 4% (premium on redemption) = 10%

At the end of	Debenture Outstanding	Ratio	Loss to be written off every year
March 2010	50,00,00,000	5	= 1,38,88,889
March 2011	50,00,00,000	5	= 1,38,88,889
March 2012	30,00,00,000	3	= 83,33,333
March 2013	30,00,00,000	3	= 83,33,333
March 2014	20,00,00,000	2	= 55,55,556
		18	Rs 5,00,00,000

Loss on Issue of Debenture Account

Dr.

Cr.

Date	Particulars	J.F.	Amount Rs	Date	Particulars	J.F.	Amount Rs
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2009				2010			
April 01	Debenture		5,00,00,000	March 31	Profit and Loss		1,38,88,889
					Balance c/d		3,61,11,111
			5,00,00,000				5,00,00,000
2010				2011			
April 01	Balance b/d		3,61,11,111	March 31	Profit and Loss		1,38,88,889
					Balance c/d		2,22,22,222
			3,61,11,111				3,61,11,111
2011				2012			
April 01	Balance b/d		2,22,22,222	March 31	Profit and Loss		83,33,333
					Balance c/d		1,38,88,889
			2,22,22,222				2,22,22,222

2012				2013			
April 01	Balance b/d		1,38,88,889	March 31	Profit and Loss		83,33,333
					Balance c/d		55,55,556
			1,38,88,889				1,38,88,889
2013				2014			
April 01	Balance b/d		55,55,556	March 31	Profit and Loss		55,55,556
			55,55,556				55,55,556

Question 15:

A company issues the following debentures:

- (i) 10,000, 12% debentures of Rs 100 each at par but redeemable at premium of 5% after 5 years;
- (ii) 10,000, 12% debentures of Rs 100 each at a discount of 10% but redeemable at par after 5 years;
- (iii) 5,000, 12% debentures of Rs 1,000 each at a premium of 5% but redeemable at par after 5 years;
- (iv) 1,000, 12% debentures of Rs 100 each issued to a supplier of machinery costing Rs 95,000. The debentures are repayable after 5 years; and

(v) 300, 12% debentures of Rs 100 each as a collateral security to a bank which has advanced a loan of Rs 25,000 to the company for a period of 5 years.

Pass the journal entries to record the: (a) issue of debentures; and (b) repayment of debentures after the given period.

Answer:

In the books of

Journal

a) Issue of Debentures

S. No.	Particulars	L.F.	Debit Amount Rs	Credit Amount Rs
(i)	Bank A/c Dr.		10,00,000	
	To 12% Debenture Application A/c			10,00,000
	(Debenture Application money of 10,000 12% debentures @ 100 each received)			
	12% Debenture Application A/c Dr.		10,00,000	
	Loss on Issue of Debenture A/c Dr.		50,000	

	To 12% Debenture A/c		10,00,000
	To Premium on Redemption of Debenture A/c		50,000
	(Debenture Application money of 10,000 12% debentures @ Rs 100 each transferred to 12% Debentures Account and the Debentures are issued with term of repayable at 5% premium)		
(ii)	Bank A/c Dr.	9,00,000	
	To Debenture Application and Allotment A/c		9,00,000
	(Debenture Application money received excluding discount on issue)		
	12% Debenture Application & Dr. Allotment A/c	9,00,000	
	Discount on Issue of Debenture A/c Dr.	1,00,000	
	To Debentures A/c		10,00,000
	(Debenture Allotment made due)		

(iii)	Bank A/c	Dr.	52,50,000	
	To Debenture Application and Allotment A/c			52,50,000
	(Debenture Application money received)			
(iv)	Debenture Application and Allotment A/c	Dr.	52,50,000	
	To Debenture A/c			50,00,000
	To Security Premium A/c			2,50,000
	(Allotment of debenture at premium)			
(iv)	Machinery A/c	Dr.	95,000	
	To Vender A/c			95,000
	(Machinery purchased from supplier)			
	Vender A/c	Dr.	95,000	

	Discount on Issue of Debenture Dr.		5,000	
	To 12% Debenture A/c			1,00,000
	(Debenture issue at discount to vender of machinery)			
(v)	12% Debenture Suspense A/c Dr.		30,000	
	To Debenture A/c			30,000
	(300, 12% Debentures of Rs 100 each issued as collateral security to the bank against a loan of Rs 25,000)			

b) Repayment of Debentures

S.No.	Particulars	L.F.	Debit Amount Rs	Credit Amount Rs
(i)	12% Debentures A/c Dr.		10,00,000	
	Premium on Redemption of Debenture A/c Dr.		50,000	

	<p>To Debenture Holders A/c</p> <p>(Amount due on redemption of debentures)</p>		10,50,000
	<p>Debenture Holders A/c Dr.</p> <p>To Bank A/c</p> <p>(Payment made to Debenture Holders)</p>	10,50,000	10,50,000
(ii)	<p>12% Debenture A/c Dr.</p> <p>To Debenture Holders A/c</p> <p>(Amount due on redemption of debentures)</p>	10,00,000	10,00,000
	<p>Debenture Holders A/c Dr.</p> <p>To Bank A/c</p> <p>(Payment made to Debenture Holders)</p>	10,00,000	10,00,000
(iii)	<p>12% Debenture A/c Dr.</p>	50,00,000	

	<div>To Debenture Holders A/c</div> <div>(Amount due on redemption of debentures)</div>		50,00,000
	<div>Debenture Holders A/c Dr.</div> <div>To Bank A/c</div> <div>(Payment made to Debenture Holders)</div>	50,00,000	50,00,000
(iv)	<div>12% Debenture A/c Dr.</div> <div>To Vender A/c</div> <div>(Amount due to vender)</div>	1,00,000	1,00,000
	<div>Vender A/c Dr.</div> <div>To Bank</div> <div>(Payment made to vender)</div>	1,00,000	1,00,000
(v)	<div>12% Debenture A/c Dr.</div>	30,000	

	To Debenture Suspense A/c			30,000
	(Debenture and debenture Suspense Account closed)			

Question 16:

A company issued debentures of the face value of Rs 5,00,000 at a discount of 6% on April 01, 2012. These debentures are redeemable by annual drawings of Rs,1,00,000 made on March 31 each year. The directors decided to write off discount based on the debentures outstanding each year.

Calculate the amount of discount to be written-off each year. Give journal entries also.

Answer:

Journal

Date	Particulars	L.F.	Debit Amount Rs	Credit Amount Rs
2012				
Apr 1	Bank A/c Dr.		4,70,000	

Apr 1	To Debenture Application and Allotment A/c			4,70,000
	(Debenture Application money received)			
	Debenture Application and Allotment A/c	Dr.	4,70,000	
	Discount on Issue of Debenture A/c	Dr.	30,000	
	To Debentures A/c			5,00,000
	(Debenture Application money transferred to Debenture Account)			

Assuming that the amount of discount on issue of debentures is to be written off in 5 years.

Year	Debenture outstanding	Ratio	Amount written off
2012	5,00,000	5	= 10,000
2013	4,00,000	4	= 8,000

2014	3,00,000	3	=	6,000
2015	2,00,000	2	=	4,000
2016	1,00,000	1	=	2,000
		15		30,000

Date	Particulars	L.F.	Debit Amount Rs	Credit Amount Rs
2013 Mar 31	<div>Profit and Loss A/c Dr.</div> <div>To Discount on Issue of Debentures A/c</div> <div>(Discount on issue of debentures written off)</div>		10,000	10,000
2014 Mar 31	<div>Profit and Loss A/c Dr.</div>		8,000	

		To Discount on Issue of Debentures A/c			8,000
		(Discount on issue of debentures written off)			
2015					
Mar 31	Profit and Loss A/c	Dr.	6,000		
		To Discount on Issue of Debenture A/c			6,000
		(Discount on issue of debentures written off)			
2016					
Mar 31	Profit and Loss A/c	Dr.	4,000		
		To Discount on issue of Debentures A/c			4,000
		(Discount on issue of debenture written off)			
2017					

Mar 31	Profit and Loss A/c	Dr.	2,000	
	To Discount on Issue of Debenture A/c			2,000
	(Discount on issue of debenture written off)			

Question 17:

A company issued 10% Debentures of the face value of Rs,1,20,000 at a discount of 6% on April 01, 2011. The debentures are payable by annual drawings of Rs 40,000 commencing from the end of third year.

How will you deal with discount on debentures?

Show the discount on debentures account in the company ledger for the period of duration of debentures. Assume accounts are closed on March 31 every year.

Answer:

In the books of.....

Journal

Date	Particulars	L.F.	Debit Amount Rs	Credit Amount Rs
2011				
Apr. 01	Bank A/c Dr. To Debenture Application and Allotment A/c (Debentures Application Money received)		1,12,800	1,12,800
Apr. 01	Debentures Application and Allotment A/c Dr. Discount on issue of Debenture A/c Dr. To 10% Debenture A/c (Debenture Application Money transferred to Debenture Account)		1,12,800 7,200	1,20,000
2012				
Mar. 31	Profit and Loss A/c Dr.		1,800	

		To Discount on Issue of Debentures A/c			1,800
		(Discount on issue of debenture written off)			
2013					
Mar. 31	Profit and Loss A/c	Dr.	1,800		
		To Discount on Issue of Debenture A/c			1,800
		(Discount on issue of debenture written off)			
2014					
Mar. 31	Profit and Loss A/c	Dr.	1,800		
		To Discount on Issue of Debenture A/c			1,800
		(Discount on issue of debenture written off)			
2015					

Mar. 31	Profit and Loss A/c	Dr.	1,200	
	To Discount on Issue of Debentures A/c			1,200
	(Discount on issue of debenture written off)			
2016				
Mar. 31	Profit and Loss A/c	Dr.	600	
	To Discount on Issue of Debentures A/c			600
	(Discount on issue of debenture written off)			

Discount on Issue of Debentures

Dr.

Cr.

			Amount				Amount
Date	Particulars	J.F.	Rs	Date	Particulars	J.F.	Rs

2011 Apr. 01	10% Debentures		7,200	2012 Mar. 31	Profit and Loss		1,800
					Balance c/d		5,400
			7,200				7,200
2012 Apr. 01	Balance b/d		5,400	2013 Mar. 31	Profit and Loss		1,800
					Balance c/d		3,600
			5,400				5,400
2013 Apr. 01	Balance b/d		3,600	2014 Mar. 31	Profit and Loss		1,800
					Balance c/d		1,800
			3,600				3,600

2014				2015			
Apr. 01	Balance b/d		1,800	Mar. 31	Profit and Loss		1,200
					Balance c/d		600
			1,800				1,800
2015				2016			
Apr. 01	Balance b/d		600	Mar 31	Profit and Loss		600
			600				600

i) Working Note:

Amount of Discount on Issue of Debenture

Year	Debenture Outstanding	Ratio	Amount written off every year
2011-12	1,20,000	3	= 1,800
2012-13	1,20,000	3	= 1,800

2013-14	1,20,000	3	=	1,800
2014-15	80,000	2	=	1,200
2015-16	40,000	1	=	600
		12		Rs 7,200

Question 18:

B. Ltd. issued debentures at 94% for Rs 4,00,000 on April 01, 2011 repayable by five equal drawings of Rs 80,000 each. The company prepares its final accounts on March 31 every year.

Indicate the amount of discount to be written-off every accounting year assuming that the company decides to write-off the debentures discount during the life of debentures. (Amount to be written-off: 2012 Rs 8,000; 2013 Rs 6,400; 2014 Rs 4,800; 2015 Rs 2,000; 2016 Rs 1,600).

Answer:

Amount of discount to written off every year

In 2012 = ₹8,000

In 2013 = ₹6,400

In 2014 = ₹4,800

In 2015 = ₹3,200

In 2016 = ₹1,600

Working Notes:

Year	Debentures Outstanding	Ratio	Months	New Ratio (Ratio × Months)	Amounts written off
2012					
Apr-Mar	3,20,000	5	12	60	24,000 × 60 180 = ₹8,000 $24,000 \times 60 / 180 = ₹8,000$
2013					
Apr-Mar	2,40,000	4	12	48	24,000 × 48 180 =

						₹6,400 $24,000 \times 48180 = ₹6,400$
2014						
Apr-Mar	1,60,000	3	12	36	24,000	\times 36 180 = ₹4,800 $24,000 \times 36180 = ₹4,800$
2015						
Apr-Mar	80,000	2	12	24	24,000	\times 24 180 = ₹3,200 $24,000 \times 24180 = ₹3,200$
2016						

Apr-Mar	80,000	1	12	12	24,000
					×
					12
					180
					=
					₹1,600
					24,000 × 12 ÷ 180 = ₹1,600
				180	

Note: As per NCERT, ₹2,000 discount has been written off in the year 2015 which is incorrect because then the total discount amounts to ₹22,800. Therefore, it should be ₹3,200.

Question 19:

B. Ltd. issued 1,000, 12% debentures of Rs 100 each on April 01, 2014 at a discount of 5% redeemable at a premium of 10%.

Give journal entries relating to the issue of debentures and debentures interest for the period ending March 31, 2015 assuming that interest is paid half yearly on September 30 and March 31 and tax deducted at source is 10%.

Answer:

Date	Particulars	L.F.	Debit Amount Rs	Credit Amount Rs

2014				
Apr. 01	Bank A/c	Dr.	95,000	
	Loss on Issue on Debentures A/c	Dr.	15,000	
	To 12% Debenture A/c			1,00,000
	To Premium on Redemption of Debentures A/c			10,000
	(Debenture issued at discount and redeemable at Premium)			
Sept. 30	Debenture Interest A/c	Dr.	6,000	
	To Income Tax Payable A/c			600
	To Debenture Holders A/c			5,400
	(Amount of interest on 12% debentures Rs 1,00,000 due for 6 months and 10% tax deducted at source)			
Sept. 30	Debenture Holders A/c	Dr.	5,400	

		To Bank A/c			5,400
		(Interest paid to Debenture Holders)			
2015					
Mar. 31	Debenture Interest A/c	Dr.	6,000		
		To Income Tax Payable A/c			600
		To Debenture Holders A/c			5,400
		(Amount of interest on 12% Debentures Rs 1,00,000 due for 6 months and 10% tax deducted at source)			
Mar. 31	Debenture Holders A/c	Dr.			5,400
		To Bank A/c			5,400
		(Interest paid to Debenture Holders)			
Mar. 31	Profit and Loss A/c	Dr.	12,000		
		To Debenture Interest A/c			12,000

	(Interest on debentures transferred to Profit and Loss Account)			
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Question 20:

What journal entries will be made in the following cases when company redeems debentures at the expiry of period by serving the notice: (a) when debentures were issued at par with a condition to redeem them at premium; (b) when debentures were issued at premium with a condition to redeem that at par; and (c) when debentures were issued at discount with a condition to redeem them at premium?

Answer:

S.No.	Particulars	L.F.	Debit Amount Rs	Credit Amount Rs
(a)	<div> <div>Debenture A/c</div> <div>Dr.</div> </div> <div> <div>Premium on Redemption of Debenture A/c</div> <div>Dr.</div> </div> <div> <div>To Debenture Holders A/c</div> <div>(Amount due for redemption of Debentures)</div> </div>			

	<div> <div>Debenture Holders A/c</div> <div>Dr.</div> </div> <div> <div>To Bank A/c</div> <div>(Payment made to Debenture Holders)</div> </div>		
(b)	<div> <div>Debenture A/c</div> <div>Dr.</div> </div> <div> <div>To Debenture Holders A/c</div> <div>(Amount due for redemption of debentures that were issued at premium with term of redeemable at par)</div> </div>		
	<div> <div>Debenture Holders A/c</div> <div>Dr.</div> </div> <div> <div>To Bank A/c</div> <div>(Payment made to Debenture Holders)</div> </div>		
(c)	<div> <div>Debenture A/c</div> <div>Dr.</div> </div> <div> <div>Premium on Redemption of Debenture A/c</div> <div>Dr.</div> </div> <div> <div>To Debentures Holders A/c</div> </div>		

	(Amount due for redemption on debentures that were issued at discount with the term of redeemable at premium)			
	Debenture Holders A/c To Bank A/c (Payment made to Debenture Holders)			

Dr.