ACCOUNTANCY

Chapter 2: Issue Of Debentures

ISSUE OF DEBENTURES

Introduction to Debentures

- **Meaning and Characteristics of Debentures:**

  Meaning of Debentures as per Section 2(30) of the Companies Act, 2013: Debenture includes debenture stock, bonds and any other instrument of the company evidencing a debt, whether constituting a charge on the assets of the company or not.

- **Understanding Debentures and Debenture holders:**

i. **Debentures:**

- It is a document known as Debenture Certificate.
- It is an acknowledgement of debt by the company.
- It is an agreement between the company and its debenture holders for repayment of the principal amount on a specified date along with interest at a pre-determined rate charged on the principal amount until the principal is repaid.
- It is an evidence of a debt to the holder usually arising out of a loan and mostly secured by a charge.

ii. **Debenture holders:**

- They are the persons to whom debentures are issued by a company.
- These persons are lenders to the company as they provide funds in exchange of debentures issued to them.

- **Characteristics or Features of a Debenture:**

i. A document known as Debenture Certificate.
ii. An acknowledgement of debt by the company.
iii. Involves an agreement between the company and its debenture holders to fix the mode and period of repayment of principal and interest.
iv. It is a common practice to prefix 'Debentures' with the rate of interest like if the rate of interest is 10%, the title of the debentures will be '10% Debentures'.
v. It is treated as an external equity or long term borrowings by the company.

vi. It is usually secured by way of charge on the assets of the company.

vii. The interest charged on debentures is a charge against profit.

- **Meaning of a Bond:** Bond is similar to debenture, both in terms of contents and texture. It is an acknowledgment of debt issued by the company and signed by an authorized signatory. Traditionally, bonds were issued by the Government. But these days, bonds are also being issued by semi-government and non-government organisations as an acknowledgement of debt.

- **Difference between Share and Debenture:**

Areas Compared	Shares	Debentures
Nature	Shares Are Ownership Capital, Issued By A Company To The Public	Debentures Are A Debt Instrument, Issued To Raise Loans From The Market
Holder	The Owner Of The Share Is Called Shareholder	The Owner Is Called Debenture Holder
Return Policy	Receive Dividend Announced By The Company	Based On Fixed Or Floating Interest Rates, A Return Is Paid On Maturity
Rating	No Rating Is Given. Investors Guess Share Performance Based On Historical And Current Data Received From Different Financial Charts	Rated By ICRA On A Scale Of A To D. Companies With AAA Rating Are Considered The Safest
Status	Shareholders Enjoy Ownership Status In The Company	Treated As Lenders
Security	Not Secured. Depends On Market Fluctuation And Performance	Unsecured Loans, But Repayment Is Assured. Get Attached To The Company's Assets If The Company Declares Bankruptcy
Conversions	Can't Convert Equities Into Debentures	Can Be Converted Easily To Equities
Risk	High Risk	Secured Investment
Voting Rights	Shareholders Have Voting Rights In The Company	Debenture Holders Don't Have Any Rights To Vote

- **Difference between Shareholder and Debentureholder: Following are the points of difference between Shareholders and Debentureholders.**

Debentureholder	Shareholder
Debentureholder is the lender of the company	A shareholder is the owner of the company.
A debentureholder gets interest on his investment at the specified rate whether the company earns a profit or not.	A shareholder gets a dividend.
A debentureholder has no right to control the activities of the company by voting or otherwise	A shareholder has a right of control over the working of the company by attending and voting in the General Meeting.
Debentureholders are relatively safe. Secured debentureholders are almost free from risk.	Shareholders are at a greater risk. They can even lose the amount invested in shares.

Types of Debentures

Types and disclosure of Debentures in Balance Sheet:

- **Following are the different kinds of debentures classified based on:**

i. **Security point of view:**

- **Secured:** Such debentures are secured by either a fixed charge or a floating charge on the assets of the company. Such charge is to be registered with the Registrar of the Companies.
- **Unsecured:** Such debentures are not secured by any charge on assets of the company.

ii. **Redemption/Permanence point of view:**

- **Redeemable:** Such debentures are repayable by the company at the end of a specified period or by instalments during the existence of the company.
- **Irredeemable:** Such debentures are not repayable during the lifetime of the company and are repayable only when the company is liquidated.

iii. **Records/Negotiability point of view:**

- **Registered:** Such debentures are registered in the company's records in the holder's name. All amounts towards principal and interest are to be paid to the registered debentureholder only. Any transfer of such debentures requires execution of transfer deed.
- **Bearer:** Such debentures are not registered in the records of the company in the name of the holder. They are easily transferable by mere delivery. Interest is paid to the person who produces coupons attached to the debenture.

iv. **Priority point of view:**

- **First Debentures:** Such debentures are to be repaid before the other debentures.
- **Second Debentures:** Such debentures are to be repaid after the first debentures are redeemed.

v. **Coupon rate point of view:**

- **Specific Coupon Rate:** Such debentures are issued with a specified rate of interest, called the coupon rate. This rate may be either fixed or floating. If it's a floating rate, it is usually linked with the bank rate.
- **Zero Coupon Rate (Bonds):** Such debentures do not carry a specific rate of interest. They are issued at a substantial discount. Such difference between the face value and issue price is the total amount of interest related to the duration of debentures.

vi. **Convertibility point of view:**

- **Convertible:** Such debentures are convertible into shares. Where only a part of the debentures amount is convertible into Equity Shares, they are known as Partly Convertible Debentures. However, when full amount of debentures is convertible into Equity Shares, they are known as Fully Convertible Debentures.
- **Non-Convertible:** Such debentures are not convertible into shares.

- **Disclosure of Debentures in the Balance Sheet:** Since these are the borrowings of a company, they are considered as liability and therefore, shown in the Equity and Liabilities part of the Balance Sheet. They can be disclosed either as Non-Current or Current Liability depending upon the tenure of such debentures. An important point to remember is that unless the question requires otherwise, debentures are shown as Long-term Borrowings under Non-current Liabilities.

i. **Non-Current Liability:** This is done when Debentures are due for redemption after 12 months from the reporting date i.e., the date of Balance Sheet or after the period of Operating Cycle. The date of issue of debentures determines whether these debentures are

Long-term borrowings or Short-term Borrowings.

ii. **Current Liability:**

- **Short-term Borrowings:** This is done when Debentures are due for redemption within 12 months from the reporting date i.e., the date of Balance Sheet or within the period of Operating Cycle.

- **Current Maturities of Long term debt:** This is a part of Debentures shown as Long- term borrowings that become due for redemption within 12 months of the Balance Sheet or within the period of Operating Cycle.

Issue of Debentures

Understanding Minimum Subscription, Issue of Debentures and Accounting Treatment:

- **Concept of Minimum Subscription with respect to Debentures under section 39(1) of the Companies Act, 2013:**

According to section 39(1) of the Companies Act, 2013, a company cannot allot securities unless minimum subscription stated in the prospectus is received. Such minimum subscription is therefore, to be decided by the company. As per SEBI, 75% of the issue should be subscribed before a company allots debentures.

- **Issue of Debentures:** As per the Companies Act, 2013, a company may issue debentures:

i. **For Cash:** It means that the company has received an amount (in cash or cheque) against the debentures issued. When debentures are issued at cash, they may be issued at par, premium or at discount.

ii. **For Consideration other than Cash:** It means that the company has not received amount (in cash or cheque) against the debentures issued. Such issue of debentures can be issue to promoters for their services, to vendors against assets purchased, etc.

iii. **For as Collateral Security:** Security given for loans in addition to the prime or principal security is known as collateral security. Debentures may be issued as collateral security when the borrower is not in a position to give any other asset as a collateral security.

- **Issue of Debentures for Cash: Such issue can be at par, at premium or at discount as follows:**

i. **At par:** Debentures are issued at their nominal (face) value.

ii. **At premium:** Debentures are issued at a price that is higher than its nominal (face) value. Such premium on issue is a capital receipt and is credited to Securities Premium Reserve

Account. Utilisation of balance in such Securities Premium Account is governed by Section 52(2) of the Companies Act, 2013.

iii. **At discount:** Here, debentures are issued at a price that is less than its nominal (face) value. Such amount of discount is debited to an account titled Discount on Issue of Debentures Account. Balance in such account is written off at the earliest but within the tenure of debentures. Since it is a capital loss it is written off from Capital Reserve, if it has a balance. If it has no balance, it is written off from Securities Premium Reserve and/or from Statement of Profit and Loss.

- **Disclosure of Unamortised Discount (loss) on issue of Debentures:**

Since the balance in such account is written off over the life of debentures but within the tenure of debentures, it will have a debit balance. It will be disclosed in the books as follows:

i. **Under Current Assets:** That part of unamortised discount or loss on issue of debentures which is to be written off within a period of 12months from the date of Balance Sheet or within the period of Operating Cycle is shown in the Balance Sheet under the head 'Current Assets' and sub-head 'Other Current Assets'.

ii. **Under Non-Current Assets:** That part of unamortised discount or loss on issue of debentures which is to be written off after a period of 12months from the date of Balance Sheet or after the period of Operating Cycle is shown in the Balance Sheet under the head 'Non-Current Assets' and sub-head 'Other Non-Current Assets'.

- **Accounting Entries:** Entries can be explained as follows:
- If amount of debentures is received in Lump Sum:

i. **For receipt of Application Money:**

Bank A/c ...Dr. (With application money received)

To Debentures Application and Allotment A/c

ii. **For allotment of Debentures:**

Debentures Application and Allotment A/c ... Dr. (With the amount of application money on the allotted debentures)

To %Debentures A/c

iii. **For Refund of Excess Application Money:**

Debentures Application and Allotment A/c ... Dr. (With the application money refunded)

To Bank A/c

- If amount of debentures is received in instalments:

i. **For receipt of Application Money:**

Bank A/c ... Dr. (With application money received)

To Debentures Application A/c

ii. **For allotment of Debentures:**

Debentures Application A/c ... Dr. (With the amount of application money on the allotted debentures)

To % Debentures A/c

iii. **For adjustment of Excess Debentures Application Money:**

Debentures Application A/c ... Dr. (With surplus application money on partially accepted applications)

To Debentures Allotment A/c

iv. **For Refund of Excess Debentures Application Money:**

Debentures Application A/c ... Dr. (With the application money refunded on rejected applications)

To Bank A/c

v. **For Allotment Money Being Called:**

Debentures Allotment A/c ... Dr. (With the amount due on Allotment)

To% Debentures A/c

vi. **For receipt of Allotment Money:**

Bank A/c ... Dr. (With the amount actually received on allotment)

To Debentures Allotment A/c

vii. **For calls money being called:**

Debentures Call A/c ... Dr. (With the money due on call)

To% Debentures A/c

viii. **For receipt of call money:**

Bank A/c ... Dr. (With amount received on call)

To% Debentures Call A/c

- **Section 52(2) of the Companies Act, 2013 on use of the amount received as premium on securities:** As per section 52(2) of the Companies Act, 2013, use of the amounts received as premium on securities is restricted to the following purposes only:

i. Issuing fully paid bonus shares to the members.

ii. Writing off preliminary expenses of the company.

iii. Writing off the expenses of, or the commission paid or discount allowed on any issue of securities or debentures of the company.

iv. Providing for the premium payable on the redemption of any redeemable Preference Shares or any debentures of the company.

v. In purchasing its own shares i.e., in case of buy back of shares.

- **Disclosure of Securities Premium Reserve:** It is shown in Equity and Liabilities Part of Balance Sheet under head 'Shareholders' Funds' and sub-head 'Reserves and Surplus'.

- **Collateral Security:** Loans taken are secured by mortgage of the assets which are known as prime or principal security. Security given in addition to the prime or principal security is termed as Collateral Security. Such security is realised by the lender only if the due amount cannot be recovered by realising the principal security.

- **Disclosure of Debentures issued at Collateral Security in the Balance Sheet: Since** it is for the loan of the company, such debentures issued as Collateral Security are shown in the Notes to Account in which the loan secured by debentures is shown.

- **Accounting of Debentures issued as collateral security:** When the debentures are issued as collateral security, they can be dealt in following 2 ways:

i. **First Method:** As per this method, entry for issue of such debentures is not passed in the books of account at the time of issuing such debentures. It is disclosed under the head Secured Loans in the Equity and Liabilities part of the Balance Sheet.

ii. **Second Method:** As per this method, entry for issue of such debentures is passed in the books of account as follows:

Debentures Suspense A/c ... Dr.

To % Debentures A/c

At the time when the loan is paid to the lender, this entry will be reversed to cancel or nullify the effect of entry already passed. In balance sheet, such debentures are disclosed separately from the other debentures.

- **If the borrower fails to repay the loan:** In case if the borrower fails to pay the loan along with interest, the lender can recover the amount due by selling primary security or by redeeming collateral security, i.e., debentures.

Accounting treatment for the same is as follows:

i. At the time of issuing the debentures as collateral security, no immediate liability is created and therefore, no journal entry is passed.

ii. Liability arises when the lender exercises his right vested in the collateral security.

Following journal entries are to be passed as and when the lender exercises this option:

a. % Debentures A/c ... Dr.

To Debentures Suspense A/c

b. Loan A/c ...Dr. (Principal)

Outstanding Interest A/c …Dr. (Interest outstanding for the period intervening the date of default on the loan to date of invoking security by the lender)

To % Debentures A/c (Principal + Interest outstanding)

- **Oversubscription of Debentures:**

i. It is a situation where applications received for debentures is more than the number of debentures issued.

ii. In such situation the company may make allotment by any of the 3 options available:

a. Rejecting excess applications.

b. Partial or Pro-rata allotment.

c. A combination of the above 2 alternatives.

iii. Such excess application money received on account of oversubscription may be retained for adjustment towards allotment and the respective calls, in case of pro-rata allotment, if so provided in the terms of issue. However, in case of applicants to whom no debentures are allotted, such excess application money is refunded to the respective applicants.

- **Undersubscritption of Debentures:**

i. It is a situation where the applications received are for lesser number of debentures than the number of debentures offered for subscription.

ii. In this situation, allotment is made to all the applicants.

iii. In such situation where the allotment is made to all the applicants, Journal entries are passed for the number of debentures subscribed.

- **Issue of Debentures for consideration other than Cash: Such** issue is possible under the following circumstances where debentures are issued to:

i. **Promoters for rendering their services:** Such issue is made for services rendered by promoters for incorporating the company. Entry to be passed is as follows:

Incorporating Expenses A/c ... Dr.

To % Debentures A/c

iii. **Vendors against purchase of assets or business:** Entry to be passed is as follows:

a. If debentures are issued for purchase of assets:

Sundry Assets A/c ... Dr. (With agreed value of assets taken over)

To Vendor's A/c

b. **If debentures are issued for purchase of business:** When a business is purchased, both assets and liabilities are taken over for a consideration which can be equal to, more than or less than the difference between values of assets and liabilities.

Entry to be passed in each of these cases is as follows:

I. If consideration is equal to the difference between the value of assets and liabilities:

Sundry Assets A/c (individually) ... Dr. (agreed value)

To Sundry Liabilities (individually) (agreed value)

To Vendor's A/c (purchase consideration)

II. If consideration is more than the difference between the value of assets and liabilities, such excess is debited to Goodwill Account:

Sundry Assets A/c (individually) ... Dr. (agreed value)

Goodwill A/c ...Dr. (excess consideration over net assets)

To Sundry Liabilities (individually) (agreed value)

To Vendor's A/c (purchase consideration)

III. If consideration is less than the difference between the value of assets and liabilities, such shortfall is credited to Capital Reserve Account:

Sundry Assets A/c (individually) ... Dr. (agreed value)

To Sundry Liabilities (individually) (agreed value)

To Vendor's A/c (purchase consideration)

To Capital Reserve A/c (excess of net assets over consideration)

- **Accounting Entries for issue of Debentures to Vendors when debentures are:**

i. **Issued at par:**

Vendor's A/c ... Dr. (nominal value of debentures)

To % Debentures A/c

ii. **Issued at premium:**

Vendor's A/c ... Dr. (purchase consideration)

To% Debentures A/c (nominal value of debentures)

To Securities Premium A/c (premium amount)

iii. **Issued at discount:**

Vendor's A/c ... Dr. (purchase consideration)

Discount on Issue of Debentures A/c ... Dr. (discount amount)

To% Debentures A/c (nominal value of debentures

- **Calculation of Number of Debentures:** When a business is purchased and consideration is paid in the form of issue of debentures, number of debentures is to be calculated as follows:

$$\text{Number of Debentures Issued} = \frac{\text{Purchase Consideration}}{\text{Issue Price of Debenture}}$$

Various cases of Issue of Debentures from the redemption point of view:

Debentures issued at par, at premium or at discount may be redeemed either at par or at premium:

- **Debentures redeemable at par:** It means debentures are redeemable at their nominal (face) value.
- **Debentures redeemable at premium:** It means debentures are redeemable at a value that is higher than their nominal (face) value.

Depending on the terms of issue and redemption of debentures, there may be six cases of redemption as follows:

Base	Conditions of Issue	Conditions of Redemption
1	Issued at par	Redeemable at par
2	Issued at discount	Redeemable at par
3	Issued at premium	Redeemable at par
4	Issued at par	Redeemable at premium
5	Issued at discount	Redeemable at premium
6	Issued at premium	Redeemable at premium

- **Differences between Premium on Issue of Debentures and Premium on Redemption of Debentures:**

Following are the differences between Premium on Issue of Debentures and Premium on Redemption of Debentures:

Basis	Premium on Issue of Debentures	Premium on Redemption of Debentures
Capital Profit/Loss	It is a capital profit and is used for the purposes specified in Section 52(2) of the companies Act, 2013	It is a capital loss
Nature	It is a reserve	It is a liability
Outflow of Cash	It does not involve outflow of cash	It is paid when the debentures are redeemed
How shown in Balance Sheet	The Balance is shown in the Equity and Liabilities part of the Balance Sheet under main head Shareholders funds and sub-head reserves and surplus	It is shown in the Equity and Liabilities part of the Balance Sheet under the main head 'Non-Current Liabilities, and sub-head 'Other Long-term Liabilities'.

- **Journal Entries for each of the six cases of redemption:**

Case I: When debentures are issued at par and are redeemable at par:

In this case, since the amount payable at the time of redemption is equal to the nominal value of debentures, company will not incur any loss at the time of redemption of debentures.

Following entries are passed:

a. Bank A/c ... Dr.

To Debentures Application A/c (application money)

b. Debentures Application A/c ... Dr. (application money)

To% Debentures A/c (nominal value)

Case II: When debentures are issued at discount but are redeemable at par:

In this case, since the amount payable at the time of redemption is equal to the nominal value of debentures, company will not incur any loss at the time of redemption of debentures.

Following entries are passed:

a. Bank A/c ... Dr.

To Debentures Application A/c (application money)

b. Debentures Application A/c ... Dr. (application money)

Discount on Issue of Debentures A/c ... Dr. (discount amount)

To% Debentures A/c (nominal value)

Case III: When debentures are issued at premium and are redeemable at par:

In this case, since the amount payable at the time of redemption is equal to the nominal value of debentures, so company will not incur any loss at the time of redemption of debentures.

Following entries are passed:

a. Bank A/c ... Dr.

To Debentures Application A/c (application money)

b. Debentures Application A/c ... Dr. (application money)

To % Debentures A/c (nominal value)

To Securities Premium Reserve A/c (premium amount)

Case IV: When debentures are issued at par and are redeemable at premium:

In this case, since the amount payable at the time of redemption is more than the nominal value of debentures, company will incur loss at the time of redemption of debentures. Difference between the redeemable value and the issue price is the loss which is to be debited to Loss on Issue of Debentures Account at the time of allotment of debentures. This is done as per the concept of prudence.

Following entries are passed:

a. Bank A/c ... Dr.

To Debentures Application A/c (application money)

b. Debentures Application A/c ... Dr. (application money)

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

To% Debentures A/c (nominal value)

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

Case V: When debentures are issued at discount and are redeemable at premium:

In this case, company will incur loss on two counts, i.e., discount allowed at the time of issue of debentures and premium payable at the time of its redemption. These losses are to be accounted at the time of issue of debentures as per the principle of prudence.

Following entries are passed:

a. Bank A/c ... Dr.

To Debentures Application A/c (application money)

b. Debentures Application A/c ... Dr. (application money)

Discount on Issue of Debentures ...Dr. (discount amount)

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

To% Debentures A/c (nominal value)

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

Instead of using 2 separate accounts for as 'Discount on Issue of Debentures' and 'Premium Payable on Redemption', one combined account can be used titled as 'Loss on Issue of Debentures Account'. Entry will be as follows:

Debentures Application A/c ... Dr. (application money)

Loss on Issue of Debentures A/c ... Dr. (discount+ premium)

To% Debentures A/c (nominal value)

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

Case VI: When debentures are issued at premium and are redeemable at premium:

In this case, premium received by the company at the time of issue of debentures is a capital receipt and is credited to Securities Premium Reserve Account. On the other hand, premium payable at the time of redemption of debentures is a loss for the company and is provided in the books of account following the principle of prudence.

Following entries are passed:

a. Bank A/c ... Dr.

To Debentures Application A/c (application money)

b. Debentures Application A/c ... Dr. (application money)

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

To% Debentures A/c (nominal value)

To Securities Premium Reserve A/c (premium received on issue)

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

- **Interest on Debentures:**

i. It is a charge against profit of the company and is payable whether the company earns profit or incurs loss.

ii. It is calculated at a fixed rate of interest on the nominal (face) value.

iii. It is not payable on debentures issued as collateral security.

iv. It is prefixed on debentures i.e., if the rate is 15% p.a. then debentures will be titled '15% Debentures.'

v. Balance in the Debentures' Interest Account is transferred to Statement of Profit and Loss (Finance Cost) at the end of the year.

vi. Interest payment may be subject to TDS.

- **Journal entries for interest on Debentures are as follows:**

i. When Interest on Debentures is due and Tax is ignored:

Interest on Debentures A/c ... Dr.

To Debentureholders' A/c

ii. When Interest on Debentures is due and Tax is Deducted at Source:

Interest on Debentures A/c ... Dr.

To Debentureholders' A/c To TDS Payable A/c

iii. When Interest on Debentures is paid:

Debentureholders' A/c ... Dr.

To Bank A/c

iv. When TDS is deposited in Government Account:

TDS Payable A/c ... Dr.

To Bank A/c

v. When Interest on Debentures is transferred to Statement of Profit and Loss at the end of the year:

Statement of Profit and Loss (Finance Cost) ... Dr.

To Debentures' Interest A/c

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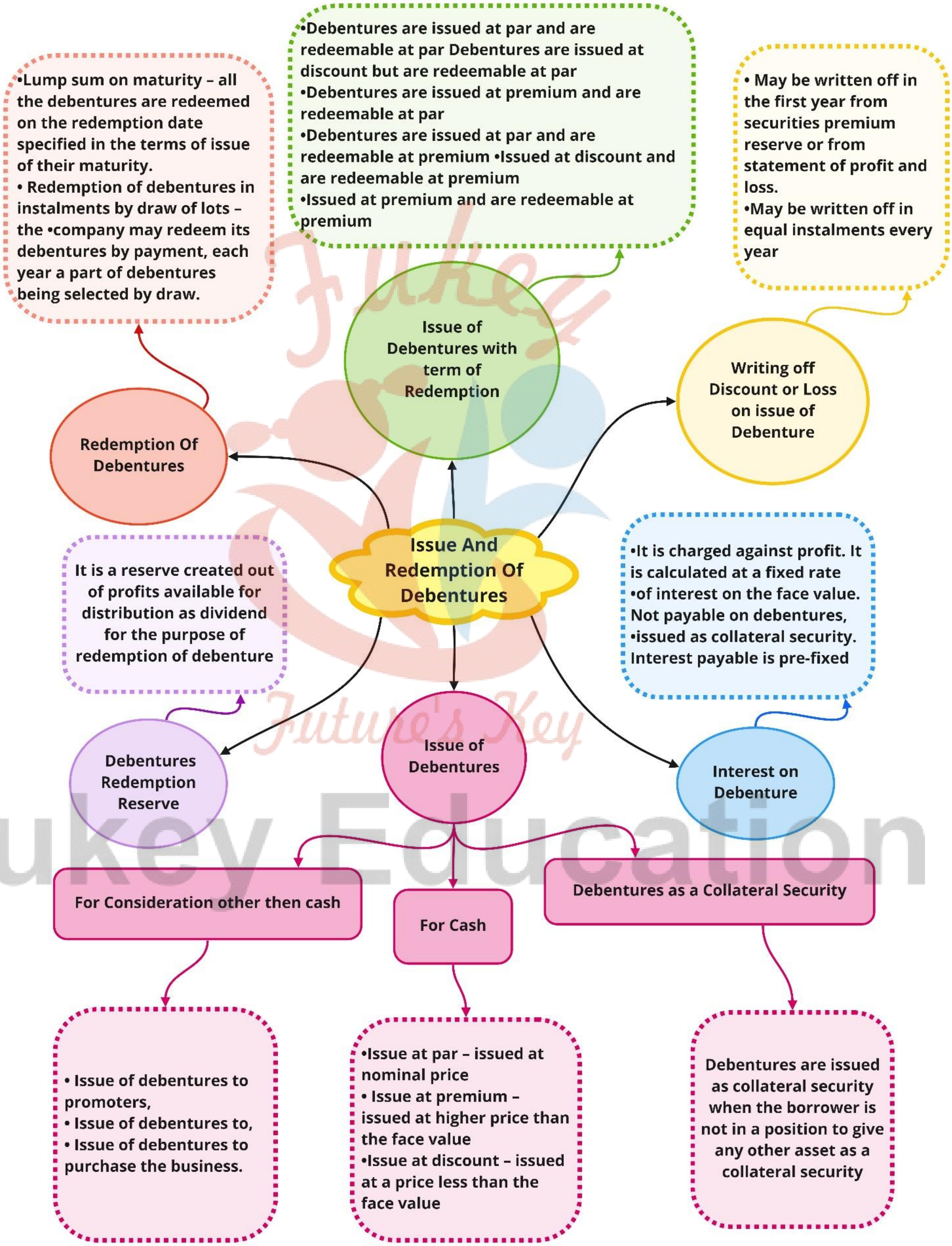

Important Questions

Multiple Choice questions-

Question 1. Premium on issue of debenture is ________.

(a) capital profit

(b) capitalised loss

(c) normal profit

(d) normal loss.

Question 2. Debenture holders are the _______ of company.

(a) Owner

(b) Creditors

(c) Money lender

(d) All of these.

Question 3. Public Limited company can issue:

(a) Equity Share

(b) Preference Share

(c) Debenture

(d) All of these.

Question 4. _____ is written acknowledgment of debt.

(a) Equity share

(b) Preference share

(c) Debenture

(d) All of these.

Question 5. _____ debentures have to be redeemed within a fixed period of time.

(a) Convertible

(b) Redeemable

(c) Participating

(d) Naked.

Question 6. Debentures may be issued at _______.

(a) par

(b) premium

(c) Discount

(d) All of these.

Question 7. When the number of debenture applied for is less than the number of debenture offered, is called ________ subscription.

(a) over

(b) under

(c) minimum

(d) None of these.

Question 8. The provisions of Companies Act 2013 with respect to redemption to debentures are to protect the interest of

(a) debenture holders

(b) creditors

(c) shareholders

(d) Banks

Question 9. Discount on issue of debenture is ________.

(a) capitalised profit

(b) capitalised loss

(c) normal profit

(d) normal loss.

Question 10. Discount on issue of debentures is ________ asset.

(a) Current profit

(b) fixed

(c) fictitious

(d) intangible.

Very Short Questions-

1. What is meant by 'Issue of Debentures as Collateral Security'?

2. State the provision of the Companies Act, 2013 for the creation of Debenture Redemption Reserve.

3. Profit arisen on account of buying an existing business at profit is transferred to which

account?

4. Name the debentures which continue till the continuity of the company.
5. Name the debenture which may be converted into equity shares at specified time.
6. Name the debentures which have charge on the company's assets.
7. When a debenture is issued at a price less than its face value or nominal value, what does such difference represent?
8. When debentures are redeemed more than the face value of debenture, What does the difference between face value of debenture and redeemed value of debenture is called?
9. Under which head is the 'Debenture Redemption Reserve' shown in the Balance Sheet?
10. When the company issues debentures to the lenders as an additional/secondary security, in addition to other assets already pledged/ some primary security. What does such issue of debentures is called?

Short Questions-

1. What is meant by a Debenture?
2. What does a Bearer Debenture mean?
3. State the meaning of 'Debentures issued as a Collateral Security'.
4. What is meant by 'Issue of debentures for Consideration other than Cash'?
5. What is meant by 'Issue of debenture at discount and redeemable at premium?
6. What is 'Capital Reserve'?
7. What is meant by an 'Irredeemable Debenture'?
8. What is discount on issue of debentures?
9. On 1st April 2015, P Ltd. Issued 6,000 12% Debentures of ₹ 100 each at par redeemable at a premium of 7%. The Debentures were to be redeemed at the end of third year. Prepare Loss on issue of 12% Debentures Account.

Long Questions-

1. Explain the different types of debentures?

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

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?

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

5. Explain the guidelines of SEBI for creating Debenture Redemption Reserve.

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

MCQ Answers-

1. Answer: (a) capital profit
2. Answer: (b) Creditors
3. Answer: (d) All of these.
4. Answer: (c) Debenture
5. Answer: (b) Redeemable
6. Answer: (d) All of these.
7. Answer: (b) under
8. Answer: (a) debenture holders
9. Answer: (b) capitalised loss
10. Answer: (c) fictitious

Very Short Answers-

1. Answer: Debenture issued as secondary security/additional security over and above the primary security is known as Issue of Debentures as Collateral Security.

2. Answer: Where a company has issued Debentures, it shall create a DRR equivalent to at least 25% of the nominal value of debentures outstanding for the redemption of such debentures.

3. Answer: Capital Reserve.

4. Answer: Irredeemable.

5. Answer: Convertible debentures.

6. Answer: Secured debentures (also known as mortgaged debentures).

7. Answer: Discount.

8. Answer: Premium on redemption of debentures.

9. Answer: 'Reserve & Surplus'.

10. Answer: Issue of dedentures as collateral security.

Short Answers-

1. Debenture is derived from the Latin word "debere" which translates to borrow. Debentures are not backed by any collaterals. These are issued by governments and corporations to raise funds or capital for long term borrowing.

2. When records are not maintained for debenture and holders and the debenture can be transferred by delivery, such debentures are known as Bearer Debenture. These debentures are issued physically on paper and are payable to bearer of the debenture. These are also called as unregistered debentures.

3. Collateral security refers to an additional layer of security over and above the primary security. It is seen in case of company taking a loan from a financial institution, in such cases, company issues debentures which are additional security or collateral security. The money lender will not be receiving any interest on these debentures. In case the company defaults in making payment and the primary security is not sufficient to cover the debt, then debentures can be used for recovering the amount.

4. A company purchases any asset from its vendors or suppliers and issues debentures to them instead of paying in cash. This process is known as issue of debenture for consideration other than cash. It helps both the seller and purchaser as the seller gets interest on debentures issued and the purchaser do not need to arrange cash immediately. Debentures are issued at par, premium or at a discounted rate to the seller.

5. It may happen that due to challenging market conditions a company has to raise funds from market by issuing debenture below its par value and to attract investor interest has to offer redeemable value higher than its par value, this is termed as issue of debenture at discount and redeemable at premium. The difference that is generated due to such arrangement is treated as loss on issue of debenture.

6. The reserve that is created from the capital profits is called as Capital Reserve, these are profits that is obtained from activities that are different than the normal business activities. Examples of such activities are: profit obtained from reissuing of debentures, premium on issue of share and debenture, profit redemption on debenture, profits obtained from sale of fixed asset etc. These can be used to issue bonus shares but cannot be used for paying dividend. The capital reserve is used to meet future capital losses.

7. Debentures that are not redeemable by a company during its life time are called irredeemable debentures. These debentures are only payable at the time of winding up of the company. Also called as perpetual debentures because of indefinite life span. These type of debentures are not issued in India.

8. Debentures which are issued at a value less than its face value (nominal value) is said to be issued at discount. There is no restriction on companies for issuing debentures on discount.

9.

Loss on issue of Debenture = 6,000 × 7 = ₹ 42,000

Loss to be w/o per year = $\frac{42,000}{3}$ ₹ 14,000

Dr. **Loss on Issue of Debentures Account** Cr.

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
2015 April 1	To 12% Debenture	42,000	2016 March 31	By Statement of Profit & Loss	42,000
		42,000			**42,000**

Long Answers-

1. Debenture refers to a long term instrument that companies use to borrow money from the market. It is the acknowledgement of a debt that is taken by a company. There are many types of debentures based on the nature which are:

1. **Based on tenure:**

i. Redeemable Debenture: Debentures that have a specific date of redemption that is mentioned on the certificate and the company is bound to pay the person/persons holding the debenture, the principal amount on that date.

ii. Perpetual/Irredeemable Debenture: Debentures that do not mention a specific date for redemption. The only way these can be redeemed is when the company is liquidated.

2. **Based on Convertibility:**

i. Convertible Debenture: Those type of debentures that have the flexibility to convert into equity shares. The terms and conditions governing the conversion are clearly mentioned at the time of issue of debenture.

ii. Non-Convertible Debenture: These are debentures that do not have any special features and are not converted into equity shares.

3. **Based on Security:**

i. Mortgage Debenture: A type of debenture that is backed by some asset or assets and such asset can be used to recover funds in case.

ii. Naked Debenture: Debenture that is issued basing solely on the basis of credibility of the issuer.

4. **Based on Priority:**

i. First Debenture: Also known as preferred debenture. These debentures are the first to be paid in case of winding up of a company.

ii. Second Debenture: These are ordinary debenture and are paid after the first debenture.

5. **Based on registration:**

i. Registered Debenture: Debentures that are registered with the age, name, address etc. are added and to the debenture.

ii. Bearer Debenture: These debenture are transferred by delivery to the new holder.

2.

Basis of Comparison	**Shares**	**Debenture**
Meaning	Shares are funds that are owned by company	Debentures are funds that are borrowed from outside i.e. it is debt for company
Dividend	Shareholders earn dividend from the profit of the company	Debenture holders earn interest for the amount taken as debt
Deduction	Being appropriation of profit not liable to be deducted	Being a expense for business, deducted from profit
Conversion	Shares cannot be converted into debentures	Some debentures can be converted into shares after a period of time
Voting Right	Shareholders have voting right	No voting right

Risk	Shareholders have the highest risk	Debenture holders have the lowest risk
Compulsion to return	It is not mandatory to declare dividend	It is mandatory to pay interest to creditors.
Status of Holders	Shareholders are owners	Debenture holders are creditors
Position in Financial Statement	Shown under Shareholder Funds on equity and liabilities side of Balance Sheet	Shown as non-current liabilities in equity and liabilities side of Balance Sheet.
Status at Liquidation	Payment made after clearing all liabilities	Payment made before shareholders.

Debentures are also called as long term debts. A company issues debentures for getting funding for achieving growth in the long term. Interest needs to be paid on those loans. This interest is an expense for the business and is deducted as per applicable tax laws. Hence, debentures are known as loan capital.

3. Collateral security refers to an additional layer of security over and above the primary security. It is seen in case of company taking a loan from a financial institution, in such cases, company issues debentures which are additional security or collateral security. The money lender will not be receiving any interest on these debentures. In case the company defaults in making payment and the primary security is not sufficient to cover the debt, then debentures can be used for recovering the amount.

Treatment of Debentures: Debentures when issued for the first time by a company are not active and to make it active an accounting entry is required to be passed.

Balance Sheet

Liabilities	Amt. (₹)	Assets	Amt. (₹)
Loan (Secured by the issued of Debentures of ₹ .... As Collateral Security) **Debentures** (In addition to these debentures, debentures of ₹ .... has been issued as Collateral Security)			

For creating accounting record Debenture Suspense A/C is debited and debenture account is credited. Debentures are represented in liabilities side and Debenture suspense A/c is shown on credit side. When the debt is paid off by the business debenture account is debited and debenture suspense account gets credited.

4. **Redemption of Debentures Out of Capital:**

It refers to the condition when the debentures are redeemed from the capital without utilising the profits for redemption. Such a condition results in no profit being transferred to the Debenture Redemption Reserve, a reserve that needs to be created as debentures cannot be redeemed entirely from the capital. SEBI has issued guidelines for the redemption of debenture by creating Debenture Redemption reserve. However, there are some industries that are exempted from creating a reserve and they are:

i. Companies that issue debentures with maturity of 18 months.

ii. Companies involved in infrastructure sector like maintenance, construction, business development activities.

Redemption of Debenture Out of Profits:

Debentures when redeemed out of profit does not utilize capital for redemption. It is mandatory to create a DRR before redeeming debenture. This rule has been created by SEBI (Securities and Exchange Board of India) and as per that a company should transfer an amount equal to 50% of debentures issued, to DRR before redeeming the debentures. Profit gets transferred to DRR from Profit and Loss Appropriation Account. This reduces the total profit and therefore this process is called Redemption of Debenture out of profits. DRR is shown under Reserve and Surplus section of Liabilities part of balance sheet. After all debentures are redeemed a DRR account is closed by transferring it to general reserve.

5. **These points need to be followed while creating Debenture Redemption Reserve (DRR):**

i. DRR needs to be created for companies whose issue debenture with maturity of more than 18 months.

ii. For partly convertible debentures, DRR needs to be created for non-convertible portion of debenture in the same way as is done for fully non-convertible debenture issue.

iii. Company should create DRR equivalent to 50% of debenture issue before debenture redemption commences.

iv. Withdrawal from DRR is permissible only after 10% on the debenture liability has been actually redeemed by the company.

As per SEBI's guidelines the following type of companies will be exempted from creating DRR:

i. Company issuing debentures with a maturity up to 18 months.

ii. Companies involved in infrastructure sector like maintenance, construction, business development activities.

6. **Following steps are involved:**

i. Calculate the amount from profit that needs to be set aside every year with information obtained from Sinking Fund Table.

ii. This amount that is set aside every year in Step 1 is transferred to a Debenture Redemption Fund (Sinking Fund) by debiting P & L Appropriation Account.

iii. The instalment hence determined is invested to obtain amount essential for redeeming the debenture by debiting the DRF (Debenture Redemption Fund).

iv. The interest on the amount thus invested will be received on bi-annual or annual basis.

v. The total investment which includes investment and the interest is re-invested in the following year.

vi. Repeat the steps of transferring and investing till the last instalment which will be debited from P & L appropriation account.

vii. The investment is sold off at the year of redemption.

viii. The profit/loss that is obtained from the sale of investment is transferred appropriately by debiting/crediting Debenture Redemption Fund (DRF) investment account to the DRF Account.

ix. Payment is processed for the holders of debenture.

x. The balance remaining, if any, from the DRF Account is transferred to the General Reserve.