

Debentures

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Fundamentals Of Accounting

Learning Objectives

After studying this unit, you will be able to:

- Understand the meaning and basic purpose for raising debentures by the company
- Differentiate between shares and debentures of a company
- Understand various types of debentures
- Pass entries for issue of debentures payable in installments

- Make entries for issue of debentures considering the conditions of redemption
- Pass entries for issue of debentures as collateral security
- Pass entries for debentures issued for consideration other than for cash
- Write off discount on issue of debentures.
- Calculate interest on debentures

Features of debentures

1. It is a document which evidences a loan made to a company.
2. It is a fixed interest-bearing security where interest falls due on specific dates.
3. Interest is payable at a predetermined fixed rate, regardless of the level of profit.

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4. The original sum is repaid at a specified future date or it is converted into shares or other debentures
 5. It may or may not create a charge on the assets of a company as security.
 6. It can generally be bought or sold through the stock exchange at a price above or below its face value.

Distinction between debentures and shares

Debentures	Shares
1. Debentureholders are the creditors of the company	1. Shareholders are the owners of the company.
2. Debentureholders have no voting rights and consequently do not pose any threat to the existing control of the company.	2. Shareholders have voting rights and consequently control the total affairs of the company.

3. Debenture interest is paid at a predetermined fixed rate. It is payable, whether there is any profit or not. Debentures rank ahead of all types of shares for payment of the interest due on them.

4. Interest on debentures are the charges against profits and they are deductible as an

3. Dividend on equity shares is paid at a variable rate which is vastly affected by the profits of the company (however, dividend on preference shares is paid at a fixed rate)

4. Dividends are appropriation of profits and these are not deductible in

expense in determining taxable profit of the company.

determining taxable profit of the company.

5. There are different kind of debentures, such as Secured/ Unsecured; Redeemable/ Irredeemable; Registered/ Bearer; Convertible / Non-convertible, etc.

5. There are only two kinds of shares – Equity Shares and Preference Shares.

6. In the Company Balance Sheet, Debentures are shown under “Secured Loans”.

6. In the Company Balance Sheet, shares are shown under “Share Capital”.

7. Debentures can be converted into shares as per the terms of issue of debentures

7. Shares cannot be converted into debentures in any circumstances.

8. Debentures cannot be forfeited for non-payment of calls money.

8. Shares can be forfeited for non-payment of allotment and calls moneys.

9. At maturity, debentureholders get back their money as per the terms and conditions of redemption

9. Equity shareholders cannot get back their money before the liquidation of the company (however, preference shareholders can get back their money before liquidation).

10. At the time of liquidation, debentureholders are paid-off before the shareholders.

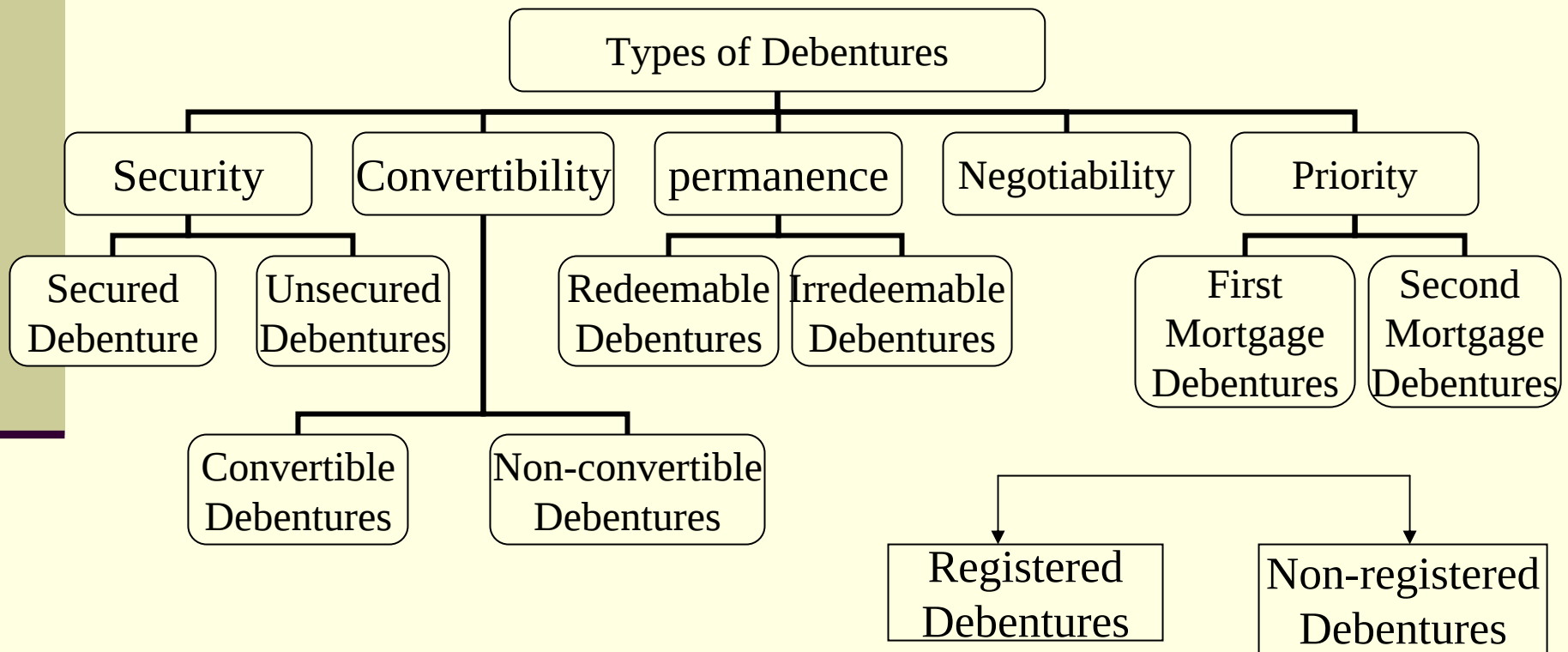
10. At the time of liquidation shareholders are paid at last, after paying debentureholders creditors, etc.

Types of Debentures

The following are the types of debentures issued by a company. They can be classified on the basis of:

- (1) Security;
- (2) Convertibility;
- (3) Permanence;
- (4) Negotiability; and
- (5) Priority.

Summary



ISSUE OF DEBENTURES

Accounting Entries for issue of Redeemable Debentures

Issue of redeemable debentures can be categorized into the following:

1. Debenture issued at a par and redeemable at par or at a discount.
2. Debenture issued at a discount and redeemable at par or at discount;

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3. Debenture issued at premium and redeemable at par or at discount;
 4. Debenture issued at par and redeemable at premium;
 5. Debenture issued at a discount and redeemable at premium.

Accounting Entries

Journal entries in each of the above cases are discussed below:

- 1. Debenture issued at par redeemable at par:** When debenture are issued at par, the issue price is equal to par value, in this regard the following entries are recorded:
(a) for receipt of application money:

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

(b) for transfer of application money to debentures account :

Debenture Application A/c Dr.

To....% Debenture A/c

2. **Debenture issued at Discount and Redeemable at par or at discount:** When debentures are issued at discount, issue price will be less than par value. The difference between the two is considered as loss on issue on debentures and is to be

written-off over the life of debentures. The entries with regards to issue are given below:

(a) For receipt of application money

Bank A/c	Dr.
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To Debenture application A/c	
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(b) At the time of making allotment

(i) Debenture Application A/c	Dr.
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Discount on issue of debenture A/c	Dr.
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To.....% Debenture A/c	
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3. Debenture Issued at Premium and Redeemable at par or at discount

When debenture are issued at premium, the issue price is more than the par value. The premium is transferred to securities premium account. In this regard, the following journal entries are recorded:

When premium amount is received at the time of application;

(a) For receipt of application money

Bank A/c Dr.

To Debenture Application A/c

(b) For transfer of application of money at the time of allotment

Debenture application A/c Dr.

To....% Debentures A/c

To Securities Premium A/c

4. Debenture issued at par and redeemable at a premium

In this case, the issue price is same as par value but the redemption value is more than the par value, therefore redemption premium is recorded as a loss on issue of debentures at the time of allotment of debenture. Following journal entries are recorded in this regard:

(a) For receipt of application money

Bank A/c

Dr.

To Debenture application A/c

(b) At the time of making allotment

(i) Transfer of application money to
debenture account

Debenture Application A/c

Dr.

To...% Debenture A/c

(ii) Call made consequent upon allotment.

Debenture Allotment A/c	Dr.
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Loss on issue of debenture a/c	Dr. [Equal to Debenture Redemption Premium]
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To.....% Debenture A/c

To Debenture redemption
premium A/c

5. Debenture Issued at discount and redeemable at premium

In this situation the issue price is less than par value but redemption value is more than par value. The difference between the redemption price and the issue price is treated as discount/loss on issue of debenture. Suppose, a 10% debenture of Rs. 1,000 is issued at a discount of Rs. 100 and redeemable at a premium of Rs. 5 per

debenture, the amount of loss will be equal to Rs.900 – Rs. 1,005 = Rs. 105. This is to be treated as loss on issue. It is to be noted that premium on redemption of debentures is also credited by Rs. 5.

(a) For the receipt of application money

Bank A/c

Dr.

To Debenture Application A/c

(b) At the time of making allotment

(i) Transfer of application money to debenture account

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

(ii) Call made consequent upon allotment of debenture at discount and redeemable at premium

Debenture Allotment A/c

Dr.

To Debenture Redemption Premium A/c

(c) For receipt of call made on allotment

Bank A/c

Dr.

To Debenture Allotment A/c

6. Debenture Issued at premium and redeemable at premium

(a) For the receipt of application money

Bank A/c

Dr.

To Debenture Application A/c

(b) At the time of making allotment

(i) Transfer to application money to
debenture account

Debenture Application A/c

Dr.

To % Debenture A/c

(ii) Call made consequent upon allotment of debenture at premium and redeemable at premium

Debenture Allotment A/c Dr.

Loss on issue of

Debenture A/c

Dr. [Amount equal to the premium on redemption]

To.....% Debenture A/c

To Debenture Premium A/c

To Debenture Redemption Premium A/c

Accounting for issue of debentures payable in installments

(a)	<i>When cash is received</i> Bank Account To Debentures Application Account	Dr.
(b)	<i>When excess money is refunded</i> Debentures Application Account To Bank Account	Dr.
(c)	<i>When the debentures are allotted</i> Debentures Application Account To Debentures Account	Dr.

The accounting entries would be as follows:

(a) When cash is received

Bank Account

Dr. [Nominal value
plus premium]

To Debentures

Application Account

(b) When excess money is refunded

Debentures Application

Dr.

To Bank Account

(c) When the debentures are allotted

Debentures Application

Account

Dr.

To Debentures Account

To Debentures Premium
Account

(d) When debentures premium is transferred

Debentures Premium Account Dr

To Capital Reserve Account

The accounting entries would be as follows:

(a) When Cash is received

Bank Account

Dr. (Actual
cash received)

To Debentures Application
Account

(b) When excess money is refunded

Debentures Application Account

Dr.

To Bank Account

(c) When the debentures are allotted

Debentures Application
Account

Dr. [Actual cash
received]

Discount on Issue of
Debentures Account

Dr. [Discount on
debentures]

To Debentures A/c

[Nominal value
of debentures]

ISSUE OF DEBENTURES AS COLLATERAL SECURITY

Accounting Entries

There are two methods of showing these types of debentures in the accounts of a company.

Method 1

Under this method, no entry is made in the books of account of the company at the time

of making issue of such debentures. In the Balance Sheet, the fact of the debentures being issued and outstanding is shown by a note under the liability secured.

Method 2

Under this method, the following entry is made to record the issue of such debentures:

Debentures Suspense Account	Dr.
To Debentures Account	

The Debentures Suspense Account will appear on the assets side of the Balance Sheet and Debentures on the liabilities side of the Balance Sheet. When the loan is repaid, the entry is reversed in order to cancel it.

Issue of Debentures in consideration other than for cash

Just like shares, debentures can also be issued for consideration other than for cash, such as for purchase of land, machinery, etc. In this case, the following entries are passed :

(a) Sundry Assets Account Dr. [Assets
taken over]

(b) Vendors Account Dr.
To Debentures Account

Treatment of Discount on issue of Debentures

Illustration

HDC Ltd. issues 10,000. 12% debentures of Rs. 100 each at Rs. 94 on 1st January, 2006. Under the terms of issue, 1/5th of the debentures are annually redeemable by drawings, the first redemption occurring on 31st December, 2006. Calculate the amount of discount to be written-off in 2006 to 2010.

Solution

Calculation of amount of discount to be written-off

At the Year end	Debentures outstanding	Ratio of benefit derived	Amount of discount to be written-off
2006	Rs. 10,00,000	5	5/15 th of Rs. 60,000=Rs. 20,000
2007	Rs. 8,00,000	4	4/15 th of Rs. 60,000= Rs. 16,000
2008	Rs. 6,00,000	3	3/15 th of Rs. 60,000= Rs. 12,000
2009	Rs. 4,00,000	2	2/15 th of Rs. 60,000 = Rs. 8,000
2010	Rs. 2,00,000	1	1/15 th of Rs. 60,000 = Rs. 4,000
	TOTAL	15	

INTEREST ON DEBENTURES

1. *For making interest due*

Interest A/c

Dr.

To Debenture holders' A/c

2. *For making payment of interest and deduction of tax at source (TDS)*

Debenture holders A/c

Dr.

To TDS Payable A/c

To Bank A/c

3. *For making payment of tax deducted at source*

TDS payable A/c	Dr.
To Bank A/c	

4. *For transferring interest to profit and loss account*

Profit and Loss A/c	Dr.
To Interest A/c	

MCQ 1

1. Which of the following statements is true?
 - (a) A debenture holder is an owner of the company
 - (b) A debenture holder can get his money back only on the liquidation of the company
 - (c) A debenture issued at a discount can be redeemed at a premium
 - (d) A debenture holder receives interest only in the event of profits

MCQ 2

2. Premium on redemption of debentures account is _____.

- (a) A real account
- (b) A nominal account – income
- (c) A personal account
- (d) A nominal account - expenditure

MCQ 3

3. Which of the following statements is false?

- (a) At maturity, debenture holders get back their money as per the terms and conditions of redemption
- (b) Debentures can be forfeited for non payment of call money
- (c) In company's balance sheet, debentures are shown under secured loans
- (d) Interest on debentures is charged against profits

MCQ 4

4. Which of the following statements is false?
- (a) A company can issue convertible debentures
 - (b) Debentures cannot be secured
 - (c) A company can issue redeemable debentures
 - (d) Debentures have no right to participate in profits over and above their fixed interest

MCQ 5

5. Debenture premium cannot be used to _____.

- (a) Write off the discount on issue of shares or debentures
- (b) Write off the premium on redemption of shares or debentures
- (c) Pay dividends
- (d) Write off capital loss

MCQ 6

6.F Ltd. purchased Machinery from G Company for a book value of Rs. 4,00,000. The consideration was paid by issue of 10% debentures of Rs. 100 each at a discount of 20%. The debenture account was credited with _____.

(a) Rs. 4,00,000

(b) Rs. 5,00,000

(c) Rs. 3,20,000

(d) Rs. 4,80,000

MCQ 7

7. Loss on issue of debentures is treated as _____.

- (a) Intangible asset
- (b) Current asset
- (c) Current liability
- (d) Miscellaneous expenditure

MCQ 8

8. T Ltd. has issued 14% Debentures of Rs. 20,00,000 at a discount of 10% on April 01, 2004 and the company pays interest half-yearly on June 30, and December 31 every year. On March 31, 2006, the amount shown as “interest accrued but not due” in the Balance Sheet will be
- (a) Rs. 70,000 shown along with Debentures
 - (b) Rs. 2,10,000 under current liabilities
 - (c) Rs. 1,40,000 shown along with Debentures
 - (d) Rs. 2,80,000 under current liabilities

MCQ 9

9. On May 01, 2004 U Ltd. issued 7% 10,000 convertible debentures of Rs. 100 each at a premium of 20%. Interest is payable on September 30 and March 31 every year. Assuming that the interest runs from the date of issue, the amount of interest expenditure debited to profit and loss account for the year ended March 31, 2005 = ?

(a) Rs. 70,000

(b) Rs. 58,333

(c) Rs. 84,000

(d) Rs. 64,167

MCQ 10

10. Which of the following is/ are true with respect to debentures?
- (a) They can be issued for cash
 - (b) They can be issued for consideration other than cash
 - (c) They cannot be issued as collateral security
 - (d) Both (a) and (b) above

MCQ 11

11. W Ltd. issued 20,000, 8% debentures of Rs. 10 each at par, which are redeemable after 5 years at a premium of 20%. The amount of loss on redemption of debentures to be written off every year = ?

(a) Rs. 40,000

(b) Rs. 10,000

(c) Rs. 20,000

(d) Rs. 8,000

MCQ 12

12. When debentures are issued as collateral security, the final entry for recording the transaction in the books is _____.
- (a) Credit debentures a/c. and debit cash a/c.
 - (b) Debit debenture suspense a/c. and credit cash a/c.
 - (c) Debit debenture suspense a/c. and credit debentures a/c.
 - (d) Debit cash a/c. and credit the loan a/c. for which security is given.

MCQ 13

13. Which of the following is false?

- (a) A company can issue redeemable debentures
- (b) A company can issue debentures with voting rights
- (c) A company can buy its own shares
- (d) A company can buy its own debentures

MCQ 14

14. Which of the following is false with respect to debentures?

- (a) They can be issued for cash
- (b) They can be issued for consideration other than cash
- (c) They can be issued as collateral security
- (d) They can be issued in lieu of dividends

MCQ 15

15. Debentures can be _____.

- I. Mortgage Debentures or Simple Debentures.
- II. Registered Debentures or Bearer Debentures.
- III. Redeemable Debentures or Irredeemable Debentures
- IV. Convertible Debentures or Non-convertible Debentures

MCQ 16

16. Which of the following statements is false?

- (a) Debenture is a form of public borrowing
- (b) It is customary to prefix debentures with the agreed rate of interest
- (c) Debenture interest is a charge against profits
- (d) The issue price and redemption value of debentures cannot differ.

MCQ 17

17. As per the Companies Act, “Interest accrued and due on debentures” should be shown

- (a) Under Debentures
- (b) As Current Liabilities
- (c) As Provisions
- (d) As a reduction of bank balance

MCQ 18

18. T Ltd. purchased land and building from U Ltd. for a book value of Rs. 2,00,000. The consideration was paid by issue of 12% Debentures of Rs. 100 each at a discount of 20%. The Debentures account is credited with_____.

(a) Rs. 2,60,000

(b) Rs. 2,50,000

(c) Rs. 2,40,000

(d) Rs. 1,60,000

MCQ 19

19. P Ltd. issued 5,000, 12% debentures of Rs. 100 each at a premium of 10%, which are redeemable after 10 years at a premium of 20%. The amount of loss on redemption of debentures to be written off every year = ?

(a) Rs. 80,000

(b) Rs. 40,000

(c) Rs. 10,000

(d) Rs. 8,000

MCQ 20

20. Which of the following is true with regard to 10% Debentures issued at a discount of 20%?
- (a) The carrying amount of debentures gets reduced each year at a rate of 20%
 - (b) Issue price and the carrying amount of debentures are equal
 - (c) At the time of redemption, the debenture holder will be paid the issue price
 - (d) The face value and the carrying amount of debentures are equal.

THE END

Debentures