

## **UNIT 5: ACCOUNTING FOR DEBENTURES**

### **LEARNING OBJECTIVES**

- I) Understand the meaning and features of debentures.
- II) Differentiate between shares and debentures.
- III) Understand different classes of debentures
- IV) Journal entries regarding issue of debentures for cash and for consideration other than cash.
- V) Accounting treatment of debentures issued as collateral security
- VI) Accounting treatment of issue and redemption of debentures at par, discount and at premium.
- VII) Understand the methods of redemption of debentures.
- VIII) Accounting treatment of redemption of debentures out of capital and profit.
- IX) Understand the redemption of debentures by purchase in the open market
- X) Understand redemption of debentures by conversion into shares and new debentures.

- 1) What do you mean by Debentures?

Debentures is an instrument of debt owned by a company as an acknowledgement of debt, such measurements are issued under the seal of company and duly signed by authorized signatory.

- 2) Write any four types of debentures

- i) Redeemable debentures
- ii) Perpetual Debentures
- iii) Convertible debentures
- i) Secured debentures

- 3) What is debenture Trust Deed?

Debenture trust deed is a document created by the company whereby trustee is appointed to protect the interest of debenture holders before they are offered for public subscription.

- 4) What is meant by convertible debentures?

Convertible debentures are those, the holders of which are given an option to exchanging the amount of their debentures with equity shares or other securities after a specified period.

- 5) Why is premium on the issue of debentures considered as a capital profit?

Premium on the issue of debentures is considered a capital profit because it is not an income arising from the normal course of business operations.

- 6) Explain deep discount Bond

When debentures are issued without interest rate and issue price is thereby discounted, the issue of debenture is said to have been made as deep discount bond.

- 7) Differentiate between shareholders and debenture holder,

Point of Difference	Share holder	Debenture holder
1) Status	There are the owners of the company	They are the creditors of the company
2) Return	They are paid Dividend	They are paid interest
3) Security	Shares are not secured	Debentures are ordinarily secured

- 8) What is the nature of interest on debentures?

Interest on debentures is a charge against profits.

- 9) State in brief, the SEBI Guidelines regarding Debenture Redemption Reserve

Ans. At per SEBI Guidelines, an amount equal to 50% of the debenture issue must be transferred to DRR before the redemption begins. In other words, before redemption, at least an amount equal to 50% of the debenture issue must stand to the credit of DRR

- 10) Name the head under which discount on issue of debentures appears in the Balance Sheet of "C" Company.

Ans. Discount on issue of debentures will appear under the heading Miscellaneous Expenditure.

- 11) What are the exceptions for creating debenture Redemption Reserve?

- (i) An infrastructure company, (ii) Debentures are issued for less than 18 months maturity period (iii) if debentures issued by private placement.

- 12) What do you mean by debentures issued as collateral security?

The issue of debentures as a collateral security means the issue of debentures as an additional security against the loan in addition to principal security that may be offered.

- 13) A Ltd issued 5,000 13% debentures of Rs.100 each at par and raised a loan of

Rs.80, 000 from Bank. Collaterally secured by Rs. 100,000 13% debentures. How will You show the debenture in the Balance Sheet of the Company assuming that the company has recorded the issue of Debentures as collateral security in the books.

**Balance Sheet**

Liabilities		Assets	
Secured Loans	Amount	Current assets	Amount
13% Debenture			
5,000 deb of Rs. 100 each at par	500000	Bank a/c	500000
Bank loan (secured by the issue of 1000 13% deb of Rs.100 each)	80000		

15) Ashoka Ltd. had Rs. 5, 00,000 12% debentures outstanding as on 1<sup>st</sup> Jan, 2003. During the year company took a loan of Rs. 3, 00,000 from Bank of Punjab for which the company placed with the bank debentures of Rs. 3, 60,000 as collateral security.

Pass journal entries and also show how the debentures and bank loan will appear in the balance sheet.

	Bank a/c	Dr.	3,00,000	
	To Bank loan a/c			3,00,000
	(Being loan taken from bank)			
	Debenture suspense a/c	Dr.	3,60,000	
	To 12 % Debenture a/c			3,60,000
	(Being Debentures issued as collateral security )			

16) XYZ Co. Ltd., issued 10000 10% debentures of Rs.100 each at a premium of Rs. 5 payable as follows

On application Rs.40, on Allotment Rs.65 (including premium)

All the debentures were subscribed and money was received, pass necessary journal entries to record the issue of debentures

Journal Entries

1) Bank a/c To 10% Debenture application (Being application money received)	Dr.	4,00,000	4,00,000
2) 10% Deb Application a/c To 10% Debenture a/c (Being application money transferred to debenture a/c)	Dr.	4,00,000	4,00,000
3) 10% Deb allotment a/c To Debenture a/c To S Premium a/c (Being debenture allotment due)	Dr.	6,50,000	6,00,000 50,000
4) Bank a/c To 10% Deb allotment a/c (Being allotment money received)	Dr.	6,50,000	6,50,000

17) Pass Journal Entries to record the Issue of Debentures

- 1) 5000 15% debenture of Rs.100 each issued at Discount of 5% and redeemable at premium at 5% after 5 years.
- 2) 10000 15% debenture of Rs.100 each issued at a premium of 10% and redeemable at par after 6 years.

Ans: Journal Entries

1) Bank a/c loss on issue of Deb a/c To 15% debenture a/c To premium on redemption of debenture (Being issue of debenture at discount and redeemable at 5% premium)	Dr. Dr.	4,75,000 50,000	5,00,000 25,000
2) Bank a/c To Debenture a/c To Premium a/c  To premium a/c (Being issue of debenture at premium and redeemable at par)	Dr.	1100000	1000000 100000

18) Journalise the following transactions:

- (a) 10 debentures issued at Rs. 100 repayable at Rs. 100.  
 (b) 10 debentures issued at Rs. 95, repayable at Rs. 100  
 (c) 10 debentures issued at Rs. 105 , repayable at Rs. 100  
 (d) 10 debentures issued at Rs. 100, payable at Rs. 105.  
 (e) 10 debentures issued at Rs. 95, Repayable at Rs. 105.

Date	Particulars	Debit Amt	Credit Amt
(a)	Bank a/c Dr.  To debenture Application a/c  Being Debenture application money received)	1,000	1,000
	Debenture Application a/c Dr.  To Debenture a/c  (Being 10 debentures of Rs. 100 each issued at par redeemable at par)	1,000	1,000
(b)	Bank a/c Dr.  To debenture Application a/c  Being Debenture application money received)	950	950
	Debenture Application a/c Dr.  Discount on issue of Debentures Dr.  To Debenture a/c  (Being 10 debentures of Rs. 100 each issued at a discount of 5% and repayable at par.)	950 50	1,000
(c)	Bank a/c Dr.  To debenture Application a/c  Being Debenture application money received)	1,050	1050
	Debenture Application a/c Dr.	1,050	

	To Debenture a/c		1,000
	To Securities premium a/c		50
	(Being 10 debentures of Rs. 100 each issued at premium of 5% and redeemable at par)		
(d)	Bank a/c Dr.	1,000	
	To debenture Application a/c		1,000
	Being Debenture application money received)		
	Debenture Application a/c Dr.	1,000	
	Loss on issue of debentures a/c Dr.	50	
	To Debentures a/c		1,000
	To Premium on redemption of debentures a/c		50
	(Being 10 debentures of Rs. 100 each issued at par but repayable at a premium of 5%)		
(e )	Bank a/c Dr.	950	
	To debenture Application a/c		950
	Being Debenture application money received)		
	Debenture Application a/c Dr.	950	
	Loss on issue of debentures a/c Dr.	100	
	To Debentures a/c		1,000
	To Premium on redemption of debentures a/c		50
	(Being 10 debentures of Rs. 100 each issued at discount of 5% but repayable at a premium of 5%)		

19) A building has been purchased for Rs.1,10,000 from X Ltd., X Ltd., has been issued 12% debentures in Purchase Consideration at a Premium of 10% Journalise the above transaction.

Ans: Journal entries

1) Building a/c To vendors a/c (Being purchasing of a building on credit)	Dr.	110000	110000
2) Vendors a/c To 12% debentures a/c To securities premium a/c (Being issue of 12% debentures at 10% premium)	Dr.	110000	100000 10000

20) Raghav Limited purchased a running business from Krishna traders for a sum of Rs. 15,00,000 payable Rs. 3,00,000 by cheque and for the balance issued 9% debentures of Rs. 100 each at par.

The assets and liabilities consisted of the following:

Plant and Machinery	4, 00,000
Building	6, 00,000
Stock	5, 00,000
Debtors	3, 00,000
Creditors	2, 00,000

Record necessary journal entries in the books of Raghav Limited.

Date	Particulars	L.F	Dr. (Rs.)	Cr.(Rs.)
	Plant and Machinery a/c      Dr.		4,00,000	
	Building    a/c                      Dr.		6,00,000	
	Stock a/c                              Dr.		5,00,000	
	Debtors a/c                           Dr.		3,00,000	
	To Creditor's a/c			2,00,000
	To Krishna Traders			15,00,000
	To Capital Reserve ( Bal. Fig)			1,00,000
	( Being assets and liabilities taken over from the vendor company).			

	Krishna Traders a/c	Dr.	15,00,000	
	To Bank			3,00,000
	To 9% Debentures a/c			12,00,000
	( Being issues of 12,000 debentures of Rs.. 100 each at par and rest paid by a cheque)			

21) What do you mean by Redemption of debentures by purchase in the open market?

A company, if authorised by its Articles of Association, can redeem its own debentures by purchasing them in the open market. This is called redemption of debentures by purchase in the open market. Debentures may be purchased at par or at a premium. But this procedure is usually adopted by the company only when its debentures are quoted at a discount in the open market.

22) LCM Ltd., purchased for cancellation its own 10, 00,000, 9% debenture of Rs.500 each of Rs.480 each. Record necessary Journal entries.

Journal Entries

1) Own debentures a/c	Dr.	480000000	
To Bank a/c			480000000
(Being purchased its own debenture at Rs.480/- each)			
2) 9% Debentures a/c	Dr.	500000000	480000000
To Own debentures a/c			2000000
To Profit on cancellation of debentures.			

23) A company authorized its Rs.1, 10,000 debenture holders to convert them into preference shares. Pass the necessary journal entry if

- Debentures were converted into shares of Rs.100 at par
- Debentures were converted into shares of Rs.100 at a premium of 10%

Ans: a) Debentures A/c Dr. 1, 10,000



	T0 preference Share capital a/c		1, 10,000
b)	Debentures a/c	Dr.	1, 10,000
	To preference share capital a/c		1, 00,000
	To securities premium a/c		10,000
	(Being debentures converted into preference Shares issued at 10% premium)		

24) White Ltd., issued 8,00,000 8% debentures of Rs.100 each redeemable at a premium of 10%. According to the terms of redemption, the company redeemed 25% of the above debentures by converting them into shares of 50 each issued at a premium of 60% pass Journal entry regarding redemption of debentures.

1)	8% debentures a/c	Dr.	2, 00, 00,000
	Premium on redemption of debentures a/c	Dr.	20,00,000
	To Debenture holders a/c		2, 20, 00,000
	(Being 25% of debentures redeemed at a premium)		
2)	Debenture holders A/c	Dr.	2, 20, 00,000
	To share capital		1, 37, 50,000
	To security premium a/c		82, 50,000
	(Being issue of 2, 75,000 shares of Rs.50 each at a Premium of 60% to the debenture holders on conversion of 2,00,000 debentures)		

25). Journalise the following transactions in the books of Raja Ltd.,

1) 200 12% debentures of Rs.100 each issued at a discount of 10% were converted into 10% preference shares of Rs.100 each issued at a premium of 25%. The debentures were converted at the option of the debentures-holders before the date of redemption.

2) Issued 1000 12% debentures of Rs.100 each at a discount of 10% redeemable at a premium of 5%.

Journal Entries

Ans

1) 12% Debenture a/c	Dr.	20,000	
To discount on issue of debenture a/c			2,000
To debenture holders a/c			18,000
(Being the amount due to debenture holders on conversion of 200, 12% debenture)			

2) Debenture holders a/c	Dr.	18,000	
To 10% preference share Capital			14,400
To securities premium			3,600
(Being issue of 144, 12% preference shares Of Rs.100 each.)			
3) Bank a/c	Dr.	90,000	
Loss on Issue of Deb a/c	Dr.	15,000	
To 12% Debenture a/c			100,000
To premium on redemption of deb a/c			5,000
(Being issue of 1000, 12% debenture of Rs.100 each at a discount of 10% and redeemable at premiums of 5%).			

26) On January 1<sup>st</sup>, 2006 S Ltd issued 1,000 10% debentures of Rs. 500 each at par redeemable after 7 years. However the company gave an option to debenture holder to get debentures converted into equity shares of Rs. 100 each at a premium of Rs. 25 per share any time after the expiry of one year.

Arvind the holder of 200 debentures informed on Jan, 2006 that he wanted to exercise the option of conversion of debentures into equity shares.

Pass necessary Journal entries to record the issue of debentures on Jan, 2004 and conversion of debentures on Jan, 2006.

#### Journal of S Limited

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
	Bank a/c Dr.		5,00,000	
	To 10% Debenture a/c			5,00,000
	( Being Debenture money received)			
	10% Debenture a/c Dr.		1,00,000	
	To Debenture holder a/c			1,00,000
	( Being Amount due to debenture holders on redemption.)			
	Debenture holders a/c Dr.		1,00,000	

	To Equity share capital a/c			80,000
	To Securities Premium a/c			20,000
	Being payment made to debenture holders)			

27) Animesh Ltd issued 1,000, 12 % Debenture of 100 each in the following manner:

- (i) For cash at par Rs. 50,000 nominal
- (ii) For creditors of Rs. 45,000 against purchase of machinery Rs. 35,000 nominal
- (iii) To SBI bank against a loan of Rs. 10,000 as collateral security Rs. 15,000 nominal

**Pass Journal entries.**

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
	Debenture Application a/c      Dr. To 12% Debentures a/c (Being 12% Debentures issued at par)		50,000	50,000
	Bank a/c To Debenture Application a/c (Being Application money received on 500 debentures @ Rs. 100 )		50,000	50,000
	Machinery a/c      Dr. To Vendor a/c ( Being Machinery purchased )		45,000	45,000
	Vendor a/c      Dr. To 12% Debentures a/c To Securities Premium a/c (Being Debentured issued to vendor at premium.)		45,000	35,000 10,000
	Bank a/c      Dr. To Bank Loan a/c ( Being Loan borrowed )		10,000	10,000
	Debenture Suspense a/c      Dr. To 12% Debentures a/c ( Being Debentures issued as collateral security)		15,000	15,000

28) Dipesh Ltd redeemed its 8,000, 11 % Debentures of Rs. 100 each in the following manner;

- (i) 4,000 debentures were purchased @ Rs. 95.
- (ii) 3,000 debentures were purchased @ Rs. 93
- (iii) 1,000 debentures were purchased @ Rs. 97.50.

The expenses on purchase of own debentures amounted to Rs. 200.

The debentures were purchased for immediate cancellation. Pass journal entries.

### Journal Entries

Date	particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
	P/L appropriation a/c Dr.  To Debenture Redemption Reserve a/c (Being Debenture redemption reserve created @ 50% of debentures.)		4,00,000	4,00,000
	Own Debentures a/c Dr.  To Bank a/c  ( Being Own debentures purchased )		7,56,700	7,56,700
	11% Debentures a/c Dr.  To Own Debentures a/c  To Gain on cancellation of own  Debentures a/c (Being Own debentures cancelled)		8,00,000	7,56,700 43,300
	Gain on cancellation of own Debentures a/c  To capital reserve a/c  (Being Gain transferred to capital reserve)		43,300	43,300
	DRR a/c Dr.  To General reserve a/c  Being DRR transferred to general Reserve)		4,00,000	4,00,000