

Unit Structure

- 3.0 Objectives
- 3.1 Introduction and Meaning
- 3.2 Definition
- 3.3 Features
- 3.4 Types of Debentures
- 3.5 Distinguish between Shares and Debentures
- 3.6 Debenture Interest
- 3.7 Issue of Debentures
- 3.8 Terms of redemption
- 3.9 Accounting entries
- 3.10 Treatment of discounts
- 3.11 Solved Problems
- 3.12 Exercise

3.0 OBJECTIVES :

After studying the unit the students will be able to

- Define Debentures
- Explain the types of Debentures
- Understand the difference between Shares and Debentures
- Know the terms of issue and redemption of Debentures
- Journalise the transactions
- Solve the problems

3.1 INTRODUCTION AND MEANING:

A Debenture is a document acknowledging a loan to company and executed under the common seal of the company, usually containing provisions as to payment, of interest and the repayment of principal amount and giving a charge on the assets of a such a company, which may give security for the payment over the some or all the assets of the company.

Issue of Debentures is one of the most common method of raising the funds available to the company. It is a important source of finance.

3.2 DEFINITION:

Debenture may be defined as a certificate issued by company under it's seal acknowledging a debt due by to it's holder. The essential characteristic of debentures is indebtedness Sec.2(12) of the Companies Act. 1956 a Debenture includes debenture stock bonds any other securities of a company whether constituting a charge on company assets or not.

A person who purchases a debenture is called a debenture holder.

3.3 FEATURES:

A Debenture has the following basic features:-

- (a) It is document which creates or acknowledges a debt.
- (b) It is in the form of certificate issued under the seal of the company.
- (c) It usually shows the amount & date of repayment of the loan.
- (d) It shows the rate of interest & date of interest payment.
- (e) Normally debentures are secured & issued against the assets of the company.

3.4 TYPES OF DEBENTURES:

Different types of debentures can be classified as follows:-

I) ON THE BASIS OF SECURITY:

- a) **Naked Debentures:** These Debentures are not secured against any assets of the Co. In case of winding of the company, debentures holders holding unsecured debentures treated as unsecured creditors.
- b) **Secured Debentures:** These Debentures are secured by a charge on the assets of the company. These debentures are secured either on a particular assets called fixed charge or on the general assets of the company called floating charge. The debentures holder has a right to recover outstanding loan & interest out of such charge assets. These debentures are issued by the company under an agreement which is called "Mortgage Deed". Such mortgage is registered with Register of Companies.

II) ON THE BASIS OF PERFORMANCE:

- a) **Redeemable Debentures:** The debentures are redeemed by repayment of the amount of debentures after a specified date, as per terms & conditions issued.
- b) **Irredeemable Debentures:** In this case the issuing company does not fix any date by which debentures should be redeemed & the debentures holder cannot demand repayment of the sum of debenture from the company so long as it is going concern.

III) ON THE BASIS OF PRIORITY:

- a) **First debentures:** As the name implies this type of debentures are repaid before the repayment of other debentures.
- b) **Second debentures:** These debentures are paid after payment of first debentures.

IV) ON THE BASIS OF CONVERTIBILITY:

- a) **Convertible debentures:** Holders of such debentures are given option to convert the debentures fully or partly into equity shares or preference shares or new debentures after a specified time.
- b) **Nonconvertible debentures:** The holders of this type of debentures do not have any right to convert them into equity shares etc.,
- v) **On the basis of Records:**
 - a) Bearer debentures: Just like bearer cheques these debentures can be transferred freely. Payment of interest is made on productions of coupons attached with debentures.
 - b) Registered debentures: These are transferred only by transfer deed. The complete particulars in regard to such debentures are entered into register & the interest is paid only to those whose name appears in the register.

3.5 DISTINCTION BETWEEN SHARES & DEBENTURES

Shares		Debentures	
1.	Share capital is an ownership capital.	1.	Debentures capital is creditorship capital i.e. borrowing.
2.	A shareholder is the owner of the company.	2.	A debenture holder is the creditor of the company.

3.	Share capital is not returnable in the life time of the company. However, the redeemable preference shares are refunded during the life-time of the company.	3.	Debenture capital returnable during the lifetime of the company. The exception is the irredeemable debentures which are not redeemable during the life-time of the company.
4.	Shareholders enjoy the voting rights.	4.	Debentures holders do not have the voting rights.
5.	Dividend is payable on shares & it is an appropriation of profits	5.	Interest on debentures is payable at a fixed rate on specified date irrespective of profits of the company.
6.	Dividend depends on the profit of the company.	6.	Interest is paid on debentures & it is a charge on the revenue of the company.
7.	Shares are unsecured.	7.	Debentures are generally secured.
8.	In the event of winding up of the company shareholders are the last person in re-fund of their capital.	8.	Debenture holder being the creditors are paid prior to the shareholders. If secured they have priority even over the unsecured creditors.

3.6 DEBENTURE INTEREST:

Debentures being borrowed capital, they carry a specific rate of interest payable on specified date Debentures interest is expenditure & it is payable as an when interest is due whether there is a profit or loss. It is usually paid half-yearly. The amount of interest is calculated & paid on nominal value i.e., face value of Debentures.

The following Journal entries are passed.

a) When debentures interest is due:

Debenture Interest A/c	Dr. (Gross amt.)
To Tax Deducted as source (With income tax)	
To Debentures holder A/c (Net amt. payable)	

b) When net amount due is paid:

Debentures Holder A/c	Dr.
To Bank A/c	

c) At the end of the year balance in debenture interest being expense transferred to P & L A/c

P & L A/c	Dr.
To Debenture Interest A/c	

3.7 ISSUE OF DEBENTURES:

3.7.1 Debentures can, be issued in three ways.

- a) **At par:** Debenture is said to have been issued at par when the amount collected for it is equal to the nominal value of debentures. e.g. the issue of debentures of Rs. 100/- for Rs. 100/-.
- b) **At Discount:** Debenture is said to have been issued at discount when the amount collected is less than the nominal value, for e.g., issue of debentures of Rs. 100/- for Rs. 95/-. The difference of Rs. 5/- is the discount and is called discount on issue of Debentures. This discount on issue of debentures is a capital loss & it is charged to P & L A/c over the period of its benefit to the company & it is shown under the head “Miscellaneous Expenditure” on the assets side of the Balance Sheet.
- c) **At Premium:** When the price charged is more than it’s nominal value, a debentures is said to be issued at a premium. e.g., issue of debentures of Rs. 100 each for Rs. 120, the excess amount over the nominal value i.e., Rs. 20 is the premium on issue of debentures. Premium received on issue of debentures is a capital gain & it is credited to “Securities Premium A/c”. Premium on issue of debentures cannot be utilised for distribution of dividend. Premium on debentures is shown under the head Reserves & Surplus on the liability side of the Balance Sheet.

3.7.2 ISSUE OF DEBENTURES FOR CASH:

Debentures may be issue for cash at a par, at a discount or at a premium. When amount is payable in installments entries will be similar to the issue of shares. Any premium or discount on issue of debentures is usually adjusted at the time of making allotment. Premium payable on redemption of debentures is also adjusted at the time of issue of debentures.

3.7.2 ISSUE OF DEBENTURES FOR NON-CASH CONSIDERATION

Debentures may be issued for consideration other than cash such as acquisition of business, or assets. It should be noted that ouch debentures may be issue at par or at a premium or at a discount.

3.7.3 ISSUE OF DEBENTURES AS A COLLATERAL SECURITY

Debentures can be issued as collateral security against a loan or overdraft from bank or other financial institution. Collateral Security means an additional or parallel security. Debentures issued as collateral security is a contingent liability. However, it can become a definite liability only in the invent of default by the company in repaying the loan. No interest is payable on such debentures. Normally no entry is passed in

	c) Allotment money due	Debentures Allotment A/c Dr. To Debentures A/c
	d) For receipt of allotment money	Bank A/c Dr. To Debenture Allotment A/c
	e) Call money due	Debenture Call A/c Dr. To Debentures A/c
	f) Receipt of call money	Bank A/c Dr. To Debenture Call A/c
<p>Note: Discount or premium on issue of debentures should be adjusted at the time of making allotment entries for such will be the similar to the issue of shares.</p>		
2)	Issue for cash (collection in lump sum)	
	a) Issue at par redeemable at par	Bank A/c Dr. To Debentures A/c
	b) Issue at discount redeemable at par.	Bank A/c Dr. Discount on issue of Debentures A/c Dr. To Debentures A/c
	c) Issued at premium redeemable at par.	Bank A/c Dr. To Debentures A/c To Securities Premium A/c
	d) Issued at par redeemable at premium.	Bank A/c Dr Loss on issue of debentures A/c Dr. To Debentures A/c To Premium on redemption of debentures A/c
	e) Issued at a discount redeemable at premium.	Bank A/c Dr. Loss on issue of debentures A/c Dr. To Debentures A/c To Premium on redemption of debentures A/c.

3)	Issue of Debentures for Non-cash consideration	
	a) On purchase of business	Sundry Assets A/c Dr. *Goodwill A/c Dr. To Sundry Liabilities A/c To Vendor A/c To Capital Reserve A/c
Note: Goodwill=P.C consideration – Net Assets. OR Capital Reserve = Net Assets – P. C		
	b) On issue of Debentures to Vendor	
	(i) Issue at per redeemable at par	Vendor A/c Dr. To Debentures A/c
	(ii) Issued at discount redeemable at par	Vendor A/c Dr. Discount on issue of Debentures A/c Dr. To Debentures A/c
	(iii) Issued at premium redeemable at par	Vendor A/c Dr. To Debentures A/c To Securities Premium A/c
	(iv) Issued at par redeemable at premium.	Vendor A/c Dr. Loss on issue of debenture A/c Dr. To Debentures A/c To Premium on redemption of debentures A/c
	(v) Issued at a discount redeemable at premium	Vendor A/c Dr. Loss on issue of debentures A/c Dr To Debentures A/c To Premium on redemption of debentures A/c
4)	Issue of Debenture as collateral security	No Entry

3.10 TREATMENT OF DISCOUNT ON ISSUE OF DEBENTURES :

Discount on issue of debentures is a capital loss & such loss is written off from books of account as early as possible. Following journal entries passed to write off discount.

P & L A/c Dr.
 To Discount on issue of Debentures A/c

Balance on discount is shown in the balance sheet on the assets side under the head “Miscellaneous Expenditure”.

The amount of discount is written off in the following ways.

- a) When debentures are redeemed after certain period.
In this case total discount on debentures is written off equally each year over the period of debenture tenure.

$$\text{Discount to be written off} = \frac{\text{Total Discount}}{\text{No.of years after which debentures will be redeemed}}$$

Check Your Progress

- **State whether true or false**

1. Registered debentures are transferred only by transfer deed.
2. Redeemable Debentures are redeemed at any time.
3. Debenture interest is payable only when a company makes profits.
4. When the price charged is more than its nominal value, a debenture is said to be issued at a premium.
5. If the debentures are redeemed at discount such discount is a revenue profit for the company.
6. Premium payable on redemption of debentures is a capital loss for the company.
7. No interest is payable on the debentures issued as a collateral security.

- **Fill in the blanks**

1. When debentures are to be redeemed at their face value they are to be said as-----.
2. Accumulated balance of premium on redemption is shown under the head----- on the assets of the Balance Sheet.
3. If the term on issue of debentures is 'Issued at par redeemable at premium' the journal entry is-----
4. Debentures issued as collateral security is a ----- liability.
5. The amount of interest is calculated and paid on----- of Debentures.
6. Premium received on issue of debentures is a capital gain and it is credited to-----.
7. Debentures which are secured by a charge on the assets of the company are termed as -----

Answers for check your progress

State whether true or false