ACCOUNTANCY THEORY NOTES

CBSE – GRADE 12

CHAPTER – IV
ACCOUNTING FOR DEBENTURES

SHORT NOTES

I. ISSUE OF DEBENTURES

1.Meaning of Debenture It means a document of companies indebtedness issued under the seal of the company and containing a contract for the repayment of the principal sum at a specified date with interest at a fixed rate.

2.Definition of Debenture According to 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.

3. Bond Bond is an instrument of acknowledgement of debt. Bond is similar to debenture in terms of contents and texture. However, bonds can be issued without pre-determined rate of interest.

4.Issue of Debentures for Cash Debentures, like shares, issued for cash, may be issued (i)at par (ii) at premium or (iii) at discount

Issue of Debentures at Par Debentures are said to be issued at par when the issue price and face value of the debentures is same.

Issue of Debentures at a Premium Debentures are said to be issued at premium when the issue price is more than the face value.

Issue of Debentures at a Discount Debentures are said to be issued at discount when they are issued at a price below its nominal or face value.

5. Issue of Debentures as Collateral Security

When a company takes a loan, it may provide primary security on its assets. However, the lending institution may insist on some more assets as secondary or collateral security. In such a situation, the company may issue debentures to the lender as secondary or collateral security, such an issue of debentures is known as 'debentures issued as collateral security'.

If the company fails to repay the loan along with the interest and the primary security is insufficient to repay the loan, only in that case the lender is free to use the debentures as collateral security. The lender may either present such debentures for redemption or sell them in the open market. Debentures issued as collateral security can be dealt in two ways

II. REDEMPTION OF DEBENTURES

1. Redemption of Debentures

Redemption of debentures means discharging the liability on account of debentures in accordance with the terms and conditions.

2. Methods of Redemption of Debentures

(i) Redemption of debentures in lump sum on maturity.
(ii) Redemption of debentures in instalments by d: aw of lots.
(iii) Redemption of debentures by conversion.
(iv)Redemption by purchase in open market.
NOTE Redemption of debentures by conversion is not in syllabus.

3. Debenture Redemption Reserve (DRR)

It is the amount set aside out of surplus, i.e Balance in Statement of Profit and Loss for redeeming the debentures. Section 71(4) of the Companies Act, 2013 requires the company to create debenture redemption reserve out of the profits available for payment of dividend and the amount so credited to debenture redemption reserve account si mil not be utilised by the company except for the redemption of debentures.

- According to Rule 18(7) of the Companies (Share Capital and Debentures) Rules, 2014, following; companies would now be required to create DRR of an amount equal to 25% of the value of debentures.

- Rule 18(7) further requires every company required to create DRR shall on or before 30th April in each year, invest or deposit in specified securities, a sum at least equal to 15% of the amount of debentures maturing for payment during the year ended 31st March of the next year.

- Exemption to Create DRR Rule 18(7) of Companies (Share Capital and Debentures) Rules, 20 s 1 exempts the following types of companies from creating DRR:
  (i) All India Financial Institution regulated by Reserve Bank of India; and
  (ii) Banking Companies.

4. Redemption of **Debentures in Lump Sum on Maturity** When all the debentures are redeemed by paying in lump sum at a time, it is called redemption in lump sum.

5. A company may adopt any of the following two options for redeeming debentures in lump sum

(i) **Redemption out of capital**

When, before or at the time of redemption, profits are neither required by law nor otherwise transferred to DDR, such redemption is said to be out of capital. Section 71 of the Companies Act, 2013 restricts redemption of debentures out of capital by requiring every Company (except All India Financial Institutions and Banking Companies) to create a Debenture Redemption Reserve (DRR) out of profit available for dividend.

(ii)Redemption of debentures out of profits:

When amount specified in Section 71(4) of the Companies Act, 2013 is transferred to debenture redemption reserve out of the profit available for dividend, it is redemption of debentures out of profit.

- Section 71(4) of the Companies Act, 2013 along with rules requires that an amount equal to at least 25% of the value of debentures to be transferred to debenture redemption reserve account before the redemption of debentures. The company at its option, any transfer more amount to debenture redemption reserve than prescribed. The transfer of amounts to DRR reduces the profit available for distribution of dividend.

- Further, every company that is required to create DRR is also required to invest or deposit in specified securities by 30th April a sum which is at least equal to 15% of the amount of debentures maturing for payment during the year ending on 31st March of the next year.

6. Redemption of Debentures in Instalment by Draw of Lots
In this method, the company may redeem its debentures in instalments beginning from a particular year i.e. by payment in each year of a certain portion. The actual debentures to be redeemed are selected usually by draw of lots. The holders are repaid the amount at par or at a premium as per the terms of issue.

NOTE DRR must be created before commencing redemption of debentures under this method also.

7. Redemption by Purchase in Open Market
When a company purchases its own debentures in the open market for the purpose of immediate cancellation, the purchase and cancellation of such debentures are termed as redemption by purchase in the open market. The advantage of such an option is that a company can redeem the debentures at its convenience whenever it has surplus funds. Secondly, the company can purchase them when they are available in market at a discount.

Debenture Redemption Reserve
The company should have balance of debenture redemption reserve atleast equal to 25% vof the debenture issue, before it initiates the purchase of debentures for cancellation.

Investment in Specified Securities
Section 71(4) of the Companies Act, 2013 requires that amount at least equal to 15% of nominal value of the debentures to be redeemed by 31st March of next year should be invested in specified securities by 30th April.

BOARD EXAM QUESTIONS

1. Give the meaning of 'debenture'. (Delhi 2014)
Ans. It means a document showing a company's indebtedness, issued under the seal of the company and containing a contract for the repayment of the principal sum at a specified date with interest at a fixed rate.

2. What is meant by a bond? (Compartment 2014)
Ans. Bond is an instrument of acknowledgement of debt, but it does not carry a pre-determined rate of interest.

3. Give the meaning of issue of debentures as collateral security. or
What is meant by issue of debentures as a collateral security? (All India 2014,2013)
Ans. When a company issues its own debentures to the lenders in addition to'some other asset already pledged or mortgaged, it is called issue of debentures as collateral security.

4.Pass the necessary journal entry when 10,000 debentures of Rs 100 each are issued as collateral security against a bank loan of 7 8,00,000. (Delhi 2011)
Ans.

JOURNAL

Date	Particulars		LF	Amt (Dr)	Amt (Cr)
	Debenture Suspense A/c	Dr		10,00,000	
	To Debentures A/c				10,00,000
	(Being 10,000 debentures of ₹ 100 each issued as collateral security)				

5. Why would an investor prefer to invest in the debentures of a company rather than in its share?(Delhi; All India; Foreign 2009)
Ans. An investor would prefer to invest in the debentures of a company rather than in its shares to ensure fixed and assured return as well as safety of his investments.

6. Why would an investor prefer to invest partly in shares and partly in the debentures Of a company? (All India; Delhi 2009)
Ans. An investor would prefer to invest partly in shares and partly in debentures to have high return as well as to reduce the risk.

7. Why would an investor prefer to invest in the debentures of a company rather than in its share? (Delhi; All India; Foreign 2009)
Ans. An investor would prefer to invest in the debentures of a company rather than in its shares to ensure fixed and assured return as well as safety of his investments.

8. Why would an investor prefer to invest partly in shares and partly in the debentures Of a company? (All India; Delhi 2009)
Ans. An investor would prefer to invest partly in shares and partly in debentures to have high return as well as to reduce the risk.