

CHAPTER 8

Accounting for Debentures

DEBENTURES :A debenture is a document that either creates a debt or acknowledges it. In corporate finance, the term is used for a medium- to long-term debt instrument used by large companies to borrow money. In some countries the term is used interchangeably with bond, loan stock or note. A debenture is thus like a **certificate of loan** or a loan bond evidencing the fact that the company is liable to pay a specified amount with interest and although the money raised by the debentures becomes a part of the company's capital structure, it does not become share capital.

Note : Debenture is instrument that is not secured by physical asset or collateral

In case of bond interest is not declared.

Debentures are generally freely transferable by the debenture holder. Debenture holders have no rights to vote in the company's general meetings of shareholders, The interest paid to them is a charge against profit in the company's financial statements.

Types of debentures

Convertibility point of view : there are two types of debentures:

Convertible debentures, which are can be converted into equity shares of the issuing company after a predetermined period of time.

These may be Partly Convertible Debentures (PCD): A part of these instruments are converted into Equity shares in the future at notice of the issuer. The issuer decides the ratio for conversion. This is normally **decided at the time of subscription**.

· Fully convertible Debentures (FCD): These are fully convertible into Equity shares at the issuer's notice. The ratio of conversion is decided by the issuer. Upon conversion the investors enjoy the same status as ordinary shareholders of the company.

Non-convertible debentures, which are simply regular debentures, cannot be converted into equity shares of the liable company. They are debentures without the convertibility feature, they usually carry higher interest rates than their convertible counterparts.

On basis of Security, debentures are classified into:

Secured Debentures: These instruments are secured by a charge on the fixed assets of the issuer company. So if the issuer fails on payment of either the principal or interest amount, his assets can be sold to repay the liability to the investors

Unsecured Debentures: These instrument are unsecured in the sense that if the issuer defaults on payment of the interest or principal amount, the investor is treated like along other unsecured creditors of the company .

From redemption point of view

Redeemable Debentures:- Redeemable debentures are those which are redeemed or paid off after the termination of fixed term. The amount paid off includes the principal amount and the current year's interest. The company always has the option of either to redeem a specific number of debentures each year or redeem all the debentures at

specified date.

Irredeemable or Perpetual Debentures:- Irredeemable debentures are those debentures which do not have any fixed date of redemption. They are redeemed either in the event of winding up or at a very remote period of time. Irredeemable or perpetual debenture holders

can never force the company to redeem their debentures.

Issue of Debentures :

Debentures can be issued in two ways

1 . for cash

2. for consideration other than cash

3. As collateral security

Terms of issue of: Debentures can be issued in two ways

1 .Issue of Debentures at Par

2. Issue of Debentures at Premium

Debentures payable in Instalments

1. First instalment paid along with application is called as application money

2. Second instalment paid on allotment is called as allotment money

3. Subsequent instalments paid are called as call money calls can be more than one and called First call, second call or as the case may be ISSUE OF Debentures FOR CASH

AT PAR : This means shares are issued at face value

JOURNAL ENTRIES

On receipt of application	Bank Account To Debenture Application Account	Dr.	With the application money received
On acceptance of application	Debenture Application Account To Debenture Account	Dr.	With the amount of application money on allotted debentures
On making allotment money due	Debenture Allotment Account To Debenture Account	Dr.	With the amount due on allotment of debentures
On adjustment of excess debenture application money	Debenture Application Account To Bank Account	Dr.	With the surplus money on rejected shares
On receipt of allotment money	Bank Account To Debenture Allotment Account	Dr.	With the amount actually received
On making calls	Debenture Call Account To Debenture Account	Dr.	With the amount due on particular call of debentures
On receipt of call money	Bank Account		With the amount actually received

Issue of Debenture at par : This means Debentures are issued at face value

Example

Raj Ltd. Issued 2,000 12% Debentures of Rs.100 each at par payable Rs.25 on Application, Rs.50 on Allotment and the balance on first and final call. In all 3,000 application were received. Allotment was made to 2,000 applicants others were rejected. Give Journal entries.

JOURNAL

Date	Particulars	L.F.	Debit ₹	Credit ₹
	Bank Account Dr. To 12% Debenture Application Account (Being the application money received on 3,000 debentures @Rs.25 per debenture)		75,000	75,000
	12% Debenture Application Account Dr. To 12% Debenture Account To Bank Account (Being the transfer of application money to debenture account and refund made on rejelected Applications)		75,000	50,000 25,000
	12% Debenture Allotment Account Dr. To 12% Debenture Account (Being the allotment money due on 2,000 debentures @Rs.50)		1,00,000	1,00,000
	Bank Account Dr. To 12% Debenture Allotment Account (Being the application money received)		1,00,000	1,00,000
	12% Debenture First & Final Call Account Dr. To 12% Debenture Account (Being the call money due on 2,000 debentures @ Rs.25)		50,000	50,000
	Bank Account Dr. To 12% Debentur First & Call Account (Being the application money received)		50,000	50,000

Importan : If % of debenture is given then it must be written along with Debenture

ISSUE OF DEBENTURES AT PREMIUM : It is issue of Debenture at more than face value

Note : Premium is Presumed To be Demanded on Allotment Unless Specified and Credited to Securities Premium Account

Example Z Ltd. Invited applications for 5,000, 8% Debentures of Rs.100 each at a premium of 2%, Rs.40 were payable on Application and balance an allotment. Applications were received for 4,800 shares and accepted in full. All money duly received. Journalise the transactions.

Date	Particulars	L.F.	Debit ₹	Credit ₹
	Bank Account Dr. To Debenture Application Account (Being the application money received on 4800 debentures @Rs.40 per debenture)		1,92,000	1,92,000
	8% Debenture Application Account Dr. To Debenture Account (Being the transfer of application money to 8% debenture account)		1,92,000	1,92,000
	12% Debenture Allotment Account Dr. To 8% Debenture Account To Security Premium Account (Being the allotment money due on 4,800 debentures @Rs.60 and premium of Rs.2 share)		2,97,600	288000 9600
	Bank Account Dr. To Debenture Allotment Account (Being the application money received)		2,97,600	2,97,600

Oversubscription of debentures : In such case excess application are rejected or partial or Pro-rata allotment is done or combination of both is carried on.

Ganga Ltd. issued 2,000 debentures of Rs.100 each at a premium of 10% payable Rs.25 on application Rs.40 (including premium) payable on allotment and balance on First and final Call. In all 3,500 application were received 500 application were rejected and allotment was made to applicants of 3,000 debentures on Pro-rata basis. The excess money was adjusted on allotment. Give journal entries.

Date	Particulars	L.F.	Debit ₹	Credit ₹
	Bank Account Dr. To 12% Debenture Application Account (Being the application money received on 3,500 debentures @Rs.25 per debenture)		87,500	87,500
	12% Debenture Application Account Dr. To 12% Debenture Account To Bank Account To Debenture Allotment Account (Being the transfer of application money to debentureaccountand refund made on rejected Applications)		87,500	50,000 12,500 25,000

12% Debenture Allotment Account Dr. To 12% Debenture Account To Security Premium Account (Being the allotment money due on 2,000 debentures @Rs.30 and premium of Rs.10)	80,000	60,000 20,000
Bank Account Dr. To 12% Debenture Allotment Account (Being the application money received Rs.80,000-Rs.25,000)	55,000	55,000
12% Debenture First & Final Call Account Dr. To 12% Debenture Account (Being the call money due on 2,000 debentures @Rs.45)	90,000	90,000
Bank Account Dr. To 12% Debenture First & Call Account (Being the application money received)	90,000	90,000

Issue of debentures for consideration other than cash

When Debentures are issued for purchase of asset

When Debentures are issued for purchase of asset at par	Sundry Asset Account Dr. To Vendor	With the purchase consideration
	Vendor Dr. To Debenture Account	
When Debentures are issued for purchase of asset at premium	Sundry Assets Account Dr. To Vendor	With the purchase Consideration No. of debentures x par value No. of debentures x premium
	Vendor Dr. To Debenture Account To Security Premium Account	
When business is purchased and debentures issued	When Purchase consideration is equal to net value of assets Sundry Assets Account Dr. To Sundry Liabilities Account To Vendor	Value of asset Value of liability Purchase consideration
	When Purchase consideration more than net value of assets Sundry Asset Account Dr. Goodwill account Dr. To Sundry Liabilities Account	

	To Vendor When Purchase consideration is less than net value of asset Sundry Assets Account Dr To Sundry Liabilities Account To Capital Reserve To Vendor	Purchase Consideration Value of asset Value of liability Excess liability Purchase consideration
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Example : A company purchased assets of book value of Rs.99,000 from Girish. It was agreed that Purchase consideration be paid by issuing 11% Debentures of Rs.100 each. Assume Debentures have been issued (i) at par (ii) at a premium of 10%.

Give Journal

Date	Particulars	L.F.	Debit ₹	Credit ₹
(i)	Sundry Assets Account Dr. To Girish (for assets purchase)		99,000	99,000
(ii)	Debentures are issued at par Girish Dr. To 11% Debentures (For the issue of debenture at par)		99,000	99,000
	Debentures are issued at premium Girish Dr. To 11% Debentures To Security Premium Account For issue of 900 debentures of Rs.100 each at 10% premium)		99,000	90,000 9,000

When Purchase consideration is more than net value of assets

A company issued debentures of Rs.100 each at par for the purchase of the following assets and liabilities from Gupta Bros. at purchase consideration of Rs.15,00,000

Plant- Rs.3,50,000 Stock Rs.4,50,000
Land and Building Rs.6,00,000 Sundry Creditors Rs.1,00,000

pass necessary Journal entries

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Date	Particulars	L.F.	Debit ₹	Credit ₹
	Plant Account Dr. Land and Building Account Dr. Stock Account Dr.		3,50,000 6,00,000 4,50,000	

	Goodwill Account	Dr.	2,00,000	
	To Sundry creditors Account			1,00,000
	To Gupta Bros.			15,00,000
	(Being the purchase of business)			
	Gupta Bros			
	To Debenture Account		15,00,000	
	(Being issue of 15,000 shares of Rs.100 each as payment of business price)			15,00,000

Calculation : Goodwill = purchase consideration+liabilities
assets = Rs.15,00,000+Rs.1,00,000-Rs.14,00,000 =Rs.1,00,000

When Purchase consideration is less than net value of assets

Zee Ltd. Took over the following assets and liabilities of business of Usha Ltd.

ASSETS : Machinery-Rs.1,00,000, Furniture Rs.1,80,000 Stock-Rs.20,000

Liabilities - Creditors Rs.80,000

The purchase price was agreed at Rs.1,08,000. This is to settle by issue of 12% Debentures at premium of 20% pass necessary Journal entries.

Date	Particulars	L.F.	Debit ₹	Credit ₹
	Machine Account	Dr.	1,00,000	
	Furniture Account	Dr.	1,80,00	
	Stock Account	Dr.	20,000	
	To Creditors Account			80,000
	To Capital Reserve			1,12,000
	To Usha Co. Ltd.			1,08,000
	(Being the purchase of business)			
	Usha Co. Ltd.			
	To 12% Debenture Account			
	To Security Premium Account			
	Being issue of 900 debentures of Rs.100 each at premium of 20%)			

Calculations ; Net assets = total assets-liabilities = Rs.3,00,000-Rs.80,000=Rs.2,20,000

Capital reserve = Net assets - purchase consideration = Rs.2,20,000-Rs.1,08,000 = Rs.1,12,000

Collateral security means security provided to lender in addition to the principal security. It is a subsidiary or secondary security. Whenever a company takes loan from bank or any financial institution it may issue its debentures as secondary security which is in addition to the principal security. Such an issue of debentures is known as 'issue of debentures as collateral security'. The lender will have a right over such debentures only when company fails to pay the loan amount and the principal security is exhausted. In case the need to

When Debentures are issued at par and redeemable at par

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Date	Particulars	L.F.	Debit ₹	Credit ₹
	Bank Account Dr. To % Debenture Application Account (Being the application money received)			
	Debenture Application Account Dr. to % Debenture Account (Being the transfer of application money to debenture account)			

Example : Larsen and Tourbo Ltd. Issued 50,000 8% debentures of Rs.100 each payable on application at par and redeemable at par any time after 7 years from the date of the issue Record necessary entries for the issue of debentures in the book of Company.

Solution : Books of Larsen & Turbo Ltd. Issued 50,000 8% debentures of Rs.100 each payable on application at par and redeemable at par any time after 7 years from the date of the issue Record necessary entries for the issue of debentures in the book of Company.

Solution : Books of Larsen & Toubro Ltd.

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Date	Particulars	L.F.	Debit ₹	Credit ₹
	Bank Account Dr. To % Debenture Application Account (Being the application money received)		50,00,000	50,00,000
	Debenture Application Account Dr. To % Debentures Account (Being the transfer of application money to debenture account)		50,00,000	50,00,000

When Debentures are issued at premium redeemable at par

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Date	Particulars	L.F.	Debit ₹	Credit ₹
	Bank Account Dr. To % Debenture Application Account (Being the application money received)			
	Debenture Application Account Dr. To % Debenture Account To Security Premium Account (Being the debenture issued at premium and redeemable at par)			

Example : Green Ltd. Issued Rs.80,000, 9% Debenture at a premium of 5% redeemable at par Give the necessary Journal entry.

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Date	Particulars	L.F.	Debit ₹	Credit ₹
	Bank Account Dr. To % Debenture Application Account (Being the application money received)		84,000	84,000
	Debenture Application Account Dr. To % Debenture Account To Security Premium Account (Being the debenture issued at premium and redeemable at par)		84,000	80,000 4,000

When Debentures are issued at par redeemable at premium

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Date	Particulars	L.F.	Debit ₹	Credit ₹
	Bank Account Dr. To % Debenture Application Account (Being the application money received)			
	Debenture Application Account Dr. Loss on issue of Debenture Account Dr. To % Debenture Account To Security Premium Account (Being the debenture issued at premium and redeemable at par)			

Example : White Ltd. Issued Rs.60,000, 9% Debenture at par & redeemable at 10% premium. Give the necessary Journal entry.

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Date	Particulars	L.F.	Debit ₹	Credit ₹
	Bank Account Dr. To % Debenture Application Account (Being the application money received)		60,000	60,000
	Debenture Application Account Dr. Loss on issue of Debenture Account Dr. To % Debenture Account To Security Premium Account (Being the debenture issued at premium and redeemable at par)		60,000 6,000	60,000 6,000

When Debentures are issued at Premium redeemable at premium

Date	Particulars	L.F.	Debit ₹	Credit ₹
	Bank Account Dr. To % Debenture Application Account (Being the application money received) Debenture Application Account Dr. Loss on issue of Debenture Account Dr. To % Debenture Account To Premium on Redemption of Debenture account (Being the debenture issued at premium and redeemable at premium)			

Example : Give Journal Entry assuming the face value of 10% debentures at Rs.100 issued at Rs.105 and repayable at Rs.110.

Date	Particulars	L.F.	Debit ₹	Credit ₹
	Bank Account Dr. To % Debenture Application Account (Being the application money received)		105	105
	Debenture Application Account Dr. Loss on issue of Debenture Account Dr. To % Debenture Account To Security Premium Account To Premium on Redemption of Debenture account (Being the debenture issued at 5% premium and redeemable at 10% premium)		105 10	100 5 10

WRITING OFF LOSS ON ISSUE OF DEBENTURES

The loss on issue of debentures is fictitious asset and shown on assets side of Balance Sheet and should be written off as soon as possible by debiting profit and loss account

Profit and Loss Account Dr.
To Loss on issue of Debentures A/c

WRITING OFF LOSS ON ISSUE OF DEBENTURES

First Method : When debentures are redeemed after fixed period here loss is spread equally over life of debenture therefore called equal instalment method.

Example : A limited company has issued Rs.1,00,000 9% debentures at a discount of 6% 1st Jan 2000. These debentures are to be redeemed equally over 3 years starting from the end of 1st year show discount on issue account for 3 years

Loss on issue of Debentures Account = Amount x rate/100 = 1,00,000x6/100
= Rs.6.

		Rs.		Rs.	
1.1.2000	To 9% Debenture Account	6,000	31.12.2001	By Profit Loss Account	2,400
				By Balance c/d	3,600
		6,000			6,000
1.1.2001	To Balance b/d	3,600	31.12.2001	By Profit & Loss Account	1,800
				By Balance c/d	1,800
		3,600			3,600
1.1.2002	To Balance b/d	1,800	31.12.2002	By Profit & Loss Account	1,200
		1,800			1,800
1.1.2003	To Balance b/d	600	31.12.2003	By Profit & Loss Account	600

Proportion Method or variable instalment method : In this method loss on issue of debenture is written off each year in proportion to amount of debenture which reduces with every instalment paid

Example : A limited company has issued Rs.1,00,000 9% debentures at a discount of 6% 1st Jan 2000. These debenture are to be redeemed in equal instalments over 4 years starting from the end of 1st year show discount on issue account for 4 years.

Loss on issue of Debentures Account = Amount x rate/100= 1,00,000x6/100 = Rs.6,000

Year	Outstanding Debentures	Ratios	Amount of Loss to be written off
Ist	1,00,000		Rs.6,000x4/10=Rs.2,400
2nd	75,000	3	Rs.6000x $\frac{3}{10}$ = Rs.1,800
3rd	50,000	2	Rs.6000x2/10=Rs.1,200
4th	25,000	1	Rs.6000x1/10 = Rs.600

Discount on issue of Debenture Account

1.1.2000	To 9% Debenture Account	Rs. 6,000	31.12.2000	By Profit & Loss Account	Rs. 2,000
				By Balance c/d	4,000
		6,000			6,000
1.1.2001	To Balance b/d	4,000		By Profit & Loss Account	2,000
1.1.2002	To Balance b/d	4,000			4,000
		2,000		By Profit & Loss Account	2,000

Interest on Debentures :

Interest on Debentures is calculated at a final rate on its face value and is usually payable half yearly & is paid even company is suffering from loss because it is charge on profit.

Income Tax is deducted from interest before payment to debenture holders

Journal Entries

- (1) When Interest is Due

	Debenture's interest A/c	Dr	(Green Interest)
	To Debenture holder A/c		(Net interest)
	To Income Tax Payable A/c		(Income Tax deducted)
- (2) When interest is paid

	Debenture holder A/c	Dr	(With interest)
	To Bank A/c		
- (3) On payment of Income Tax to Government

	Income Tax payable at	Dr	
	To Bank A/c		(Amount of Income tax deducted at source)
- (4) On transfer of interest on debenture to Profit & loss Account

	Profit & Loss A/c	Dr.	
	To Debenture interest A/c		(amount of interest)

Illustration :

ABC Company Ltd., had 6% debentures of Rs.1,00,000 on 1st January 2009 on which interest is paid on 30th June and 31st December pass necessary journal entries for the payment of interest for the year 2009, 10% tax is deducted at source from interest and remitted immediately. Books are closed on 31st December.

Date	Particulars	L.F.	Debit ₹	Credit ₹
June 30 2009	Interest on Debenture A/c Dr. To Interest Account A/c To Income Tax Interest Accrued Tax Payable		3,000	2,700 300
June 30	Interest Accrued A/c Dr.		2,700	

2009	Tax Payable A/c To Bank (Interest & tax paid)		300	3,000
Dec.31 2009	Interest on Debenture A/c To Interest Accrued To Tax Payable	Dr.	3,000	2,700 300
Dec. 31 2009	Interest Accrued Tax Payable A/c To Bank (Interest & tax paid)	Dr. Dr.	2,700 300	3000
Dec.31	Profit & Loss Account To Interest on Debenture A/c (Interest transfered to P&L Account)	Dr.	6,000	6,000

Insert on Debentures :

Insert on Debentures is calculated at a fixed rate on its face value and is usually payable half yearly is paid even company is suffering from loss because it is change on profit. Income Tax is deducted from interest before payment to debenture holders

JOURNALENTRIES

(1) When Interest is Due	Debenture's interest A/c To Debenture holder A/c To Income Tax Payable A/c	Dr.	(Gross Interest) (Net Interest) (Income Tax deducted)
(2) When Interest is paid	Debenture holder A/c To Bank A/c	Dr.	(With interest)
(3) On payment of Income Tax to Government	Income Tax Payable A/c To Bank A/c	Dr.	(Amount of Income Tax deducted at source)
(4) On transfer of interest on debenture to profit and loss Account	Profit & Loss A/c To Debenture interest A/c	Dr.	(Amount of Interest)

Illustration

ABC Company Ltd., had 6% debentures of Rs.1,00,000 on 1st January 2009 on which interest is paid on 30th June and 31st December. Pass necessary journal entries for the payment of interest for the year 2009. 10% tax is deducted at source from interest and remitted immediately. Books are closed on 31st December.

ABC Ltd.
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Date	Particulars	L.F.	Dr. Amount	Cr.Amount
June 30 2009	Interest on Debenture A/c Dr. To Interest Account A/c To Income Tax (Interest Accued less Tax Payable)		3,000	2,700 300
June 30	Interest Accrued A/c Dr. Tax Payable A/c Dr. To Bank (Interest & Tax paid)		2,700 3,00	3,000
Dec.31	Interest on Debenture A/c Dr. To Interest Accrual To Tax Payable		3,000	2,700 300
Dec.31	Interest Accrual Dr. Tax Payable A/c Dr. To Bank (Interest & Tax Paid)		2,700 300	3000
Dec.31	Profit and Loss Account Dr. To Interest on Debenture A/c (Interest Transferred to P & L Account)		6,000	6,000

- (1) When Interest is Due
 Debenture's interest A/c Dr (Green Interest)
 To Debenture holder A/c (Net interest)
 To Income Tax Payable A/c (Income Tax deducted)
- (2) When interest is paid
 Debenture holder A/c Dr (With interest)
 To Bank A/c
- (3) On payment of Income Tax to Garenment
 Income Tax payable at Dr
 To Bank A/c (Amount of Income tax
 deducted at source)
- (4) On transfer of interest on debenture to Profit & loss Account
 Profit & Loss A/c Dr.
 To Debenture interest A/c (amount of interest)