

REDEMPTION OF DEBENTURES

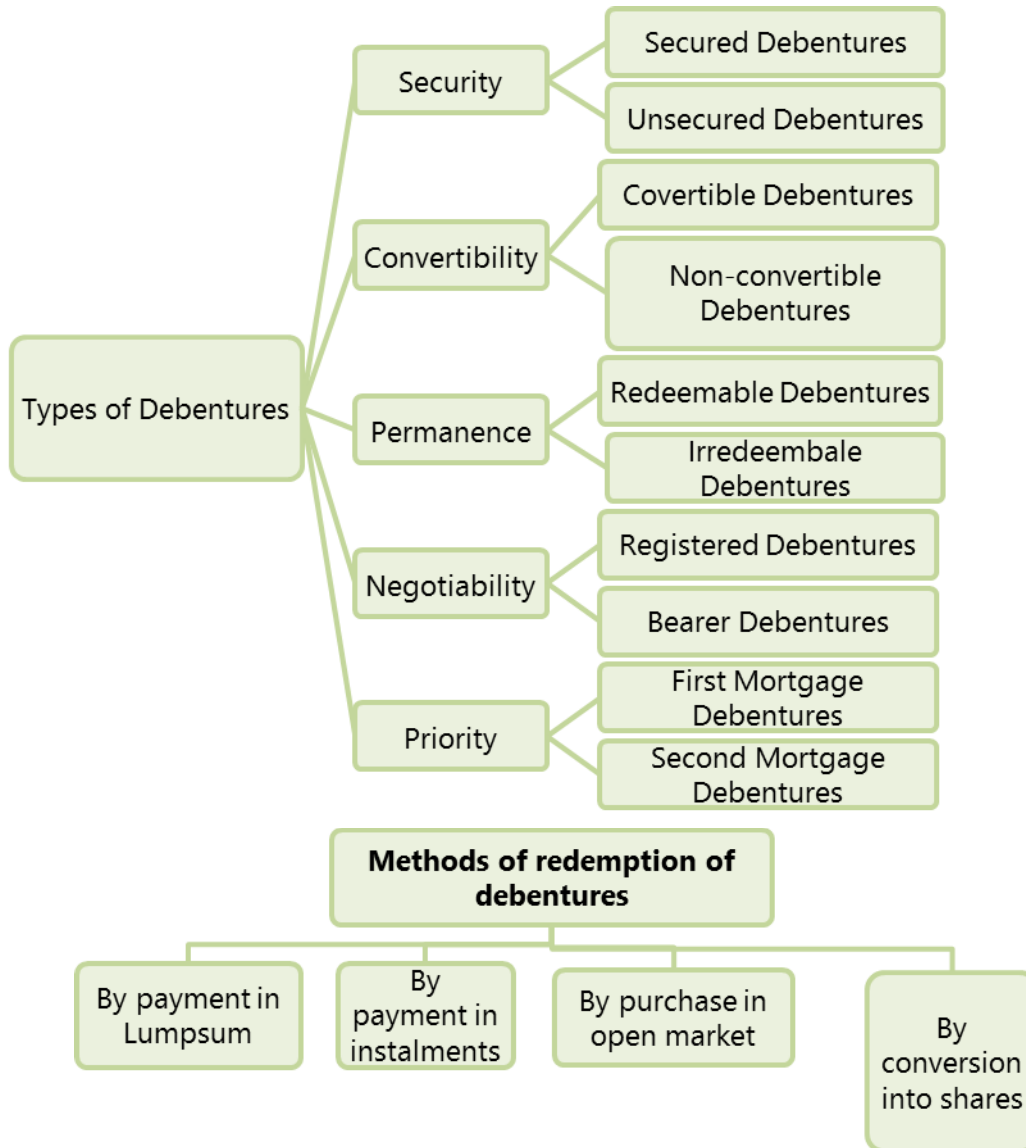


LEARNING OUTCOMES

After studying this unit, you will be able to–

- ❑ Understand about the redemption of debentures;
- ❑ Understand the requirement of creation of Debenture Redemption Reserve and making investments for the purpose of redemption of debentures;
- ❑ Understand various methods for redemption of debentures;
- ❑ Understand the accounting treatment of redemption of debentures;
- ❑ Solve problems based on redemption of debentures.

CHAPTER OVERVIEW



1. INTRODUCTION

A debenture is an instrument issued by a company under its seal, acknowledging a debt and containing provisions as regards repayment of the principal and interest.

Under Section 71 (1) of the Companies Act, 2013, a company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption.

Provided that the issue of debentures with an option to convert such debentures into shares, wholly or partly, should be approved by a special resolution passed at a duly convened general meeting.

Section 71 (2) further provides that no company can issue any debentures which carry any voting rights.

Section 71 (4) provides that where debentures are issued by a company, the company should create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account should not be utilised by the company for any purpose other than the redemption of debentures.

Basic provisions

If a charge has been created on any asset or the entire assets of the company,

- the nature of the charge
- the asset(s) charged

are described therein.

- Since the charge is not valid unless registered with the Registrar, his certificate registering the charge is printed on the bond.
- It is also customary to create a trusteeship in favour of one or more persons in the case of mortgage debentures. The trustees of debenture holders have all powers of a mortgage of a property and can act in whatever manner they think necessary to safeguard the interest of debenture holders.

As per Rule 18(2) of the Companies (Share Capital and Debentures) Rules, 2014, the company shall appoint debenture trustees as required under sub-section (5) of section 71 of the Companies Act 2013, after complying with certain conditions mentioned in that rule.

Note: *Issue of debentures has already been discussed in detail at Foundation level. Students are advised to refer the Foundation study material chapter 10 for understanding of the requirements relating to issue of debentures.*



2. REDEMPTION OF DEBENTURES

Debentures are usually redeemable i.e. either redeemed in cash or convertible after a time period.

Redeemable debentures may be **redeemed**:

- after a **fixed number** of years; or
- any time after a **certain number of years** has elapsed since their issue; or
- on giving a **specified notice**; or
- by **annual drawing**.

A company may also purchase its debentures, as and when convenient, in the open market and when debentures are quoted at a discount on the Stock Exchange, it may be profitable for the company to purchase and cancel them.

As per Rule 18 (1) of the Companies (Share Capital and Debentures) Rules, 2014, the company shall not issue secured debentures, unless it complies with the following conditions, namely:

- a. An issue of secured debentures may be made, provided the date of its redemption shall not exceed ten years from the date of issue:

Provided that the following classes of companies may issue secured debentures for a period exceeding ten years but not exceeding thirty years,

- (i) Companies engaged in setting up of infrastructure projects;
- (ii) Infrastructure Finance Companies' as defined in clause (viiia) of sub-direction (1) of direction 2 of Non-Banking Financial (Non-deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007;
- (iii) Infrastructure Debt Fund Non-Banking Financial Companies' as defined in clause (b) of direction 3 of Infrastructure Debt Fund Non-Banking Financial Companies (Reserve Bank) Directions, 2011;
- (iv) Companies permitted by a Ministry or Department of the Central Government or by Reserve Bank of India or by the National Housing

Bank or by any other statutory authority to issue debentures for a period exceeding ten years.

- b. such an issue of debentures shall be secured by the creation of a charge on the properties or assets of the company or its subsidiaries or its holding company or its associate companies, having a value which is sufficient for the due repayment of the amount of debentures and interest thereon.
- c. the company shall appoint a debenture trustee before the issue of prospectus or letter of offer for subscription of its debentures and not later than sixty days after the allotment of the debentures, execute a debenture trust deed to protect the interest of the debenture holders; and
- d. the security for the debentures by way of a charge or mortgage shall be created in favour of the debenture trustee on-
 - (i) any specific movable property of the company or its holding company or subsidiaries or associate companies or otherwise.
 - (ii) any specific immovable property wherever situate, or any interest therein:

Provided that in case of a non-banking financial company, the charge or mortgage under sub-clause (i) may be created on any movable property.

Provided further that in case of any issue of debentures by a Government company which is fully secured by the guarantee given by the Central Government or one or more State Government or by both, the requirement for creation of charge under this sub-rule shall not apply.

Provided also that in case of any loan taken by a subsidiary company from any bank or financial institution the charge or mortgage under this sub-rule may also be created on the properties or assets of the holding company.

3. DEBENTURE REDEMPTION RESERVE

A company issuing debentures is required to create a debenture redemption reserve account out of the profits available for distribution of dividend and amounts credited to such account cannot be utilised by the company except for redemption of debentures. Such an arrangement would ensure that the company will have sufficient liquid funds for the redemption of debentures at the time they fall due for payment.

An appropriate amount is transferred from profits every year to Debenture Redemption Reserve and its investment is termed as Debenture Redemption Reserve Investment. In the last year or at the time of redemption of debentures, Debenture Redemption Reserve Investments are encashed and the amount so obtained is used for the redemption of debentures.

3.1 LIABILITY OF THE COMPANY TO CREATE DEBENTURE REDEMPTION RESERVE

Section 71 of the Companies Act 2013 covers the requirement of creating a debenture redemption reserve account. Section 71 states as follows:

- (1) Where a company issues debentures under this section, it should create a debenture redemption reserve account out of its profits which are available for distribution of dividend every year until such debentures are redeemed.
- (2) The amounts credited to the debenture redemption reserve should not be utilised by the company for any purpose except for the purpose aforesaid.
- (3) The company should pay interest and redeem the debentures in accordance with the terms and conditions of their issue.
- (4) Where a company fails to redeem the debentures on the date of maturity or fails to pay the interest on debentures when they fall due, the Tribunal may, on the application of any or all the holders of debentures or debenture trustee and, after hearing the parties concerned, direct, by order, the company to redeem the debentures forthwith by the payment of principal and interest due thereon.

3.2 BALANCE IN DEBENTURE REDEMPTION RESERVE (DRR)

When the company decides to establish the Debenture Redemption Reserve Account, the amount indicated by the Debenture Redemption Reserves tables is credited to the Debenture Redemption Reserve account and debited to profit and loss account. That shows the intention of the company to set aside sum of money to build up a fund for redeeming debentures. Immediately, the company should also purchase outside investments. The entry for the purpose naturally will be to debit Debenture Redemption Reserve investments and credit bank.

If the debentures are purchased within the interest period, the price would be inclusive of interest provided these are purchased "Cum-interest"; but if purchased "Ex-interest", the interest to the date of purchase would be payable to the seller additionally. In order to adjust the effect thereof the amount of interest accrued till the date of purchase, if paid, is debited to the Interest Account

against which the interest for the whole period will be credited. As a result, the balance in the account would be left equal to the interest for the period for which the debentures were held by the company.

3.3 ADEQUACY OF DEBENTURE REDEMPTION RESERVE (DRR)

As per Rule 18 (7) of the Companies (Share Capital and Debentures) Rules, 2014, the company shall create a Debenture Redemption Reserve for the purpose of redemption of debentures, in accordance with the conditions given below—

- a. the Debenture Redemption Reserve shall be created out of the profits of the company available for payment of dividend;
- b. the company shall create Debenture Redemption Reserve (DRR) in accordance with conditions given in below table:

		Adequacy of Debenture Redemption Reserve (DRR)
(i)	For debentures issued by All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures	No DRR is required
(ii)	For other Financial Institutions (FIs) within the meaning of clause (72) of section 2 of the Companies Act, 2013	DRR will be as applicable to NBFCs registered with RBI (as per (iii) below)
(iii)	For debentures issued by NBFCs registered with RBI under section 45-IA of the RBI (Amendment) Act, 1997 and for Housing Finance Companies registered with National Housing Bank	25% of the value of outstanding debentures issued through public issue. No DRR is required in the case of privately placed debentures.
(iv)	For debentures issued by other companies including manufacturing and infrastructure companies	25% of the value of outstanding debentures issued through public issue. Also 25% DRR is required in the case of privately placed debentures by

		<p>listed companies.</p> <p>For unlisted companies issuing debentures on private placement basis, the DRR will be 25% of the value of outstanding debentures.</p>
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Note:

Where a company intends to redeem its debentures prematurely, it may provide for transfer of such amount in Debenture Redemption Reserve as is necessary for redemption of such debentures even it exceeds the limits specified in this sub-rule.

3.4 INVESTMENT OF DEBENTURE REDEMPTION RESERVE (DRR) AMOUNT

Further, as per Rule 18 (7) of the Companies (Share Capital and Debentures) Rules, 2014, every company required to create DRR shall on or before the 30th day of April of each year, deposit or invest, as the case may be, a sum which should not be less than 15% of the amount of its debentures maturing during the year ending on the 31st day of March of next year, in any one or more of the following methods, namely:

- (a) in deposits with any scheduled bank, free from charge or lien;
- (b) in unencumbered securities of the Central Government or of any State Government;
- (c) in unencumbered securities mentioned in clauses (a) to (d) and (ee) of Section 20 of the Indian Trusts Act, 1882;
- (d) in unencumbered bonds issued by any other company which is notified under clause (f) of Section 20 of the Indian Trusts Act, 1882.

The amount deposited or invested, as the case may be, above should not be utilised for any purpose other than for the repayment of debentures maturing during the year referred to above.

Provided that the amount remaining deposited or invested, as the case may be, shall not at any time fall below 15% of the amount of debentures maturing during the 31st day of March of that year.

In case of partly convertible debentures, DRR shall be created in respect of non-convertible portion of debenture issue in accordance with this sub-rule.

The amount credited to DRR shall not be utilised by the company except for the

purpose of redemption of debentures.

Note:

It should be noted that appropriation to DRR can be made any time before redemption and Investments in specified securities as mentioned above can be done before 30th April for the debentures maturing that year, however, for the sake of simplicity and ease, it is advisable to make the appropriation and investment immediately after the debentures are allotted assuming that the company has sufficient amount of profits (issued if allotment date is not given in the question). Also in some cases, the date of allotment could be missing, in such cases the appropriation and investments should be done on the first day of that year for which ledgers accounts are to be drafted.

3.5 JOURNAL ENTRIES

The necessary journal entries passed in the books of a company are given below:

1. After allotment of debentures

- (a) For setting aside the fixed amount of profit for redemption
- | | |
|-------------------------------------|-----|
| Profit and Loss A/c | Dr. |
| To Debenture Redemption Reserve A/c | |
- (b) For investing the amount set aside for redemption
- | | |
|---|-----|
| Debenture Redemption Reserve Investment A/c | Dr. |
| To Bank A/c | |
- (c) For receipt of interest on Debenture Redemption Reserve Investments
- | | |
|--|-----|
| Bank A/c | Dr. |
| To Interest on Debenture Redemption Reserve Investment A/c | |
- (d) For transfer of interest on Debenture Redemption Reserve Investments (DRRI)
- | | |
|---|-----|
| Interest on Debenture Redemption Reserve Investment A/c | Dr. |
| To Profit and loss A/c* | |

** Considering the fact that interest is received each year through cash/bank account and it is not re-invested. In the illustrations given in the chapter, the same has been considered and hence interest on DRR investment is not credited to DRR A/c but taken to P&L A/c.*

2. At the time of redemption of debentures

- (a) For encashment of Debenture Redemption Reserve Investments
- | | |
|--|-----|
| Bank A/c | Dr. |
| To Debenture Redemption Reserve Investment A/c | |
- (b) For amount due to debentureholders on redemption
- | | |
|-------------------------|-----|
| Debentures A/c | Dr. |
| To Debentureholders A/c | |
- (c) For payment to debentureholders
- | | |
|----------------------|-----|
| Debentureholders A/c | Dr. |
| To Bank A/c | |
- (d) After redemption of debentures, DRR should be transferred to general reserve
- | | |
|--------------------|-----|
| DRR A/c | Dr. |
| To General Reserve | |

Note: In case, the company purchases its own debentures in the market, additional set of accounting entries would be passed (refer para 4.3 of this chapter for the guidance).

4 METHODS OF REDEMPTION OF DEBENTURES

Redemption of debentures must be done according to the terms of issue of debentures and any deviation therefrom will be treated as a default by the company.

Redemption by paying off the debt on account of debentures issued can be done in one of the three methods viz:

4.1 BY PAYMENT IN LUMP SUM

Under payment in lumpsum method, at maturity or at the expiry of a specified period of debenture the payment of entire debenture is made in one lot or even before the expiry of the specified period.

4.2 BY PAYMENT IN INSTALMENTS

Under payment in instalments method, the payment of specified portion of

debenture is made in instalments at specified intervals.

4.3 PURCHASE OF DEBENTURES IN OPEN MARKET

Debentures sometimes are purchased in open market. In such a case Own Debenture Account is debited and bank is credited.

Suppose a company has issued 8% debentures for ₹ 10,00,000, interest being payable on 31st March and 30th September. The company purchases ₹ 50,000 debentures at ₹ 96 on 1st August 20X1. This means that the company will have to pay ₹ 48,000 as principal plus ₹ 1,333 as interest for 4 months.

Entry	₹	₹
Own Debentures (50,000 x 96/ 100)	Dr. 48,000	
Interest Account (50,000 x 8% x 4/12)	Dr. 1,333	
To Bank		49,333

It should be noted that even though ₹ 50,000 debentures have been purchased for ₹ 48,000 there is no profit. On purchase of anything, profit does not arise; only on sale, and in this case on cancellation of debentures, profit could arise.

These debentures cancelled on same date, the journal entries to be passed will be the following:

		₹	₹
8% Debentures A/c	Dr.	50,000	
To Own Debentures A/c			48,000
To Profit on cancellation of debentures			2,000
(Cancellation of ₹ 50,000 Debentures)			

Note: Students should refer to Illustration 1 for complete and detailed understanding of this concept.

Illustration 1

On January 1, Rama Ltd., had 500 Debentures of ₹ 100 each outstanding in its books carrying interest at 6% per annum. DRR balance is standing in books at ₹ 12,500. In accordance with the powers in the deed, the directors acquired debentures from the open market for immediate cancellation as follows:

March 1	₹ 5,000 at ₹ 98.00 (cum interest)
Aug. 1	₹ 10,000 at ₹ 100.25 (cum interest)
Dec. 15	₹ 2,500 at ₹ 98.50 (ex-interest)

Debenture interest is payable half-yearly, on 30th June and 31st Dec.

Show ledger accounts of Debentures and Debenture interest for the first year, ignoring income-tax.

Solution

6% Debentures Account

1st Half Year

		₹	₹		₹	
Mar. 1	To Bank-Debentures			Jan. 1	By Balance b/d	50,000
	Purchased [(5,000 x 98/ 100) – 50]	4,850				
	To Profit & Loss on cancellation of debenture A/c (5,000 – 4,850)	<u>150</u>	5,000			
June 30	To Balance c/d		45,000			
			<u>50,000</u>			<u>50,000</u>

Debenture Interest Account

		₹	₹		₹
Mar. 1	To Bank-Interest for 2 months on ₹ 5,000 Debentures @ 6%	50	June 30	By Profit & Loss A/c	1,400
June 30	To Debenture-holders (Interest) A/c (45,000 x 6% x 6/12)	1,350			
		<u>1,400</u>			<u>1,400</u>

2nd Half Year

6% Debentures Account

		₹	₹			₹
Aug. 1	To Bank-Debenture			July 1	By Balance b/d	45,000
	Purchased [(10,000 x 100.25/ 100) – 50]		9,975			
	To P & L A/c on Cancellation of debentures (10,000 – 9,975)		25			
Dec. 15	To Bank-Deb. (2,500 x 98.50/ 100) Purchased		2,462.50			
	To Profit & Loss on Cancellation of Debentures (2,500 – 2,462.50)		37.50			
Dec. 31	To Balance c/d		32,500			
			45,000			45,000

Debenture Interest Account

		₹			₹	
Aug. 1	To Bank - Interest for one month on ₹ 10,000 @ 6%		50.00	Dec.	By P & L Account	1,093.75
Dec. 15	To Bank (2,500 x 6% x 5.5/ 12)		68.75			
Dec. 31	To Debenture holders (32,500 x 6% x 6/12)		975.00			
			1,093.75			1,093.75

Notes:

- (i) Profit or loss on redemption of debenture arises only on sale or cancellation. Adjustments related to own purchases have been made in the debentures account directly since the cancellation also happened on the same day. If debentures are straightway cancelled on purchase, the profit or loss on redemption of debentures will be ascertained by comparing (i) the nominal value of debentures cancelled, and (ii) the price paid less interest to the date of purchase (if the transaction is cum-interest).
- (ii) Alternatively, Own Debentures Account can be debited on own purchase and the same can be knocked off against debentures account on cancellation i.e. Own debentures account will be credited and debenture Account debited on cancellation. The difference between the nominal value of the debentures cancelled and the amount standing to the debit on Own Debentures Account will be profit or loss on redemption of debentures.
- (iii) In case the transaction is ex-interest, the interest to the date of transaction will be paid in addition to the settled price and hence profit on redemption will be nominal value minus the settled price.

Illustration 2

The following balances appeared in the books of a company as on December 31, 20X1: 6% Mortgage 10,000 debentures of ₹ 100 each; Debenture Redemption Reserve (for redemption of debentures) ₹2,00,000 ; Investments in deposits with a scheduled bank, free from any charge or lien ₹ 1,50,000 at interest 4% p.a. receivable on 31st December every year. Bank balance with the company is ₹9,00,000.

The Interest on debentures had been paid up to December 31, 20X1.

On February 28, 20X2, the investments were realised at par and the debentures were paid off at 101, together with accrued interest.

Write up the concerned ledger accounts (excluding bank transactions). Ignore taxation.

Solution**6% Mortgage Debentures Account**

20X2		₹	20X2		₹
Feb. 28	To Debenture-holders A/c	10,00,000	Jan. 1	By Balance b/d	10,00,000

Premium on Redemption of Debentures Account

20X2		₹	20X2		₹
Feb. 28	To Debenture-holders A/c	10,000	Feb. 28	By Profit and loss A/c	10,000

Debentures Redemption Reserve Investment Account

20X2		₹	20X2		₹
Jan. 1	To Balance b/d	1,50,000	Feb. 28	By Bank	1,50,000

Debenture Interest Account

20X2		₹	20X2		₹
Feb. 28	To Bank (10,000 x 100 x 6% x 2/12)	10,000	Feb. 28	By Profit & Loss A/c	10,000

Bank A/c

20X2		₹	20X2		₹
Jan 01	To Balance b/d	9,00,000	Feb. 28	By Debenture-holders (10,000 x 101)	10,10,000
Feb 28	To Interest on Debentures Redemption Investments (1,50,000 x 4% x 2/12)	1,000			
	To Debentures Redemption Reserve investment A/c	1,50,000		By Deb. Interest A/c	10,000
		_____		By Balance c/d	31,000
		10,51,000			_____
					10,51,000

Debenture Redemption Reserve Account

20X2		₹	20X2		₹
Feb 28			Jan.1	By Balance b/d	2,00,000
			Jan.1	By Profit & Loss (b/f)	50,000

	To General Reserve-note	2,50,000			
		2,50,000			2,50,000

Note

Amount to be transferred to DRR before the redemption

$$2,50,000 = 25 \% \text{ of } (10,000 \times 100)$$

Illustration 3

Sencom Limited issued ₹ 1,50,000 5% Debentures on 30th September 20X0 on which interest is payable half yearly on 31st March and 30th September. The company has power to purchase debentures in the open market for cancellation thereof. The following purchases were made during the year ended 31st December, 20X2 and the cancellation were made on the same date. On 31 December 20X0, balance in the DRR of the company was ₹ 25,000 and investments made for the purpose of redemption were ₹ 20,000.

1st March 20X2 - ₹ 25,000 nominal value purchased for ₹ 24,725 ex-interest.

1st September 20X2 - ₹ 20,000 nominal value purchased for ₹ 20,125 cum-interest.

You are required to draw up the following accounts up to the date of cancellation:

- (i) *Debentures Account; and*
- (ii) *Own Debenture (Investment) Account.*

Ignore taxation.

Solution

**Sencom Limited
Debenture Account**

20X2		₹	20X2		₹
Mar 1	To Own Debentures	24,725	Jan 1	By Balance b/d	1,50,000
Mar 1	To Profit on cancellation (25,000-24,725)	275			
Sep 1	To Own Debentures (Note 3)	19,708			

Sep 1	To Profit on cancellation (20,000-19,708)	292			
Dec 31	Balance c/d	1,05,000			
		1,50,000			1,50,000

Own Debenture (Investment) Account

		Nominal Cost ₹	Interest ₹	Cost ₹			Nominal Cost ₹	Interest ₹	Cost ₹
20X2					20X2				
Mar 1	To Bank (W.N. 1)	25,000	521	24,725	Mar 1	By Debentures A/c	25,000	-	24,725
Sep 1	To Bank (W.N. 2 & 3)	20,000	417	19,708	Sep 1	By Debentures A/c	20,000	-	19,708
					Dec. 31	By P&L A/c		938	
		45,000	938	44,433			45,000	938	44,433

Working notes:

1. $25,000 \times 5\% \times 5/12 = 521$
2. $20,000 \times 5\% \times 5/12 = 417$
3. $20,125 - 417 = 19,708$

Illustration 4

The following balances appeared in the books of Paradise Ltd as on 1-4-20X1:

- (i) 12 % Debentures ₹ 7,50,000
- (ii) Balance of DRR ₹ 1,00,000
- (iii) DRR Investment 1,12,500 represented by 10% ₹ 1,125 Secured Bonds of the Government of India of ₹ 100 each.

Annual contribution to the DRR was made on 31st March every year. On 31-3-20X2, balance at bank was ₹ 7,50,000 before receipt of interest. The investment were realised at par for redemption of debentures at a premium of 10% on the above date.

You are required to prepare the following accounts for the year ended 31st March, 20X2:

- (1) Debentures Account
- (2) DRR Account
- (3) DRR Investment Account
- (4) Bank Account
- (5) Debenture Holders Account.

Solution

1. 12% Debentures Account

Date	Particulars	₹	Date	Particulars	₹
31 st March, 20X2	To Debenture holders A/c	7,50,000	1 st April, 20X1	By Balance b/d	7,50,000
		<u>7,50,000</u>			<u>7,50,000</u>

2. DRR Account

Date	Particulars	₹	Date	Particulars	₹
			1 st April, 20X1	By Balance b/d	1,00,000
31 st March, 20X2	To General reserve A/c note 1	1,87,500	1 st April, 20X1	By Profit and loss A/c (Refer Note 1)	87,500
		<u>1,87,500</u>			<u>1,87,500</u>

3. 10% Secured Bonds of Govt. (DRR Investment) A/c

		₹			₹
1 st April, 20X1	To Balance b/d	1,12,500	31 st March, 20X2	By Bank A/c	1,12,500
		<u>1,12,500</u>			<u>1,12,500</u>

4. Bank A/c

		₹			₹
31 st March,	To Balance b/d	7,50,000	31 st March,	By 12% Debenture	8,25,000
	To Interest on DRR	11,250			

20X2	Investment		20X2		
	To DRR Investment A/c	1,12,500		By Balance c/d	48,750
		8,73,750			8,73,750

5. Debenture holders A/c

		₹			₹
31 st March, 20X2	To Bank A/c	8,25,000	31 st March, 20X2	By 12% Debentures	7,50,000
				By Premium on redemption of debentures @ 10%	75,000
		8,25,000			8,25,000

Note 1 –

Calculation of DRR before redemption = 25% of ₹ 7,50,000 = 1,87,500

Available balance = ₹ 1,00,000

DRR required = 1,87,500 – 1,00,000 = ₹ 87,500.

Illustration 5

The Summarized Balance Sheet of BEE Co. Ltd. as on 31st March, 20X1 is as under:

Liabilities	₹	Assets	₹
Share Capital :		Freehold property	1,15,000
Authorised:		Stock	1,35,000
30,000 Equity Shares of ₹ 10 each	<u>3,00,000</u>	Trade receivables	75,000
Issued and Subscribed:		Cash	30,000
20,000 Equity Shares of ₹ 10 each		Balance at Bank	2,00,000
fully paid	2,00,000		
Profit and Loss Account	1,20,000		
12% Debentures	1,20,000		
Trade payables	<u>1,15,000</u>		
	5,55,000		<u>5,55,000</u>

At the Annual General Meeting, it was resolved:

- (a) To give existing shareholders the option to purchase one ₹ 10 share at ₹ 15 for every four shares (held prior to the bonus distribution), this option being taken up by all shareholders.

(b) To issue one bonus share for every five shares held.

(c) To repay the debentures at a premium of 3%.

Give the necessary journal entries and the company's Balance Sheet after these transactions are completed.

Solution

Journal of BEE Co. Ltd.

		Dr. ₹	Cr. ₹
Bank A/c	Dr.	75,000	
To Equity Shareholders A/c			75,000
(Application money received on 5,000 shares @ ₹ 15 per share to be issued as rights shares in the ratio of 1:4)			
Equity Shareholders A/c	Dr.	75,000	
To Equity Share Capital A/c			50,000
To Securities Premium A/c			25,000
(Share application money on 5,000 shares @ ₹ 10 per share transferred to Share Capital Account, and ₹ 5 per share to Securities Premium Account vide Board's Resolution dated...)			
Securities Premium A/c	Dr.	25,000	
Profit & Loss A/c	Dr.	25,000	
To Bonus to Shareholders A/c			50,000
(Amount transferred for issue of bonus shares to existing shareholders in the ratio of 1:5 vide General Body's resolution dated...)			
Bonus to Shareholders A/c	Dr.	50,000	
To Equity Share Capital A/c			50,000
(Issue of bonus shares in the ratio of 1 for 5 vide Board's resolution dated...)			

Profit and Loss A/c To Debenture Redemption Reserve (for DRR created 25% x 1,20,000)	Dr.	30,000	30,000
12% Debentures A/c Premium Payable on Redemption A/c @ 3% To Debenture holders A/c (Amount payable to debentures holders)	Dr. Dr.	1,20,000 3,600	1,23,600
Profit and loss A/c To Premium Payable on Redemption A/c (Premium payable on redemption charged to Profit & Loss A/c)	Dr.	3,600	3,600
Debenture Redemption Reserve A/c To General Reserve (for DRR transferred to general reserve)	Dr.	30,000	30,000
Debenture holders A/c To Bank A/c (Amount paid to debenture holders on redemption)	Dr.	1,23,600	1,23,600

Balance Sheet of BEE Co. Ltd. as on..... (after completion of transactions)

Particulars	Note No	₹
I. Equity and liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	3,00,000
(b) Reserves and Surplus	2	91,400
(2) Current Liabilities		
(a) Trade payables		1,15,000
Total		5,06,400
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment		
(i) Tangible Assets	3	1,15,000

(2) Current assets		
(a) Inventories		1,35,000
(b) Trade receivables		75,000
(c) Cash and bank balances	4	1,81,400
Total		5,06,400

Notes to Accounts

		₹
1. Share Capital		
30,000 shares of ₹ 10 each fully paid (5,000 shares of ₹ 10 each, fully paid issued as bonus shares out of securities premium and P&L Account)		3,00,000
2. Reserve and Surplus		
Profit & Loss Account	1,20,000	
Less: Premium on redemption of debenture	(3,600)	
Less: Utilisation for issue of bonus shares	(25,000)	
Less: DRR created	(30,000)	
	61,400	
General Reserve	<u>30,000</u>	91,400
3. Tangible assets		
Freehold property		1,15,000
4. Cash and bank balances		
Cash at bank (2,00,000 + 75,000 – 1,23,600)	1,51,400	
Cash in hand	<u>30,000</u>	1,81,400

Illustration 6

The summarised Balance Sheet of Convertible Limited, as on 30th June, 20X1, stood as follows:

Liabilities

	₹
Share Capital: 5,00,000 equity shares of ₹ 10 each fully paid	50,00,000
General Reserve	75,00,000

<i>Profit And loss A/c</i>	10,00,000
<i>Debenture Redemption Reserve</i>	25,00,000
<i>13.5% Convertible Debentures, 1,00,000 Debentures of ₹ 100 each</i>	1,00,00,000
<i>Other loans</i>	65,00,000
<i>Current Liabilities and Provisions</i>	<u>1,25,00,000</u>
	<u>4,50,00,000</u>

Assets :

<i>Fixed Assets (at cost less depreciation)</i>	1,60,00,000
<i>Debenture Redemption Reserve Investments</i>	15,00,000
<i>Cash and bank Balances</i>	75,00,000
<i>Other Current Assets</i>	<u>2,00,00,000</u>
	<u>4,50,00,000</u>

The debentures are due for redemption on 1st July, 20X1. The terms of issue of debentures provided that they were redeemable at a premium of 5% and also conferred option to the debenture holders to convert 20% of their holdings into equity shares at a predetermined price of ₹ 15.75 per share and the payment in cash.

Assuming that:

- (i) except for 100 debenture holders holding totally 25,000 debentures, the rest of them exercised the option for maximum conversion.*
- (ii) the investments were realised at par on sale; and*
- (iii) all the transactions are put through, without any lag, on 1st July, 20X1.*

Redraft the balance sheet of the company as on 1st July, 20X1 after giving effect to the redemption. Show your calculations in respect of the number of equity shares to be allotted and the necessary cash payment.

Solution

Convertible Limited
Balance Sheet as on July 1, 20X1

Particulars	Note No	Figures as at the end of current reporting period
		₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	60,00,000
(b) Reserves and Surplus	2	1,10,75,000
(2) Non-Current Liabilities		
(a) Long-term borrowings - Unsecured Loans		65,00,000
(3) Current Liabilities		
(a) Short-term provisions		<u>1,25,00,000</u>
Total		<u>3,60,75,000</u>
II. Assets		
(1) Non-current assets		
<i>(a) Property, Plant & Equipment</i>		
(i) Tangible assets		1,60,00,000
(2) Current assets		
(a) Cash and bank balances (Refer WN (iii))		75,000
(b) Other current assets		2,00,00,000
Total		<u>3,60,75,000</u>

Notes to Accounts

		₹
1. Share Capital		
6,00,000 Equity Shares (5,00,000 + 1,00,000) of ₹10 each (Refer WN (i))		<u>60,00,000</u>
2. Reserves and Surplus		

General Reserve	75,00,000	
Profit & Loss	10,00,000	
<i>Add:</i> Debenture Redemption Reserve transfer	25,00,000	
	110,00,000	
<i>Less:</i> Premium on redemption of debentures (1,00,000 debentures x ₹ 5 per debenture)	(5,00,000)	1,05,00,000
Securities Premium (1,00,000 shares x 5.75) (Refer WN (i))		5,75,000
		1,10,75,000

Working Notes :**(i) Calculation of number of shares to be allotted:**

Total number of debentures	1,00,000
<i>Less:</i> Number of debentures for which debentureholders did not opt for conversion	<u>(25,000)</u>
	<u>75,000</u>
20% of 75,000	15,000
Redemption value of 15,000 debentures (15,000 x 105)	₹ 15,75,000
Number of Equity Shares to be allotted :	
$= \frac{15,75,000}{15.75} = 1,00,000 \text{ shares of ₹ 10 each.}$	

(ii) Calculation of cash to be paid:

Total number of debentures	1,00,000
<i>Less :</i> number of debentures to be converted into equity shares	<u>(15,000)</u>
Balance	<u>85,000</u>
Redemption value of 85,000 debentures (85,000 × ₹ 105)	₹ 89,25,000

(iii) Cash and Bank Balance:

Balance before redemption	75,00,000
---------------------------	-----------

<i>Add</i> : Proceeds of investments sold	<u>15,00,000</u>
	90,00,000
<i>Less</i> : Cash paid to debenture holders	<u>(89,25,000)</u>
	<u>75,000</u>

SUMMARY

- Debenture may create a charge against some or all the assets of the company.
- Charge may be fixed or floating, depends upon the condition of issue.
- Debentures may be redeemed after a fixed number of years or after a certain period has elapsed.
- For redemption of debentures, a company should maintain Debenture Redemption Reserve.
- Methods of redemption: lumpsum payment; payment in instalments and purchase of debentures in open market.

TEST YOUR KNOWLEDGE

MCQ

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.
2. Which of the following statements is false?
 - (a) Debentures can be redeemed by payment in lump sum at the end of a specified period.
 - (b) Debentures cannot be redeemed during the life time of the company.
 - (c) Debentures can be redeemed by payments in annual instalments.
3. For debentures issued by other companies including manufacturing and infrastructure companies, Debentures Redemption reserve will be considered adequate if it is:

- (a) 20% of the value of debentures issued through public issue.
- (b) 25% of the value of debentures issued through public issue.
- (c) 30% of the value of debentures issued through public issue.

Theoretical Questions

Question 1

What is meant by redemption of debentures? Explain.

Question 2

Write short note on Debenture Redemption Reserve.

Practical Questions

Question 1

A company had issued 20,000, 13% debentures of ₹ 100 each on 1st April, 20X1. The debentures are due for redemption on 1st July, 20X2. The terms of issue of debentures provided that they were redeemable at a premium of 5% and also conferred option to the debenture holders to convert 20% of their holding into equity shares (Nominal value ₹ 10) at a price of ₹ 15 per share. Debenture holders holding 2,500 debentures did not exercise the option. Calculate the number of equity shares to be allotted to the debenture holders exercising the option to the maximum.

Question 2

Libra Limited recently made a public issue in respect of which the following information is available:

- (a) No. of partly convertible debentures issued- 2,00,000; face value and issue price- ₹ 100 per debenture.
- (b) Convertible portion per debenture- 60%, date of conversion- on expiry of 6 months from the date of closing of issue.
- (c) Date of closure of subscription lists- 1.5.20X1, date of allotment- 1.6.20X1, rate of interest on debenture- 15% payable from the date of allotment, value of equity share for the purpose of conversion- ₹ 60 (Face Value ₹ 10).
- (d) Underwriting Commission- 2%.
- (e) No. of debentures applied for- 1,50,000.

- (f) Interest payable on debentures half-yearly on 30th September and 31st March.

Write relevant journal entries for all transactions arising out of the above during the year ended 31st March, 20X2 (including cash and bank entries).

Question 3

On 1st April, 20X1, in MK Ltd.'s ledger 9% debentures appeared with a opening balance of ₹ 50,00,000 divided into 50,000 fully paid debentures of ₹ 100 each issued at par.

Interest on debentures was paid half-yearly on 30th of September and 31st March every year.

On 31.5.20X1, the company purchased 8,000 debentures of its own @ ₹ 98 (ex-interest) per debenture.

On same day it cancelled the debentures acquired.

You are required to prepare necessary ledger accounts (excluding bank A/c).

Question 4

A company had 16,000, 12% debentures of ₹ 100 each outstanding as on 1st April, 20X1, redeemable on 31st March, 20X2.

On 1 April 20X1, the following balances appeared in the books of accounts- Investment in 2,000 9% secured Govt. bonds of ₹ 100 each. DRR is ₹ 2,50,000. Interest on investments is received yearly at the end of financial year.

2,000 own debentures were purchased on 31st March 2012 at the average price of ₹ 99 and cancelled on the same date.

On 31st March, 20X2, the investments were realised at par and the debentures were redeemed. You are required to write up the following accounts for the year ended 31st March 20X2:

- (1) 12% Debentures Account
- (2) Debenture Redemption Reserve Account
- (3) Debenture Redemption Investments Account.

ANSWERS/ HINTS

MCQ

1. (c) 2. (b) 3. (b)

THEORETICAL QUESTIONS

ANSWER 1

Debentures are usually redeemable i.e. either redeemed in cash or convertible after a time period.

Redeemable debentures may be **redeemed**:

- after a **fixed number** of years; or
- any time after a **certain number of years** has elapsed since their issue; or
- on giving a **specified notice**; or
- by **annual drawing**.

For details, refer para 2 of the chapter.

Answer 2

1. A company issuing debentures is required to create a debenture redemption reserve account out of the profits available for distribution of dividend and amounts credited to such account cannot be utilised by the company except for redemption of debentures. Such an arrangement would ensure that the company will have sufficient liquid funds for the redemption of debentures at the time they fall due for payment. For details, refer para 3.1.

PRACTICAL QUESTIONS

Answer 1

Calculation of number of equity shares to be allotted

	Number of debentures
Total number of debentures	20,000
Less: Debenture holders not opted for conversion	(2,500)
Debenture holders opted for conversion	17,500
Option for conversion	20%
Number of debentures to be converted (20% of 17,500)	3,500

Redemption value of 3,500 debentures at a premium of 5%
 $[3,500 \times (100+5)]$ ₹ 3,67,500

Equity shares of ₹ 10 each issued on conversion
 $[\text{₹ } 3,67,500 / \text{₹ } 15]$ 24,500 shares

Answer 2**Journal Entries in the books of Libra Ltd.****Journal Entries**

Date	Particulars	Amount Dr.	Amount Cr.
		₹	₹
1.5.20X1	Bank A/c Dr. To Debenture Application A/c (Application money received on 1,50,000 debentures @ ₹ 100 each)	1,50,00,000	1,50,00,000
1.6.20X1	Debenture Application A/c Dr. Underwriters A/c Dr. To 15% Debentures A/c (Allotment of 1,50,000 debentures to applicants and 50,000 debentures to underwriters)	1,50,00,000 50,00,000	2,00,00,000
	Underwriting Commission Dr. To Underwriters A/c (Commission payable to underwriters @ 2% on ₹ 2,00,00,000)	4,00,000	4,00,000
	Bank A/c Dr. To Underwriters A/c (Amount received from underwriters in settlement of account)	46,00,000	46,00,000
01.06.20X1	Profit & Loss A/c Dr. To Debenture Redemption	20,00,000	20,00,000

	Reserve a/c (200,000 X 100 X 25% X 40%) (Being Debenture Redemption Reserve created on non-convertible debentures) Debenture Redemption Investment A/c Dr. 12,00,000 To Bank A/c (200,000 X 100 x 15% X 40%) 12,00,000 (Being Investments made for redemption purpose)		
30.9.20X1	Debenture Interest A/c Dr. 10,00,000 To Bank A/c 10,00,000 (Interest paid on debentures for 4 months @ 15% on ₹ 2,00,00,000)		
31.10.20X1	15% Debentures A/c Dr. 1,20,00,000 To Equity Share Capital A/c 20,00,000 To Securities Premium A/c 1,00,00,000 (Conversion of 60% of debentures into shares of ₹ 60 each with a face value of ₹ 10)		
31.3.20X2	Debenture Interest A/c Dr. 7,50,000 To Bank A/c 7,50,000 (Interest paid on debentures for the half year) (refer working note below)		

Working Note :

Calculation of Debenture Interest for the half year ended 31st March, 20X2

On ₹80,00,000 for 6 months @ 15%	= ₹6,00,000
On ₹1,20,00,000 for 1 months @ 15%	= ₹ 1,50,000
	<u>₹7,50,000</u>

Answer 3**MK Ltd.'s Ledger****(i) Debentures Account**

		₹			₹
31.5.X1	To Own Debentures (8,000 X 98)	7,84,000	1.4.X1	By balance b/d	50,00,000
31.5.X1	To Profit on cancellation	16,000			
31.3.X2	To balance c/d	42,00,000			
		50,00,000			50,00,000

(ii) Interest on Debentures Account

		₹			₹
31.5.X1	To Bank (Interest for 2 months on 8,000 debentures)	12,000	31.3.X2	By Profit and Loss A/c (b.f.)	3,90,000
30.9.X1	To Bank (Interest for 6 months on 42,000 debentures)	1,89,000			
31.3.X2	To Bank (Interest for 6 months on 42,000 debentures)	1,89,000			
		3,90,000			3,90,000

(iii) Debentures Redemption Reserve A/c

Date	Particulars	Amount	Date	Particulars	Amount
31 May 20X1	By General Reserve (8,000 x 100 x 25%)	2,00,000	1 April 20x1	To Profit & Loss A/c	12,50,000
31 March 20X2	By Balance c/d	10,50,000			
		12,50,000			12,50,000

(iv) Debentures Redemption Investments A/c

Date	Particulars	Amount	Date	Particulars	Amount
1 April 20x1	To Bank A/c	7,50,000	30 may 20X1	By Bank A/c (8,000 x 100 x 15%)	1,20,000
			31 March 20X2	To Balance b/d	6,30,000
		7,50,000			7,50,000

Working Note:

31.5. X1	Acquired 8,000 Debentures @ 98 per debenture (ex-interest)		₹
	Purchase price of debenture (8,000 × ₹ 98)	=	7,84,000
31.5.X1	Interest for 2 months [₹ 8,00,000 × 9% × 2/12]	=	12,000
30.9. X1	Interest on other debentures		
	₹ 42,00,000 × 9% × ½	=	1,89,000

Answer 4**12% Debentures Account**

Date	Particulars	₹	Date	Particulars	₹
31 st March, 20 X2	To Own debentures A/c	1,98,000	1 st April, 20 X1	By Balance b/d	16,00,000
		2,000			
31 st March, 20 X2	To Profit on cancellation				

31 st March, 20 X2	To Bank A/c	14,00,000			
		16,00,000			16,00,000

Debenture Redemption Reserve Account

Date	Particulars	₹	Date	Particulars	₹
			1 st April, 20 X1	By Balance b/d	2,50,000
31 st March, 20 X2	To General Reserve A/c	4,00,000	1 st April, 20 X1	By Profit and loss A/c (16,00,000 X 25%)	1,50,000
		4,00,000			4,00,000

Debenture Redemption Investments A/c

Date	Particulars	Amount	Date	Particulars	Amount
1 April 20X1	To Balance b/d	2,00,000	30 th March 20X2	By Bank A/c (2,000 x 100 x 15%)	30,000
1 April 20X1	To Bank A/c	40,000	31 March 20X2	By Bank A/c	2,10,000
		2,40,000			2,40,000