

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

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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

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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

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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.

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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

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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	
Bank Account Dr. To 12% Debenture Allotment Account (Being the application money received Rs.80,000-Rs.25,000)	55,000	60,000 20,000
12% Debenture First & Final Call Account Dr. To 12% Debenture Account (Being the call money due on 2,000 debentures @Rs.45)	90,000	55,000
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 Vendor Dr. To Debenture Account	With the purchase consideration
When Debentures are issued for purchase of asset at premium	Sundry Assets Account Dr. To Vendor Vendor Dr. To Debenture Account To Security Premium Account	With the purchase Consideration No. of debentures x par value No. of debentures x premium
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 When Purchase consideration more than net value of assets Sundry Asset Account Dr. Goodwill account Dr. To Sundry Liabilities Account	Value of asset Value of liability Purchase consideration Value of asset Excess of purchase value

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	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
	Debentures are issued at par Girish Dr. To 11% Debentures (For the issue of debenture at par)		99,000	99,000
(ii)	Debentures are issued at premium Girish Dr. To 11% Debentures		99,000	
	To Security Premium Account			90,000
	For issue of 900 debentures of Rs.100 each at 10% premium)			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	

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Goodwill Account Dr. To Sundry creditors Account To Gupta Bros. (Being the purchase of business) Gupta Bros To Debenture Account (Being issue of 15,000 shares of Rs.100 each as payment of business price)	2,00,000 15,00,000	1,00,000 15,00,000 15,00,000
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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. Furniture Account Dr. Stock Account Dr. To Creditors Account To Capital Reserve To Usha Co. Ltd. (Being the purchase of business)		1,00,000 1,80,00 20,000 1,08,000	80,000 1,12,000 1,08,000
	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

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exercised the right does not arise debentures will be returned back to the company. No interest is paid on the debentures issued as collateral security because the company pays interest on the loan. This is used when there are no assets to mortgage.

In the accounting books of the company, the issue of debentures as collateral security can be credited in two ways.

- (i) First method : No Journal entry to be made in the books of accounts of the company. Debentures are issued as collateral security. A note of this fact is given
- (ii) on the liability side of the balance sheet under the heading Secured Loans and Advances.

Liabilities	Rs.	Assets	Rs.
Secured Loans Bank Loan (Secured by issue of % Debentures as collateral security)			

(ii) Entry to be made in the books of account the company

A journal entry is made on the issue of debentures as a collateral security, Debentures suspense Account is debited because no cash is received for such issue

Following journal entry will be made

Date	Particulars	L.F.	Debit ₹	Credit ₹
	Debenture Suspense Account Dr To Debentures Account (Being the issue of Debentures of Rs.... each issued as collateral security)			

It is represented in Balance Sheet

Balance Sheet as on

Liabilities	Rs.	Assets	Rs.
Secured Loans Debenture issued as collateral security Loan from the Banks		Miscellaneous Expenditure Debenture Suspense Account	

Example : A company took a loan of Rs.3,80,000 from Vaish Cooperative Bank Ltd. and issued 13% debentures of Rs.4,00,000 as a collateral security. Explain how will you deal with the issue of debentures in the books of the company.

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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 redemable at par)			

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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

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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 debenture 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.

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		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 debentures 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 3 = 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

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		Rs.			Rs.
1.1.2000	To 9% Debenture Account	6,000	31.12.2000	By Profit & Loss Account	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 date 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		3,000	2,700 300
June 30	Interest Accrued Tax Payable Interest Accrued A/c Dr.		2,700	

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

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	Dr.	(Gross 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 A/c	Dr.		
	To Bank A/c		(Amount of Income Tax deducted at source)	
(4) On transfer of interest on debenture to profit and 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.

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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 Accrued To Tax Payable		3,000	2,700 300
Dec.31	Interest Accrued 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)