FOR THE STUDENTS OF B.COM III

By

Dr Sunil Kant Mishra

**DEBENTURES**

This chapter will cover following topics--

* Meaning and Types of Debentures,
* Issue of Debentures, different conditions of issuing debentures,
* Methods of Redemption of debentures

Debenture is another important source of borrowings. The board of director is empowered to borrow the funds as per Companies Act. Besides issuing shares, a company can raise funds in the form of debt. The source of debts can be-

* Loans from financial institutions
* Inviting deposit from public
* Inviting debt instruments-Bonds and Debentures

**Meaning of Debentures**

The word **debenture** has been derived from the Latin word ‘debere’ which means to owe. Debentures are one of the important sources of raising long-term loan or finance. It a type of Bond issued usually under the common seal of the company. Generally, by debenture we mean that document which creates loan. Debentures carry fixed rate of interest. They may be repayable within a specified period or on a specified date or they may be irredeemable.

According to Section 2(30) of the Indian Companies Act 2013, “Debenture includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not.

In the words of **E. Thomas**, “A debenture is a document under company’s seal which provides for the repayment of principal and interest thereon at regular intervals which is usually secured by fixed or floating charge on the company’s property and which acknowledges loan of a company.”

According to **Topham**, “Document given to the holder by company as acknowledgement of loan is known as debenture.”

Thus, a debenture is a document or certificate issued by a company acknowledging indebtedness for the money lent. It is an undertaking to repay the specified borrowed sum with interest at a specified rate.

**Special Features of Debentures**

Following are the special features of debentures:

1. Debenture is a written document issued under the seal of company.
2. Debenture is an instrument of loan capital of the company.
3. It is a contract for the repayment of principal and its interest at a specified date and rate.
4. The rate, term and the method of redemption etc. are predetermined.
5. It is an acknowledgement of debt from a particular person.
6. It carries a fixed rate of interest.
7. It carries the promise to pay interest after regular intervals.
8. Debenture capital is usually repayable at a fixed date.
9. It is normally secured by floating charge on the assets of the company.
10. It can be issued at par, at discount and at par.
11. It is creditor’s equity.
12. Debentures cannot be forfeited.
13. It does not carry any voting right.

**Meaning of Bond**

Bond is similar to that of debenture. Bond is generally issued by the Government. But these days bonds are being issued by the semi-government and non-government organizationstoo, as an acknowledgement of debt.

The significant difference between bonds and debentures is with regard to the condition of issue, i.e., bonds can be issued without per-determined rate of interest as in the case of deep discount bonds.

**Difference between Shares and Debentures**

|  |  |  |  |
| --- | --- | --- | --- |
| **S.No.** | **Basis of difference** | **Shares** | **Debentures** |
|  | **Symbol** | A share is the symbol of owner-ship. It represents a portion of capital. | A debenture is the symbol of loan. It represents debt of a company. |
|  | **Nature of Security** | It is ownership security. | It is creditorship security. |
|  | **Voting Right** | A shareholder enjoys the voting right | A debentureholder does not have voting right |
|  | **Nature of Return** | Dividend is paid on shares. It is an appropriation of profits. | Interest is paid on debentures. It is a charge against profit. |
|  | **Rate of Return** | Payment of dividend is made only when there is a profit. There is no fixed rate of dividend on equity shares. | Interest on debentures is a compulsory payment whether the company earns a profit or not. There is a fixed rate of interest on debentures agreed by the company. |
|  | **Refund of Capital** | Normally the amount of shares is not returned during the life-time of the company. | Debentures are issued for a definite period. Hence, the amount of debenture is returned after that period. |
|  | **Priority**  **of Repayment** | In case of winding-up of the company, the shareholders are the last persons to get back their capital. | In case of winding-up the amount of debentures is repaid prior to the shareholders. |
|  | **Security** | A share is unsecured. | Fixed or floating charge. |
|  | **Issue at Discount** | Restriction have been imposed on issue of shares at a discount. Shares can be issued at discount only on the completion of certain formalities. | There is no legal restriction on issue of debentures at a discount. |
|  | **Convertibility** | Shares cannot be converted. | Debentures can be converted into shares. |
|  | **Control** | As such a shareholder has control over the administration of company. | As such a debentureholder has no control over the administration of the company. |

**Difference between Debenture holder and Shareholder**

|  |  |  |
| --- | --- | --- |
| **S.No.** | **Debentureholder** | **Shareholder** |
|  | Debentureholder is the creditor of company. | Shareholder is the owner of company. |
|  | Interest is always received by debenture-holder, irrespective of whether company has earned profit or not. | Dividend is paid to shareholder only when company earns profit and directors recommend for it. |
|  | Debentureholder is not entitled to interfere or vote in affairs of the company. | Shareholder is entitled to participate in management, vote and interfere in affairs of company. |
|  | Debentureholder is not entitled to receive share out of profits. | Shareholder is entitled to receive share out of profit. |
|  | Debentereholder can claim interest from company if he does not receive it. | Shareholder cannot claim dividend from company if he does not receive it. |
|  | Interest on debenture is a business expenditure which is, shown on the debit side of statement of Profit and Loss like other expenses. | Dividend is declared out of divisible profit, Thus it is recorded on the debit side of Statement of Profit and Loss (Appropriation) |
|  | In case of winding up of company amount is paid to debentureholders prior to share-holders. | In case of winding up of company capital of shareholders is paid to them in the last. |

**Types of Debentures**

Following are the various types of Debentures:

1. **On the Basis of Transferability/ negotiability**
2. **Registered Debentures:** The debentures which are recorded in the Register of Debentureholders are called *registered debentures*. Payment of interest or repayment of the principal sum will be made only to the registered holder. Such debentures are transferable only by transfer deed. In other words, it cannot be transferred by mere delivery.
3. **Bearer Debentures:** Bearer debentures are those which are payable to the bearer or holder. Such debentures are transferable by delivery. The payment of interest is made through company which is attached with the debentures. No register is maintained for bearer debentures.
4. **On the Basis of Security**
5. **Secured/ Mortgage Debentures:** Mortgage debentures are those debentures which secured by creating a fixed or floating charge on the assets of the company. Thus means that if the company commits any default in paying interest or in repaying the principal sum, the debentureholders have the right to recover their dues from the mortgaged property. Mortgage debentures are also known as ‘Secured Debentures’. Secured debentures are those that are secured against some particular assets of a company. Mortgage debentures may be classified as :
6. **First Debentures:** These are debentures which are repayable in priority to other debentures.
7. **Second Debentures:** These are debentures which are repayable only after the redemption of first debentures.
8. **Simple, Naked or Unsecured Debentures:** The debentures for which the company does not offer anything by way of securities are called *simple or naked debentures*. They are also called ‘*Unsecured Debentures*’. These debentures carry a fixed rate of interest and are repayable after a specified period.
9. **On the Basis of Redemption**

**1. Redeemable Debentures:** Redeemable debentures are those debentures which are repayable by the company on a specified date or within a specified period. Repayment of these debentures may be in lump-sum or in instalments, depending upon the terms of issue.

**2.** **Irredeemable Debentures:** Irredeemable debentures are those debentures which are not payable during the life period of the company. Such debentures become repayable only on liquidation of the company.

**IV.** **On the Basis of Convertibility**

1. **Convertible Debentures:** Convertible debentures are those debentures which can be converted into shares at a specified date or within/after a specified period. Conversion takes place as per the terms of issue.
2. **Non-convertible Debentures:** There are the debentures, the holders of which have no right to convert them into equity shares.
3. **On the Basis of Coupon (Interest) Rate:** From coupon (interest**)** rate point of view debentures may be classified into two categories:
4. **Debentures Issued with Coupon Rate:** Debentures issued with specifiedrate of interest, e.g., 12% or 14% is called as coupon rate.
5. **Debentures Issued without Coupon Rate:** A debentures without coupon rate is one which does not carry a specified rate of interest. It is also called as a ‘Zero Coupon Bond’ or ‘Deep Discount Bond’.

**Objects of Issuing of Debentures**

Debentures are issued for the following purposes:

1. Setting-up of a New Projects:
2. Expansion and Diversification of Existing Projects

Purposes of Debentures

1. For Modernisation of the Plant
2. Amalgamation of the Companies
3. For increasing Long-term Resources of the company for working Capital Requirements.

**Procedure for the Issue of Debentures**

The procedure for the issue of debentures is exactly the same as in the case of issue of shares. A prospectus is issued in which terms and conditions of the issue of debentures are given.

**Terms of Issue of Debentures**

The debentures may be issued (i) at par, (ii) at a premium or (iii) at a discount

1. **At Par:** If a debenture is issued at the amount equal to its nominal value or face value, it is said to be an issue at par.

**Issue price= Face value of debenture**

1. **At Premium :** If a debenture is issued at a higher than its nominal value or face value, it is called issue at premium.

**Issue price= Face value of debenture + Premium**

1. **At Discount:** If a debenture is issued at an amount less than its face value or nominal value, it is said to be issue at discount.

**Issue price= Face value of debenture -Discount**

**Provisions of Companies Act, 2013 regarding Debenture (Section71)**

Section 71 provides terms for issue of debentures as follows:

1. A company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption.
2. The issue of debentures with an option to convert such debentures into shares, wholly or partly shall be approved by a special resolution passed at a general meeting.
3. No company shall issue any debentures carrying any voting rights.
4. Secured debentures may be issued by a company subject to conditions that the date of its redemption shall not exceed 10 years from the date of issue.
5. The infrastructure companies may issue redeemable debentures of period not more than 30 years.
6. Where debentures are issued by a company under this section, the company shall create a debenture redemption reserve account out of the profit of the company available for payment of dividend and the amount credited to such account shall not be utilised by the company except for the redemption of debentures.
7. No company shall issue a prospectus or make an offer of invitation to the public or to its members exceeding five hundred for the subscription of its debentures, unless the company has, before such issue or offer, appointed one or more debenture trustees and the conditions governing the appointment of such trustees shall be such as may be prescribed.
8. A debenture trustee shall take steps to protect the interests of the debentureholders and redress their grievances in accordance with such rules as may be prescribed.

**Important Points to Note**

1. **Premium on Issue of Debentures:** It is capital profit and is credited to *Securities Premium Account*. The balance of Securities Premium Account is shown under the head ‘Reserve and Surplus’ in the liability side of Balance Sheet.
2. **Discount on Issue of Debentures:** It is capital loss. It is debited to *Discount on Issue of Debentures Account*. The balance of Discount on issue of Debentures is shown on the assets side of Balance Sheet under the head ‘Other Current Assets/Other Non-current Assets’ depending on whether these are written off amortized in next 12 months or thereafter. It is written off with capital profits like Capital Reserve A/c, Securities Premium A/c or from Statement of profit and Loss gradually.
3. **Prefix the Rate of Interest of Debentures:** It is usual to prefix the rate of interest to the debentures. Thus, if the rate of interest is 12% Debentures. 12% debenture means that the debenture will carries [interest @12%](mailto:interest.@10%25).

**Accounting Treatment**

Accounting treatment of the issue of debentures is similar to that of the issue of shares. The only difference is that word ‘Share’ is replaced by the word ‘Debentures’. Similarly ‘Share Capital Account’ is replaced by ‘Debentures Account’. Debentures are shown on the liabilities side of the Balance Sheet under the head ‘Non-current Liabilities’.

If the **term of redemption** is given with the **terms of issue** of debentures, then additional entry for ‘premium on redemption’ will be passed with the entry for issue. No entry will be required if redemption is to be done at par/ at discount. As per principle of conservatism, anticipated loss of future should be recorded while anticipated gains of future should be ignored. Discount on redemption is anticipated gains, hence it will not be recorded at the time of issue of debenture.

**Type of issue of Debentures**

**There are three types of issuing debentures-**

1. Issue of debentures for consideration in cash
2. Issue of debentures for consideration other than cash
3. Issue of debentures as a collateral security

**Journal Entries for Issue of Debentures for Cash**

**Issue of Debentures for Cash in lump-sum when Full Amount is collected with Application:**

1. On Receipt of Application Money:

Bank A/c Dr.

To Debenture Application A/c

(Debenture application money received)

1. On Transferring Application money to Debenture Account:

Debenture Application A/c Dr.

To Debentures A/c

(Transfer of application money to Debentures A/c)

**Issue of Debentures for Cash in Installments:**

1. On Receipt of Application Money:

Bank A/c Dr.

To Debenture Application A/c

(Debentures of application money received on …. Debentures @ :- ….each)

1. On Transfer of Application Money into Debentures Account:

Debenture Application A/c Dr.

To Debentures A/c

(Transfer of application money to Debentures A/c)

1. For Refund of Application Money in case of Over-subscription:

Debenture Application A/c Dr.

To Bank A/c

(Excess application money on ….. debentures returned)

1. In case of Pro-rate Allotment excess Application Money will be

Adjusted toward Allotment

Debenture Application A/c Dr.

To Debentures Allotment A/c

(Excess application money transferred to Debentures Allotment A/c)

1. On Allotment Money due:

Debenture Allotment A/c Dr.

To Debentures A/c

(Allotment money due on ….. debentures @ :- …… per debenture)

1. On Receipt of Allotment Money:

Bank A/c Dr.

To Debenture Allotment A/c

(Allotment money received on … debentures @ :- …… per debenture)

1. On making Calls due:

Debenture First Call A/c Dr.

To Debentures A/c

(First call money due on …. debentures @ :- …… per debenture)

1. On Receipt of Call Money :

Bank A/c Dr.

To Debenture First Call A/c

(First call money received)

1. Premium on issue and Discount on Issue shall be recorded with allotment of debenture, unless other instruction is given.

* Premium on issue will be credited in **Securities Premium Reserve A/c.**
* Discount on issue will be debited to Discount on issue of Debenture A/c.

**Calls in arrear and Interest on Calls-in-Arrear**

If the calls demanded by the company are not paid, then it is known as ‘calls-in-arrear’. The debenture cannot be forfeited on account of unpaid calls. No entry is made for calls in arrears. It is shown in the balance sheet by way of deduction from the Debenture A/c, if it is still outstanding at the time of preparation of balance sheet.

Generally, interest is charged on calls-in-arrear. This interest is income for the company.

1. *Entry for Charging Interest:*

Bank A/c Dr.

To Interest on Calls-in-Arrears A/c

(Interest received on calls-in-arrear)

1. *For transferring interest on calls in arrears to statement of profit and loss*

Interest on Calls-in-Arrears A/c Dr.

To Statement of Profit & Loss

**Calls in advance and Interest on Calls-in-advance**

When a shareholder paid his dues on calls in advance, then it should be credited to Calls in Advance A/c.

Debenture holders are paid interest on the amount paid as calls-in-advance; such interest is expense for the company.

1. Interest on Calls-in-Advance A/c Dr.

To Bank A/c

(Interest paid on calls-in-advance)

1. *For transferring interest on calls in advance to statement of profit and loss*

Statement of Profit & Loss Dr

To Interest on Calls-in-Arrears A/c

**Expenditure on Issuing of Debentures**

**Journal Entry:**

Expenses on Issue of Debentures A/c Dr.

To Bank A/c

(Payment of Expenses on Issue of Debentures)

Note: Any expenditure incurred on the issue of debentures is treated as capital expenditure.

* As per AS-16, Discount on Issue of Debentures should be amortized over period of benefit that is 3 to 5 years.
* There is no restriction on issuing debentures at a discount like the shares issued at a discount u/s 53.

**Illustration 1 (Debentures Issued at Par)**

Oscar Co. Ltd. Issued 10,000 debentures of Rs. 10 each, payable as followings: Rs. 2 on Application and Rs 8 on Application

All the debentures were applied for and allotted. All money due were received. Pass necessary Journal entries.

**Solution: Journal Entries Dr. Cr.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **L.F.** | **Amount** | **Amount** |
|  | **Bank A/c Dr.**  **To Debenture Application A/c**  **(Application money on 10,000 Debentures @ Rs** 2 per debenture received) |  | Rs.  **20,000** | Rs.    **20,000** |
| **Debenture Application A/c Dr.**  **To Debentures A/c**  **(Application money transferred to Debentures A/c** | 20,000 | 20,000 |
| **Debenture Allotment A/c Dr.**  **To Debentures A/c**  **(Allotment money due on 10,000 Debentures @ Rs.** 8 per debenture) | 80,000 | 80,000 |
| **Bank A/c Dr.**  **To Debenture Allotment A/c**  **(Allotment money received)** | 80,000 | 80,000 |

**Issue of debenture other than cash**

The debentures can be issued to vendors or can be issued to discharge purchase price of business.

Journal Entry for purchase of Assets

Assets A/c Dr

To Vendor A/c

Journal Entry for purchase of business

Assets A/c Dr

To Liabilities A/c

To Vendor A/c

The debenture to vendor may be issued at par, at discount or at premium.

Calculation of number of debentures to be issued

1. Check Net amount payable to Vendor
2. Calculate issue price of debenture

Issue price in case issue is at par will be Face Value of debenture

**Issue Price**= Face value/Nominal value

Issue price in case issue is at discount

**Issue Price**= Face value/Nominal value- Discount

Issue price in case issue is at premium

**Issue Price**= Face value/Nominal value+Premium

1. Calculate number of debentures to be issued as follows

No. of debenture= net amount payable to vendor/ issue price

**Issue of debenture as collateral security**

A collateral security is an additional or secondary security for the performance of an obligation. Some times company deposits its own debenture as additional security to get loans from the financial institutions. When debentures are issued as additional security, they are called ‘issue of debentures as collateral security’. They do not carry interest. The lender is simply custodian of debentures.

Accounting Entry

1. No entry is passed for issue of debentures as collateral security.

The amount borrowed is shown in the head ‘Long term borrowings’ in the ‘Equity & Liabilities’ heading. The debentures issued are shown within bracket below loans.

1. Entry is passed

Debenture Suspense A/c Dr

To Debenture A/c

The amount borrowed is shown in the head ‘Long term borrowings’ in the ‘Equity & Liabilities’ heading. The debenture suspense A/c is shown by way of deduction from debenture A/c.

**Issue of debenture with the terms of redemption**

|  |  |  |  |
| --- | --- | --- | --- |
| **Terms of Issue** | **Terms of redemption** | **Issue terms** | **Accounting treatment/ remarks** |
| 1. At Par | 1. At Par | A1 | Usual entry will be passed |
|  | 1. At Discount | A2 | Usual entry will be passed. Discount at the time of redemption will be gain, hence at the time of issue, future gains will not be recorded. |
|  | 1. At Premium | **A3** | **Premium at the time of redemption will be loss, hence at the time of issue, future loss will be recorded.** |
| 1. At Discount | 1. At Par | B1 | Usual entry will be passed |
|  | 1. At Discount | B2 | Usual entry will be passed Discount at the time of redemption will be gain, hence at the time of issue, future gains will not be recorded. |
|  | 1. At Premium | **B3** | **Premium at the time of redemption will be loss, hence at the time of issue, future loss will be recorded.** |
| 1. At Premium | 1. At Par | C1 | Usual entry will be passed |
|  | 1. At Discount | C2 | Usual entry will be passed Discount at the time of redemption will be gain, hence at the time of issue, future gains will not be recorded. |
|  | 1. At Premium | **C3** | **Premium at the time of redemption will be loss, hence at the time of issue, future loss will be recorded.** |

**Journal Entries**

**Condition:A3- Issue of debenture at Par and redeemable at premium**

Bank A/c ……………………………..Dr. with Face value

Loss on redemption of debenture A/c… Dr with premium on redemption

To Debenture A/c with Face value

To Premium on redemption A/c with premium on redemption

**Note:**

1. Loss on redemption A/c may amortized from statement of Profit and Loss A/c spread over the tenure of debenture.
2. Premium on redemption A/c will be closed at the time of redemption by debiting the Premium on redemption A/c. The entry will be –

Debenture A/c ………………………………..Dr

Premium on redemption A/c…………………Dr

To Debentureholder’s A/c

**Condition:B3- Issue of debenture at Discount and redeemable at premium**

Bank A/c ……………………………..Dr. with Face value-Discount

Discount on issue of debenture A/c Dr with discount amount

Loss on redemption of debenture A/c… Dr with premium on redemption

To Debenture A/c with Face value

To Premium on redemption A/c with premium on redemption

**Note:**

1. Loss on redemption A/c & Discount in issue may amortized from statement of Profit and Loss A/c spread over the tenure of debenture.
2. Premium on redemption A/c will be closed at the time of redemption by debiting the Premium on redemption A/c. The entry will be –

Debenture A/c ………………………………..Dr

Premium on redemption A/c…………………Dr

To Debentureholder’s A/c

**Condition:C3- Issue of debenture at Premium and redeemable at premium**

Bank A/c ……………………………..Dr. with Face value+premium

Loss on redemption of debenture A/c… Dr with premium on redemption

To Debenture A/c with Face value

To Security premium Reserve A/c with premium on issue

To Premium on redemption A/c with premium on redemption

**Interest on Debenture**

Payment of debenture interest is a debt serving. If a company fails to pay interest regularly, it may face a serious problem from debentureholders. The debentrueholder may seek court’s intervention for payment of interest. A debentrueholder must get-

* Interest regularly
* Repayment at the time of redemption

Interest is calculated on the basis of rate of interest committed at the time of issue. Before payment of interest, the company is also required to comply with the provisions of income tax act which requires deduction of tax at source (TDS).

Necessary entries for debenture interest :-

1. For interest due

Debenture Interest A/c Dr

To Debentureholder’s A/c

To TDS A/c

1. For payment

Debentureholder’s A/c

TDS A/c

To Bank A/c

1. For transfer

Statement of Profit & Loss Dr

To Debenture Inertest A/c

**Treatment of Discount on Issue of Debenture**

The discount may be written off from the securities reserve, general reserve and statement of profit & loss.

Security Premium Reserve A/c Dr.

General Reserve A/c Dr.

Statement of Profit & Loss A/c Dr.

To Discount on issue of debenture A/c

Generally, discount is written off over period of time of debenture. In this situation a sum calculated is debited to Statement of Profit & Loss to amortised discount over a period of time.