

REDEMPTION OF DEBENTURES

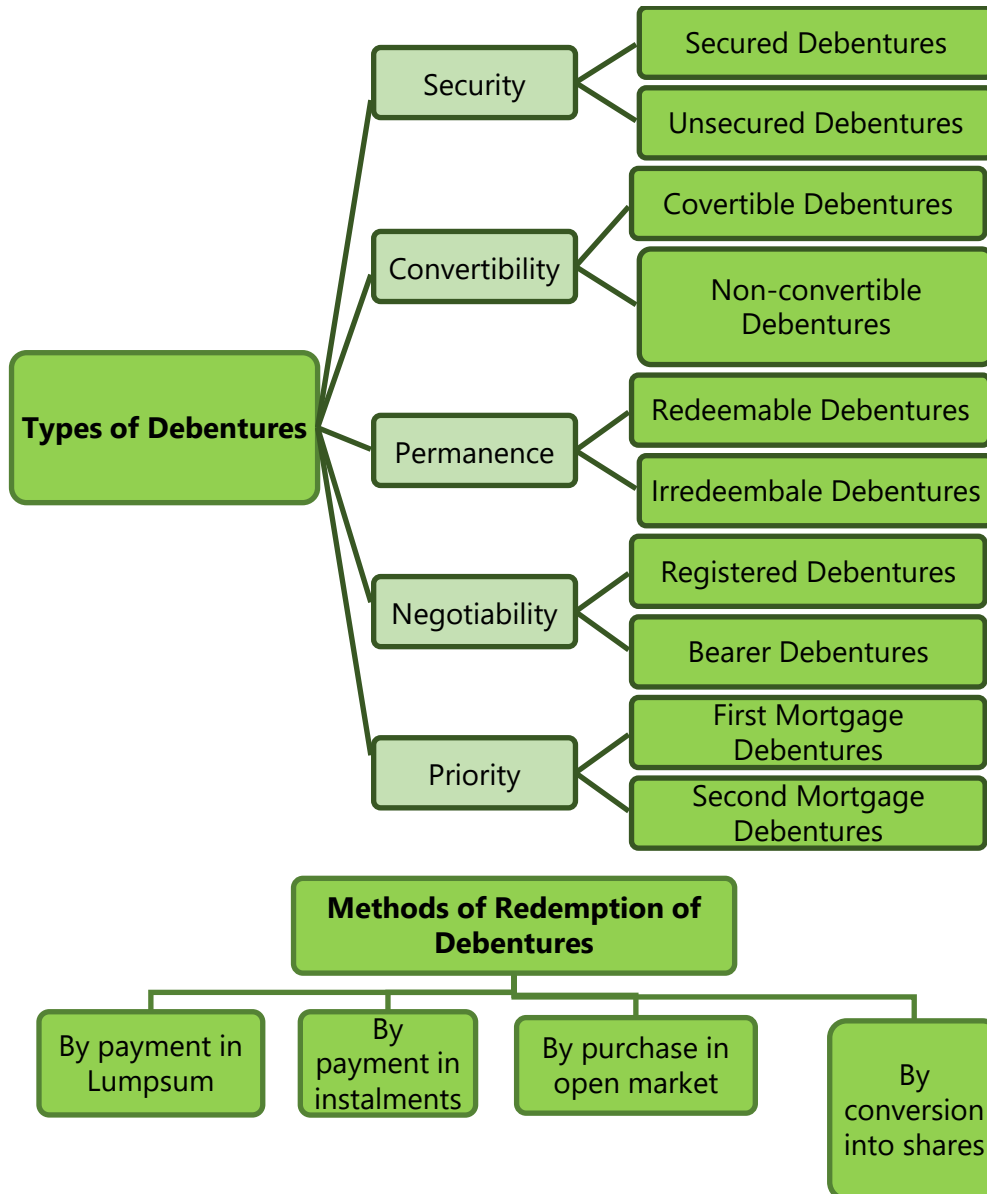


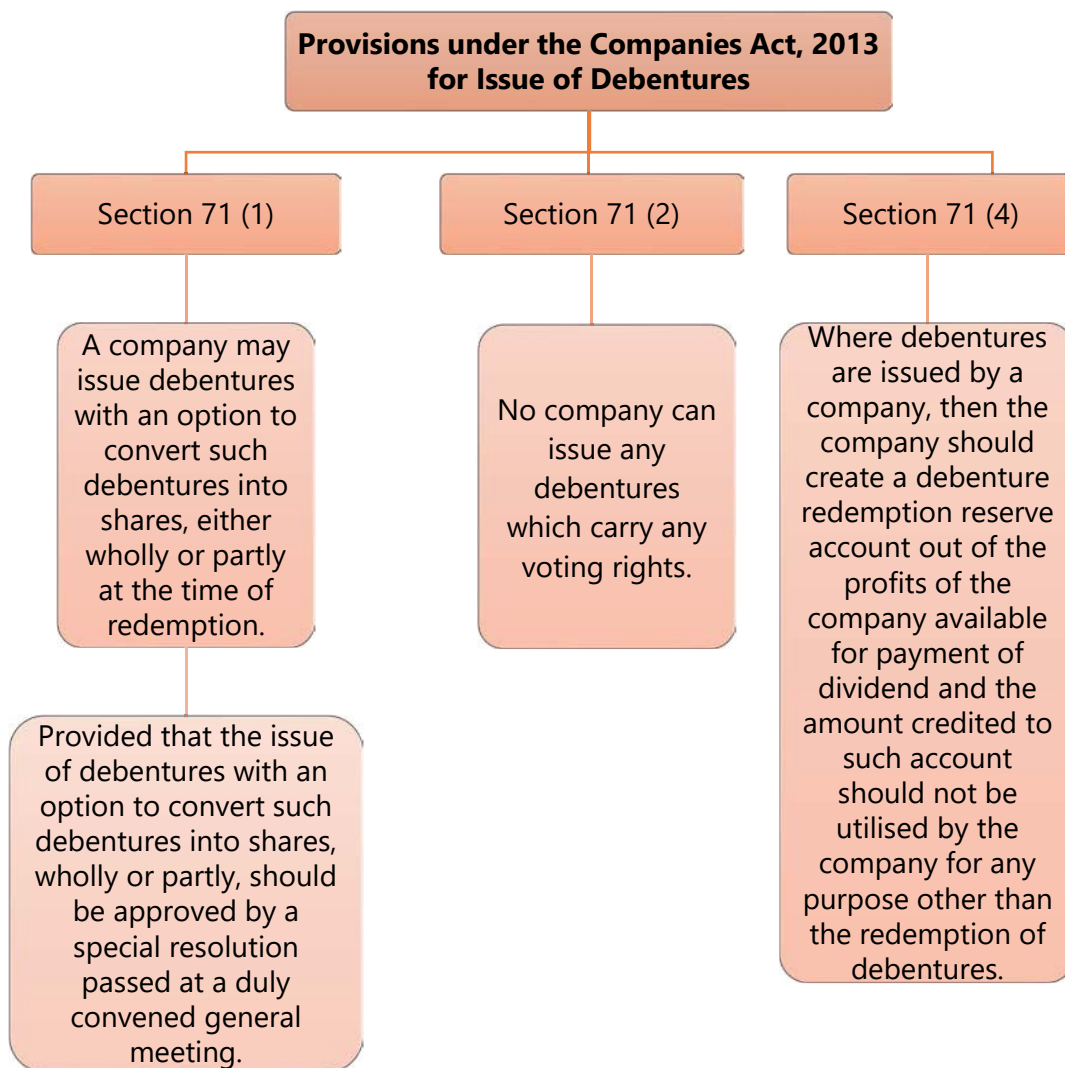
LEARNING OUTCOMES

After studying this chapter, you will be able to–

- ❑ Understand about the redemption of debentures;
- ❑ Understand the requirement of creation of a Debenture Redemption Reserve and creation of Debenture Redemption Fund (i.e. making investments for purpose of redemption of debentures);
- ❑ Understand various methods of 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 utilized 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. When the 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, a 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 repayment of the amount due on 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 may be 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 for any other purpose 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 (or Debenture Redemption Fund). 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 REQUIREMENT 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) Amendment Rules, 2019, the company shall comply with the requirements with regard to Debenture Redemption Reserve (DRR) and investment or deposit of sum in respect of debentures maturing during the year ending on the 31st day of March of next year (*refer para 3.4 below*), 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 limits with respect to adequacy of DRR and investment or deposits, as the case may be, shall be as under:

S. No	Debentures issued by	Adequacy of Debenture Redemption Reserve (DRR)
1	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
2	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 (3) below)
3	For listed companies (other than AIFIs and Banking Companies as specified in Sr. No. 1 above):	
	a. All listed NBFCs (registered with RBI under section 45-IA of the RBI Act,) and listed HFCs (Housing Finance Companies registered with National Housing Bank) for both public as well as privately placed debentures	No DRR is required
	b. Other listed companies for both public as well as privately placed debentures	No DRR is required
4	For unlisted companies (other than AIFIs and Banking Companies as specified in Sr. No. 1 above)	
	a. All unlisted NBFCs (registered	No DRR is required

	with RBI under section 45-IA of the RBI (Amendment) Act, 1997) and unlisted HFCs (Housing Finance Companies registered with National Housing Bank) for privately placed debentures	
	b. Other unlisted companies	DRR shall be 10% of the value of the outstanding debentures issued

3.4 INVESTMENT OF DEBENTURE REDEMPTION RESERVE (DRR) AMOUNT

Further, as per Rule 18 (7) of the Companies (Share Capital and Debentures) Amendment Rules, 2019, following companies

- (a) All listed NBFCs
- (b) All listed HFCs
- (c) All other listed companies (other than AIFs, Banking Companies and Other FIs); and
- (d) All unlisted companies which are not NBFCs and HFCs

shall on or before the 30th day of April in each year, in respect of debentures issued, 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 redemption 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)

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 every year. 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 the debentures , profit does not arise; only on sale and in this case on cancellation of debentures, profit could arise.

These debentures may be 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. (listed company), had 500 Debentures of ₹ 100 each outstanding in its books carrying interest at 6% per annum. In accordance with the regulatory requirements, the directors of the company acquired debentures from the open market for immediate cancellation as follows:

March 1	₹ 5,000 at face value ₹ 98.00 (cum interest)
Aug. 1	₹ 10,000 at face value ₹ 100.25 (cum interest)
Dec. 15	₹ 2,500 at face value ₹ 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 full year by splitting into first and second half years, 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			
			50,000			50,000

Debenture Interest Account

		₹	₹		₹
Mar. 1	To Bank-Interest for 2 months		June 30	By Profit & Loss A/c	1,400

	on ₹ 5,000	50			
	Debentures @ 6%				
June 30	To Debenture-holders (Interest) A/c (45,000 x 6% x 6/12)	1,350			
		1,400			1,400

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		Dec.	By P & L Account	1,093.75

		₹ 10,000 @ 6%	50.00		
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 that 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.
- (iv) As per Rule 18 (7) of the Companies (Share Capital and Debentures) Amendment Rules, 2019, in respect of debentures issued, the company would be required to deposit or invest (referred to as Debenture Redemption Reserve Investment or DRRI), as the case may be, on or before the 30th day of April in each year, 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 the given question, DRRI account is not required and hence no such adjustment has been given.

Illustration 2

The following balances appeared in the books of a company (unlisted company other than AIFI, Banking company, NBFC and HFC) as on December 31, 20X1: 6% Mortgage

10,000 debentures of ₹ 100 each; Debenture Redemption Reserve (for redemption of debentures) ₹50,000; 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-	10,10,000

Feb 28	To Interest on Debentures Redemption Investments (1,50,000 x 4% x 2/12)	1,000	holders (10,000 x 101)	
	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	50,000
	To General Reserve-note	1,00,000	Jan.1	By Profit & Loss (b/f)	50,000
		1,00,000			1,00,000

Note

Amount to be transferred to DRR before the redemption = ₹ 1,00,000 [i.e. 10% of (10,000 X 100)].

Illustration 3

Sencom Limited (listed company) 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, investments made for the purpose of redemption were ₹ 22,500.

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 (unlisted company other than AIFI, Banking company, NBFC and HFC) as on 1-4-20X1:

(i) 12 % Debentures ₹ 7,50,000

(ii) Balance of DRR ₹ 25,000

(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
		7,50,000			7,50,000

2. DRR Account

Date	Particulars	₹	Date	Particulars	₹
			1 st April, 20X1	By Balance b/d	25,000
31 st March, 20X2	To General reserve A/c (Refer Note 1)	75,000	1 st April, 20X1	By Profit and loss A/c (Refer Note 1)	50,000
		75,000			75,000

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
		1,12,500			1,12,500

4. Bank A/c

		₹			₹
31 st March, 20X2	To Balance b/d	7,50,000	31 st March, 20X2	By Debenture holders A/c	8,25,000
	To Interest on DRR Investment (1,12,500 X 10%)	11,250			
	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 (7,50,000 X 10%)	75,000
		8,25,000			8,25,000

Note 1 –

Calculation of DRR before redemption = 10% of ₹ 7,50,000 = 75,000

Available balance = ₹ 25,000

DRR required = 75,000 – 25,000 = ₹ 50,000.

Illustration 5

The Balance Sheet of BEE Co. Ltd. (unlisted company other than AIFI, Banking company, NBFC and HFC) as at 31st March, 20X1 is as under:

Particulars	Note No	₹
I. Equity and liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	2,00,000
(b) Reserves and Surplus	2	1,20,000
(2) Non-current liabilities		
(a) Long term borrowings	3	1,20,000
(3) Current Liabilities		
(a) Trade payables		1,15,000
Total		5,55,000
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	4	1,15,000
(2) Current assets		
(a) Inventories		1,35,000
(b) Trade receivables		75,000
(c) Cash and bank balances	5	2,30,000
Total		5,55,000

Notes to Accounts

		₹
1. Share Capital		
Authorised share capital		
30,000 shares of ₹ 10 each fully paid		<u>3,00,000</u>
Issued and subscribed share capital		
20,000 shares of ₹ 10 each fully paid		<u>2,00,000</u>
2. Reserve and Surplus		
Profit & Loss Account		1,20,000
3. Long term borrowings		
12% Debentures		1,20,000
4. Property, Plant and Equipment		
Freehold property		1,15,000
5. Cash and bank balances		
Cash at bank	2,00,000	
Cash in hand	<u>30,000</u>	2,30,000

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 was taken up by all the 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 (Issue of bonus shares in the ratio of 1 for 5 <i>vide</i> Board's resolution dated....)			50,000
Profit and Loss A/c To Debenture Redemption Reserve (for DRR created 10% x 1,20,000)	Dr.	12,000	12,000
Debenture Redemption Reserve Investment A/c To Bank A/c (for DRR Investment created 15% x 1,20,000)	Dr.	18,000	18,000
12% Debentures A/c	Dr.	1,20,000	
Premium Payable on Redemption A/c @ 3%	Dr.	3,600	
To Debenture holders A/c (Amount payable to debentures holders)			1,23,600
Profit and loss A/c To Premium Payable on Redemption A/c (Premium payable on redemption of debentures 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.	12,000	12,000
Bank A/c To Debenture Redemption Reserve Investment (for DRR Investment realised)	Dr.	18,000	18,000
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 at..... (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	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	(12,000)		
	79,400		
General Reserve	<u>12,000</u>		91,400
3. Property, Plant and Equipment			
Freehold property			1,15,000
4. Cash and bank balances			
Cash at bank (2,00,000 + 75,000 – 1,23,600 – 18,000 + 18,000)	1,51,400		
Cash in hand	<u>30,000</u>		1,81,400

Illustration 6

The Balance Sheet of Convertible Limited (unlisted company other than AIFI, Banking company, NBFC and HFC), as at 31st March, 20X1, stood as follows:

Particulars	Note No	₹
I. Equity and liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	50,00,000
(b) Reserves and Surplus	2	1,10,00,000
(2) Non-current liabilities		
(a) Long term borrowings	3	1,65,00,000
(3) Current Liabilities		
(a) Other current liabilities		1,25,00,000
Total		4,50,00,000
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment		1,60,00,000
(b) Non-current investment	4	15,00,000
(2) Current assets		
(a) Cash and cash equivalents		75,00,000
(b) Other current assets		2,00,00,000
Total		4,50,00,000

Notes to Accounts

		₹
1. Share Capital		
5,00,000 shares of ₹ 10 each fully paid		50,00,000
2. Reserve and Surplus		
General Reserve	90,00,000	
Profit & Loss Account	10,00,000	
Debenture redemption reserve	<u>10,00,000</u>	1,10,00,000
3. Long term borrowings		
13.5% convertible Debentures		1,00,00,000

	(1,00,000 debentures of ₹ 100 each)		
	Other loans		65,00,000
			<u>1,65,00,000</u>
4.	Non-current investments		
	Debenture redemption reserve		15,00,000

The debentures are due for redemption on 1st April, 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 April, 20X1.

Redraft the balance sheet of the company as on 1st April, 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 at April 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) Other liabilities		<u>1,25,00,000</u>
	Total	<u>3,60,75,000</u>
II. Assets		
(1) Non-current assets		
(a) Property, Plant & Equipment		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	90,00,000	
Profit & Loss	10,00,000	
Add: Debenture Redemption Reserve transfer	10,00,000	
	<u>110,00,000</u>	
Less: Premium on redemption of debentures (1,00,000 debentures x ₹5 per debenture)	<u>(5,00,000)</u>	1,05,00,000
Securities Premium (1,00,000 shares x ₹5.75) (Refer WN (i))		5,75,000
		<u>1,10,75,000</u>

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

Total number of debentures	1,00,000
----------------------------	----------

Less: Number of debentures for which debenture holders did not opt for conversion	(25,000)
	<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 shares of ₹ 10 each.

(ii) Calculation of cash to be paid:	₹
Total number of debentures	1,00,000
Less: number of debentures to be converted into equity shares	(15,000)
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
Add: Proceeds of investments sold	<u>15,00,000</u>
	90,00,000
Less: Cash paid to debenture holders	(89,25,000)
	<u>75,000</u>

SUMMARY

- Debentures 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, certain companies are required to create Debenture Redemption Reserve.
- Methods of redemption: lumpsum payment; payment in instalments and purchase of debentures in open market.

TEST YOUR KNOWLEDGE

MCQ

- Which of the following statements is true?
 - A debenture holder is an owner of the company.
 - A debenture holder can get his money back only on the liquidation of the company.
 - A debenture issued at a discount can be redeemed at a premium.
- Which of the following statements is false?
 - Debentures can be redeemed by payment in lump sum at the end of a specified period.
 - Debentures cannot be redeemed during the life time of the company.
 - Debentures can be redeemed by payments in annual instalments.
- For debentures issued by unlisted companies (other than AIFs, Banking companies, NBFCs and HFCs), Debentures Redemption reserve will be considered adequate if it is:
 - 25% of the value of debentures issued through public issue.
 - 10% of the value of debentures issued through public issue.
 - 5% of the value of debentures issued through public issue.
- At the time of cancellation of own debentures, the account credited will be
 - Debentures account.
 - Own debentures account.
 - Bank account.
- A company has issued 6% debentures for ₹ 10,00,000, interest being payable on 31st March and 30th September. The company purchases ₹ 10,000 debentures at ₹ 96 (ex-interest) on 1st August 20X1. These debentures were cancelled on same date. The amount of Profit/loss on cancellation of debentures will be
 - Profit of ₹ 600.
 - Profit of ₹ 400.
 - Loss of ₹ 400

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 (a listed company) 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 (unlisted company other than AIFI, Banking company, NBFC and HFC) ledger, 9% debentures appeared with an 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

YZ Ltd (an unlisted company other than AIFI, Banking company, NBFC and HFC) 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 ₹ 1,00,000. Interest on investments is received yearly at the end of financial year.

2,000 own debentures were purchased on 31st March 20X2 at an average price of ₹ 99 and cancelled on the same date.

On 30 March 20X2, the investments were realised at par and the debentures were redeemed on 31st March, 20X2. 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) 4. (b) 5. (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

A company issuing debentures may be 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

	<i>Number of debentures</i>
Total number of debentures	20,000
<i>Less:</i> Debenture holders not opted for conversion	<u>(2,500)</u>
Debenture holders opted for conversion	<u>17,500</u>
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 x (100+5)]	₹ 3,67,500
Equity shares of ₹ 10 each issued on conversion [₹ 3,67,500/ ₹ 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 To Debenture Application A/c (Application money received on 1,50,000 debentures @ ₹ 100 each)	Dr.	1,50,00,000	1,50,00,000
1.6.20X1	Debenture Application A/c Underwriters A/c To 15% Debentures A/c (Allotment of 1,50,000 debentures to applicants and 50,000 debentures to underwriters)	Dr. Dr.	1,50,00,000 50,00,000	2,00,00,000
	Underwriting Commission To Underwriters A/c (Commission payable to underwriters @ 2% on ₹ 2,00,00,000)	Dr.	4,00,000	4,00,000
	Bank A/c To Underwriters A/c (Amount received from underwriters in settlement of account)	Dr.	46,00,000	46,00,000
01.06.20X1	Debenture Redemption Investment A/c To Bank A/c (200,000 X 100 x 15% X 40%) (Being Investments made for redemption purpose)	Dr.	12,00,000	12,00,000

30.9.20X1	Debenture Interest A/c To Bank A/c (Interest paid on debentures for 4 months @ 15% on ₹ 2,00,00,000)	Dr.	10,00,000	10,00,000
31.10.20X1	15% Debentures A/c To Equity Share Capital A/c To Securities Premium A/c (Conversion of 60% of debentures into shares of ₹ 60 each with a face value of ₹ 10)	Dr.	1,20,00,000	20,00,000 1,00,00,000
31.3.20X2	Debenture Interest A/c To Bank A/c (Interest paid on debentures for the half year) (Refer working note below)	Dr.	7,50,000	7,50,000

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			
		<u>50,00,000</u>			<u>50,00,000</u>

(ii) Interest on Debentures Account

			₹			₹	
31.5.X1	To	Bank (Interest for 2 months on 8,000 debentures) (Refer Working Note)	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) (Refer Working Note)	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 10%)	80,000	1 April 20x1	To Profit & Loss A/c (50,000 X 100 X 10%)	5,00,000
31 March 20X2	By Balance c/d	4,20,000			
		5,00,000			5,00,000

(iv) Debentures Redemption Reserve 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, 20X2	To Own Debentures A/c	1,98,000	1 st April, 20X1	By Balance b/d	16,00,000
31 st March, 20X2	To Profit on cancellation	2,000			
31 st March, 20X2	To Bank A/c	14,00,000			
		16,00,000			16,00,000

Debenture Redemption Reserve Account

Date	Particulars	₹	Date	Particulars	₹
31 st March, 20X2	To General Reserve A/c		1 st April, 20X1	By Balance b/d	1,00,000
		1,60,000	1 st April, 20X1	By Profit and loss A/c [(16,00,000 X 10%) – 1,00,000]	60,000
		1,60,000			1,60,000

Debenture Redemption Investments A/c

Date	Particulars	Amount	Date	Particulars	Amount
1 st April 20X1	To Balance b/d	2,00,000	30 th March 20X2	By Bank A/c (2,000 x 100 x 15%) <i>(Refer Working Note 2)</i>	30,000
1 st April 20X1	To Bank A/c <i>(Refer Working Note 1)</i>	40,000	30 th March 20X2	By Bank A/c <i>(Refer Working Note 3)</i>	2,10,000
		2,40,000			2,40,000

Working Note 1:**Additional investment in Debenture Redemption Investment A/c on 1 April 20X1**

The company would be required to invest an amount equivalent to 15% of the value of the debentures in specified investments which would be equivalent to:

$$= \text{Total No of debentures} \times \text{Face value per debenture} \times 15\%$$

$$= 16,000 \times 100 \times 15\%$$

$$= ₹ 2,40,000/-$$

The company has already invested in specified investments i.e. 9% Govt bonds for an amount of ₹ 2,00,000 as per the information given in the question.

The balance amount of ₹ 40,000 (i.e. ₹ 2,40,000 less ₹ 2,00,000) would be invested by the company on 1 April 20X1.

Working Note 2:

Redemption of Debenture Redemption Investments on 30 March 20X2 amounting to ₹ 30,000

Since the company purchased 2,000 own debentures on 31 March 20X2, the company would also realize the investments of 15% corresponding to these debentures for which computation is as follows:

$$\begin{aligned} &= \text{No of own debentures to be bought} \times \text{Face value per debenture} \times 15\% \\ &= 2,000 \times 100 \times 15\% \\ &= ₹ 30,000/- \end{aligned}$$

Working Note 3:

Redemption of Debenture Redemption Investments on 30 March 20X2 amounting to ₹ 2,10,000

The remaining debentures i.e. total debentures less own debentures would be redeemed on 31 March 20X2 and hence the company would also realize the balance investments of 15% corresponding to these debentures for which computation is as follows:

$$\begin{aligned} &= (\text{Total no of debentures} - \text{No of own debentures}) \times \text{Face value per debenture} \times 15\% \\ &= (16,000 - 2,000) \times 100 \times 15\% \\ &= ₹ 2,10,000/- \end{aligned}$$