SUPPLEMENTARY DECEMBER 2023

PAPER - 10

CORPORATE ACCOUNTING AND AUDITING

SECTION - A : CORPORATE ACCOUNTING

SYLLABUS - 2022

Redemption of Preference Shares, Issue and Redemption of Debentures [Amended]

1.2

1.2.1 Redemption of Preference Shares

Redeemable preference shares have a fixed term and hence are redeem at the end of such period. On redemption the shareholders are repaid the capital that they had invested in those shares.

The redemption may occur either 'at par' or 'at premium'. When the company repays an amount equal to the face value or nominal value of the preference shares, it is called 'redemption at par'. On the other hand, when a company repays more than the face value or nominal value of the preference shares, it is known as 'redemption at premium'. Thus, under redemption at premium, the company makes payment for (a) preference share capital as well as for (b) premium.

⦿ **Provisions Regarding Issue and Redemption of Preference Shares**

The issue and redemption of preference shares are governed by Companies Act, 2013 and Companies (Share Capital and Debentures) Rules, 2014.

Section 55 of the Act states that –

(1) No company limited by shares shall, after the commencement of this Act, issue any preference shares which are irredeemable.

(2) A company limited by shares may, if so authorised by its articles, issue preference shares which are liable to be redeemed within a period not exceeding twenty years from the date of their issue subject to such conditions as may be prescribed.

Rule 10 of the Companies (Share Capital and Debentures) Rules, 2014 further states that company engaged in the setting up and dealing with of infrastructural projects may issue preference shares for a period exceeding twenty years but not exceeding thirty years, subject to the redemption of a minimum ten percent of such preference shares per year from the twenty first year onwards or earlier, on proportionate basis, at the option of the preference shareholders.

Moreover, as per Rule 9(6), a company may redeem its preference shares only on the terms on which they were issued or as varied after due approval of preference shareholders under section 48 of the Act and the preference shares may be redeemed:

(a) at a fixed time or on the happening of a particular event;

(b) any time at the company's option; or

(c) any time at the shareholder's option.

⦿ **Conditions for Redemption of Preference Shares**

Section 55(2) of the Companies Act, 2013, provides that –

(a) no such shares shall be redeemed except out of the profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of such redemption;

(b) no such shares shall be redeemed unless they are fully paid;

(c) where such shares are proposed to be redeemed out of the profits of the company, there shall, out of such profits, be transferred, a sum equal to the nominal amount of the shares to be redeemed, to a reserve, to be called the Capital Redemption Reserve Account, and the provisions of this Act relating to reduction of share capital of a company shall, except as provided in this section, apply as if the Capital Redemption Reserve Account were paid-up share capital of the company; and

(d) (i) in case of such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under section 133, the premium, if any, payable on redemption shall be provided for out of the profits of the company, before the shares are redeemed:

Provided also that premium, if any, payable on redemption of any preference shares issued on or before the commencement of this Act by any such company shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

(ii) in a case not falling under sub-clause (i) above, the premium, if any, payable on redemption shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

Note: Deemed Redemption u/s 55(3) - Where a company is not in a position to redeem any preference shares or to pay dividend, if any, on such shares in accordance with the terms of issue (such shares hereinafter referred to as unredeemed preference shares), it may, with the consent of the holders of three-fourths in value of such preference shares and with the approval of the Tribunal on a petition made by it in this behalf, issue further redeemable preference shares equal to the amount due, including the dividend thereon, in respect of the unredeemed preference shares, and on the issue of such further redeemable preference shares, the unredeemed preference shares shall be deemed to have been redeemed:

⊙ Important Points on Redemption of Preference Shares (Other than Deemed Redemption)

Based on the above provisions, the following important points can be noted:

a. Only fully paid-up preference shares can be redeemed. Partly paid-up preference shares must be converted into fully paid-up by calling up the remaining instalment(s) before they can be eligible for redemption.

b. The repayment of capital portion can be done out of two sources –
   (i) Profits of the company (which would otherwise be available for dividend payment)
   (ii) Proceeds of fresh issue of shares.

c. The premium on redemption, if any, shall be provided as follows:
   (i) In case of the prescribed class of companies and whose financial statements comply with the accounting standards prescribed u/s 133 of the Companies Act, 2013 –
      - If the preference shares were issued on or before 01.04.2014 (date of commencement of the Companies Act, 2013), premium can be provided out of Securities Premium as well as out of Profits of the Company.
      - If the preference shares were issued after 01.04.2014, premium can be provided only out of Profits of the Company.
   (ii) For other companies, there can be two sources of premium i.e., Securities Premium and Profits of the Company.

Note: For the purpose of payment of capital, the term 'Profits of the Company which would otherwise be available for dividend' shall mean 'free reserves'. Hence, Securities Premium, Revaluation Reserve, Capital Reserve (unrealized) or any Statutory Reserve will not be eligible for this purpose. But free portion of Investment Allowance Reserve, Development Rebate Reserve, Workmen Compensation Fund will be allowed.

Note: For the purpose of payment of premium, the term 'Profits of the Company' (excluding the expression 'which would otherwise be available for dividend') means all profits of the company whether realized or not. Hence, Capital Reserve (whether released or not), all Statutory Reserve (free portion only), free portion of Investment Allowance Reserve, Development Rebate Reserve, Workmen Compensation Fund will be allowed.

d. Companies may also issue fresh equity or preference shares for redemption of existing preference shares. In such a case –
   (i) If the shares are issued at par, proceeds from fresh issue = Nominal Value of shares;
   (ii) If the shares are issued at premium, proceeds from fresh issue = Nominal Value of shares (i.e., excluding premium on issue)

e. A sum equal to the nominal amount of the shares to be redeemed out of profits should be transferred tom Capital Redemption Reserve (CRR). The balance of CRR so created shall only be utilized for issue of fully paid-up bonus shares.

Accounting for Redemption of Preference Shares

(i) On issue of new shares for the purpose of redemption

Bank A/c …………………… Dr.

To Equity Share Application A/c

(Being application money received on ... shares @ ₹ ... each)

Equity Share Application A/c ……Dr.

To Share Capital A/c

To Securities Premium A/c (if new shares are issued at premium)

(Being the issue of... shares of ₹ ...each at a premium of ₹ ...each for the purpose of redemption of preference shares as per Board's Resolution No ... dated ...)

(ii) Redemption due entry

Redeemable Preference Share Capital A/c …...…… Dr.

Premium on Redemption of Preference Shares A/c …Dr. (if redeemable at premium)

To Preference Shareholders A/c

(iii) When payment is made to preference shareholders

Redeemable Preference Shareholders A/c ………. Dr.

To Bank A/c

(iv) Adjustment of premium on redemption

Profit and Loss A/c …………… Dr.

To Premium on Redemption of Preference Shares A/c

(Being the premium on redemption adjusted against profit and loss balance)

Note: In addition, the company may need to undertake transactions such as 'sale of investment' 'sale of idle assets' etc. at profit or at loss. The effect of such transaction shall also be taken into consideration while determining the required amount of fresh issue or profits to be transferred to CRR.

Consider the following illustrations.

Illustration 40

T Ltd. furnishes you with the following Balance Sheet as at 31st March, 2021 : (₹ in Lakhs)

Equity shares of ₹ 10 each fully paid	400	
12% redeemable preference shares of ₹ 100 each fully paid	200	
Reserves and surplus:		
- Capital reserve	15	
- Share Premium	25	
- Revenue reserves	260	300
Funds Employed in :		900
Fixed assets less depreciation		560
Current assets	540	
Less : Current liabilities	200	340
		900

The company redeemed preference shares on 1st April 2021 at a premium of 10%. You are required to pass journal entries to record the above.

Solution :

In the books of T Ltd

Part I - Journal

(₹ in Lakhs)

Particulars		Dr. ₹	Cr. ₹
i. Due Entry:			
12% Preference Share capital A/c	Dr.	200	
Premium on redemption of preference share A/c	Dr.	20	
To Preference Share Holders A/c			220
ii. Payment Entry:			
Preference Shareholders A/c	Dr.	220	
To Bank A/c			220
iii. Premium on redemption of preference Share			
Securities Premium A/c	Dr.	20	
To Premium on redemption of preference share A/c			20
iv. Transfer to Capital Redemption Reserve Account			
Revenue reserve A/c	Dr.	200	
To Capital Redemption Reserve A/c			200
(Being creation of capital redemption reserve to the extent of the face value of preference shares redeemed and equity shares bought back)			

Sec. 55 was intended to cover the period of transition and will have no significance after the companies fulfill the requirements stated therein.

Illustration 41

Find out in each case what amount shall be transferred to capital redemption reserve account:

	Redeemable preference shares redeemed	Fresh issue of share capital
a.	₹ 10,00,000 at par	₹ 10,00,000 at par
b.	₹ 10,00,000 at 5% premium	₹ 800,000 at par
c.	₹ 10,00,000 at par	₹ 800,000 at 10% premium
d.	₹ 10,00,000 at 5% premium	₹ 800,000 at 10% premium

Solution:

For (a) Nil.

For (b), (c) and (d) ₹ 2,00,000

Explanation:

Amount utilized from the existing sources towards the nominal value of the preference shares redeemed, should be transferred to Capital Redemption Reserve Account. So, in the above case, the difference of nominal value of shares redeemed and amount received from nominal value of fresh issue is the transferable amount.

In case of (a) the total requirement is met up by fresh issue.

In cases of (b), (c) and (d): ₹10,00,000 – ₹8,00,000 (from nominal value of fresh issue) i.e. ₹2,00,000.

Illustration 42

The Balance Sheet of Pixel Ltd. as on 31.12.2021 is given below:

Liabilities	₹ in Lakh	Assets	₹ in Lakh
Share Capital:		Fixed Assets	140
10,00,000 Equity shares of ₹10 each	100	Investments	40
1,00,000 Redeemable Pref. shares of ₹100 each	100	Stock	46
Less: Call-in-arrears on 20,000 shares	(4)	Debtors	30
Security premium account	15	Bank	30
Reserve	30		
Profit and Loss account	15		
Creditors	30		
	286		286

On 1st Jan 2022, fixed assets costing ₹40 Lakh were sold for ₹32 Lakh. It was decided that on 1st Feb 2022, company issued sufficient number of equity shares at par so as to finance redemption and to leaving a balance of ₹10 Lakh in the reserve. All the payments were made except to a holder of 10,000 shares who could not be traced. The company also made bonus issue to the existing equity shareholders in the ratio of 1: 10 as on 31.12.2021. You are required to pass the necessary journal entries.

Solution:

Workings: **Requirement of Fund for Redemption**

	No.	Rate	₹ in Lakhs
Pref Shares	1,00,000	100	100
Calls in Arrear	20,000	100	20
Bal. to be redeemed	80,000		80
Prem on redemption		20%	16
Total Fund requirement			96

Sources	Nominal Value	Premium	Total
Requirement	80	16	96
Securities Prem. A/c		15	15
P/L A/c	6	1	7
General Reserve	20		20
Balance fund requirement (From fresh issue)	60		60
New Issue	60		

Actual payment made = (80,000-10,000)*120 = ₹84 Lakh

**Bonus Shares = 10,00,000 × 1/10 = 1,00,000 @ ₹10 = ₹10 Lakhs.

Transfer to Capital Redemption Reserve	₹ in Lakh	₹ in Lakh
From P/L A/c		
Balance	15	
Less: Loss on Sale of Assets	8	
Balance	7	
Less: Used for Premium on Redemption of		
Pref. Shares	1	6
From General Reserve		20
Total		

In the books of Pixel Ltd.

Journal

Particulars		Dr. ₹ in Lakh	Cr. ₹ in Lakh
Bank A/c	Dr.	32	
Profit and Loss A/c	Dr.	8	
To Fixed Assets A/c			40
(Sale of Fixed Assets, Loss transferred)			
Bank A/c	Dr.	60	
To Equity Share Capital A/c			60
(Issue of new shares)			
Red. Pref. Share Capital A/c	Dr.	80	
Premium on Redemption A/c	Dr.	16	
To Red. Pref. Shareholders A/c			96
(Amount due on Redemption)			
General Reserve A/c	Dr.	20	
Profit and Loss A/c	Dr.	6	
To Capital Redemption Reserve A/c			26
(Transfer)			
Securities Premium A/c	Dr.	15	
Profit and Loss A/c	Dr.	1	
To Premium on Redemption A/c			16
(Transfer)			
Red. Pref. Shareholders A/c	Dr.	84	
To Bank A/c			84
(Payment to Pref. Shareholders)			
Capital Redemption Reserve A/c	Dr.	10	
To Bonus to Shareholders A/c			10
(Bonus declared)			
Bonus to Shareholders A/c	Dr.	10	
To Equity Share Capital A/c			10
(Conversion of Bonus Shares to Equity Shares)			

Illustration 43

The balance sheet of G Ltd as on 31.12.2018

Liabilities:	(₹)
Equity shares of ₹10 each	2,00,000
Less: Calls in arrear @ ₹2	10,000
14% Preference Shares of ₹100	1,00,000
Securities Premium	10,000
Investment Allowance Reserve	40,000
Development Rebate Reserve	20,000
Workmen Compensation Fund	10,000
Dividend Equalization Reserve	12,000
Profit and Loss Account	38,000
Unsecured Loans	80,000
	5,00,000
Assets	
Non Current Assets	4,00,000
Current Assets(including Bank balance ₹ 10,000)	1,00,000
	5,00,000

The board of directors decided to redeem the preference shares on 1st January 2019 on the following conditions.

Issue 4000 equity shares and ₹50,000 10% debentures.

Redeem preference shares at a premium of 10%.

Raise necessary bank loan to provide funds for redemption and to have ₹15,000 as balance.

Admit claim of ₹40,00 for workmen compensation.

Utilise ₹10,000 out of development rebate reserve for the purpose.

Necessary journal entries assuming that holders of 100 reference shares could not be traced by the company.

Solution:

In the books of G Ltd.

Journal

Remarks	Particulars		Dr. ₹	Cr. ₹
Arrangement of fund	Bank A/c	Dr.	40,000	
	To Equity Share Capital A/c			40,000
Arrangement of fund	Bank A/c	Dr.	50,000	
	To 10% Debentures A/c			50,000
Amount payable	14% Preference Share Capital A/c	Dr.	1,00,000	
	Premium on redemption A/c	Dr.	10,000	
	To Preference Shareholders A/c			1,10,000

Arrangement of fund	Securities Premium A/c	Dr.	10,000	
	To Premium on Redemption A/c			10,000
Arrangement of fund	Development Rebate Reserve A/c	Dr.	10,000	
	Workmen Compensation Fund A/c	Dr.	6,000	
	Dividend Equalization Reserve A/c	Dr.	12,000	
	Profit and Loss A/c	Dr.	32,000	
	To Capital Redemption Reserve A/c			60,000
Arrangement of fund	Bank A/c	Dr.	25,000	
	To Bank Loan A/c			25,000
Payment made except 100 shareholders who could not be traced.	Preference Shareholders A/c	Dr.	99,000	
	To Bank A/c			99,000
	Workmen Compensation Fund A/c	Dr.	4,000	
	To Claim for Workmen Compensation A/c			4,000

Note:

Amount to be transferred to CRR:	₹
Nominal value of shares to be redeemed	1,00,000
Less : Fresh issue of equity shares	40,000
CRR	60,000

Illustration 44

Books of M Limited show the following balances on 31st December 2020	₹
15000 present equity shares of ₹10 each fully paid	1,50,000
2500 10% preference shares of ₹100 each fully paid	2,50,000
500 8% redeemable preference shares pop ups ₹108, what is ₹70 paid up	₹35,000
General Reserve	75,000
Profit and Loss Account	1,60,000
Securities Premium	15,000
Investment	1,20,000
Cash at Bank	39,600

On 1st January 2021 the board of directors decided to redeem the preference shares at a premium of 8%. In order to pay of preference shareholders the company also decided to sell the Investments and use companies fund and to raise the balance by issue of sufficient number of equity shares of ₹10 each at a premium of rupee 1 per share subject to leaving a minimum bank balance of ₹9,000 after search Redemption.

Investments web sold at ₹1,08,000

Show the necessary journal entries (without narration) to record the transactions.

Solution:

In the books of M Ltd.

Journal

Remarks	Particulars	Dr. (₹)	Cr. (₹)
Arrangement of fund	Bank A/c To Equity Share Capital A/c To Securities Premium A/c	1,32,000	 1,20,000 12,000
Arrangement of fund	Bank A/c Profit and Loss A/c To Investment A/c	1,08,000 12,000	 1,20,000
Amount payable	14% Preference Share Capital A/c Premium on Redemption A/c To Preference Shareholders A/c	2,50,000 20,000	 2,70,000
Arrangement of fund	Securities Premium A/c To Premium on Redemption A/c	20,000	 20,000
Arrangement of fund	General Reserve A/c Profit and Loss A/c To Capital Redemption Reserve A/c	75,000 55,000	 1,30,000
Payment made	Preference Shareholders A/c To Bank A/c	2,70,000	 2,70,000

Note:

Amount to be transferred to CRR:	₹
Nominal value of shares to be redeemed	2,50,000
Less : fresh issue of equity shares	1,20,000
CRR	1,30,000

Note :

Amount of cash to be collected from new issue of equity shares = amount payable in redemption + minimum closing cash balance – (opening bank balance + sale of investment) = ₹ [2,70,000 + 9,600 - (39,600 + 1,08,000)] = ₹ (2,79,600 - 1,47,600) = ₹ 1,32,000.

Therefore, number of shares to be issued will be = 132000/ (10+1) = 1200

Value per share = 10+1 (including premium of ₹1)

1.2.2 Issue and Redemption of Debentures

Share capital is the primary source of finance for every company. However, companies are often found to raise debt capital for additional financing requirement. A company raises the debt capital either through institutional financing i.e., loans from banks and other financial institutions or may issue structured debt instruments (such as debentures and bonds). Debentures happens to be the most popular debt instruments issued by a company to raise borrowed capital.

As per Section 2(30) of the 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.

Following are the features of debentures as a debt instrument.

a. Debenture is a financial instrument used to raise debt capital.

b. It is written document issued under the seal of the company.

c. It normally carries a rate of interest payable at regular interval. Such rate is termed as coupon rate.

d. Debenture may be redeemable or irredeemable.

Types of Debentures

The various types of debentures are shown in the following diagram.

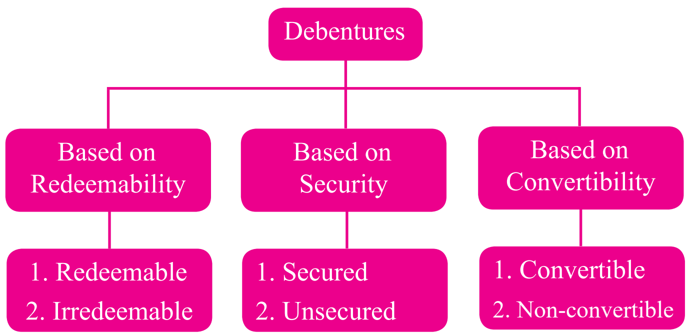

Figure 1.3: Types of Debentures

a. Redeemable vs. Irredeemable Debentures

Redeemable Debentures are debentures that are repayable by a company at the end of the pre-specified time period. Irredeemable debentures are not repayable during the life-time of the company.

b. Secured vs. Unsecured Debentures

Secured Debentures are those debentures which create a charge on the assets of the company. These are also called Mortgage Debentures. Unsecured debentures are issued without the support of a collateral security. These are also called Naked Debentures.

c. Convertible vs. Non-convertible Debentures

Debentures which are convertible into other securities viz. equity shares, preference shares or new debentures after a specified period are referred to as Convertible Debentures. They may fully convertible or partly convertible. On the other hand, Debentures which are not convertible into any other security are referred to as Non-convertible Debentures.

Note: In all the above cases, the debentures may be issued at par or at premium or at discount to the issue price.

Provisions Relating to Issue and Redemption of Debentures

The provisions relating to issue and redemption of debentures are covered by Section 71 of the Companies Act, 2013 and Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014.

Section 71 of the Companies Act, 2013 states that -

(1) 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, shall be approved by a special resolution passed at a general meeting.

(2) No company shall issue any debentures carrying any voting rights.

(3) Secured debentures may be issued by a company subject to such terms and conditions as may be prescribed.

(4) Where debentures are issued by a company under this section, the company shall 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 shall not be utilised by the company except for the redemption of debentures.

(5) No company shall issue a prospectus or make an offer or 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.

(6) A debenture trustee shall take steps to protect the interests of the debenture-holders and redress their grievances in accordance with such rules as may be prescribed.

(7) Any provision contained in a trust deed for securing the issue of debentures, or in any contract with the debenture-holders secured by a trust deed, shall be void in so far as it would have the effect of exempting a trustee thereof from, or indemnifying him against, any liability for breach of trust, where he fails to show the degree of care and due diligence required of him as a trustee, having regard to the provisions of the trust deed conferring on him any power, authority or discretion:

Provided that the liability of the debenture trustee shall be subject to such exemptions as may be agreed upon by a majority of debenture-holders holding not less than three-fourths in value of the total debentures at a meeting held for the purpose.

(8) A company shall pay interest and redeem the debentures in accordance with the terms and conditions of their issue.

*(9) Where at any time the debenture trustee comes to a conclusion that the assets of the company are insufficient or are likely to become insufficient to discharge the principal amount as and when it becomes due, the debenture trustee may file a petition before the Tribunal and the Tribunal may, after hearing the company and any other person interested in the matter, by order, impose such restrictions on the incurring of any further liabilities by the company as the Tribunal may consider necessary in the interests of the debenture-holders.

*(10) Where a company fails to redeem the debentures on the date of their maturity or fails to pay interest on the debentures when it is due, the Tribunal may, on the application of any or all of the debenture-holders, or debenture trustee and, after hearing the parties concerned, direct, by order, the company to redeem the debentures forthwith on payment of principal and interest due thereon.

(12) A contract with the company to take up and pay for any debentures of the company may be enforced by a decree for specific performance.

(13) The Central Government may prescribe the procedure, for securing the issue of debentures, the form of debenture trust deed, the procedure for the debenture-holders to inspect the trust deed and to obtain copies thereof, quantum of debenture redemption reserve required to be created and such other matters.

Additional conditions[2] have been provided by the Companies (Share Capital and Debentures) Rules, 2014.

In addition to the above, SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 also provides important guidelines for debt securities[3] to be issued by listed entities.

[2] See Rule 18 of Companies (Share Capital and Debentures) Rules, 2014

[3] See Chapter III of SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021

1.2.2.1 Accounting for Issue of Debentures – General Cases

Debentures can be issued at par or at premium or at discount. Moreover, the money can be collected in lump-sum or in instalments. The accounting entries for issue of debentures are as follows:

a. Debentures issued in lump sum

(i) On receipt of application money

Bank A/c ....Dr.

To Debenture Application A/c

(ii) For excess debenture application money refunded

Debenture Application A/c .... Dr.

To Bank A/c

(iii) On allotment of debentures

Debenture Application A/c ....Dr.

Discount on Issue of Debentures A/c .... Dr. (if issued at discount)

To Debentures A/c

To Securities Premium A/c (if issued at premium)

b. Debentures issued in instalments

(i) On receipt of application money

Bank A/c ....Dr.

To Debenture Application A/c

(ii) For excess debenture application money refunded

Debenture Application A/c .... Dr.

To Bank A/c

(iii) For debenture application money transferred to share capital

Debenture Application A/c ....Dr.

To Share Capital A/c

(iv) For debenture allotment money due

Debenture Allotment A/c ....Dr.

Discount on Issue of Debentures A/c .... Dr. (if issued at discount)

To Debenture Capital A/c

To Securities Premium A/c (if issued at premium)

(v) For debenture allotment money received

Bank A/c ....Dr.

To Debenture Allotment A/c

(vi) For debenture call money due

Debenture Call A/c …………………………. Dr.

To Share Capital A/c

(vii)For debenture call money received

Bank A/c …………………………………Dr.

To Debenture Call A/c

Note: In case of issue of debentures at discount, the Discount will always be accounted in allotment. However, premium will be accounted with the instalment in which it is included. If nothing is mentioned specifically, it is accounted with allotment money.

Note: The premium on issue of debenture is included in Securities Premium A/c and the same is reflected under Reserve and Surplus in the Balance Sheet. The discount on issue of debentures is amortized over the life of the debentures on a proportionate basis. Accordingly, the amount amortized during the year is shown under Depreciation and Amortization in the Statement of Profit and Loss. The remaining amount is shown in the assets section of the Balance Sheet. The portion to be amortized over next 12 months is included in Other Current Assets while the portion that will not be amortized over next 12 months is shown in Other Non-current Assets. (Refer to illustration 58)

Consider the following illustration.

Illustration 45

P Ltd. issued 50,000, 8% Debentures of ₹100 each at a premium of ₹20 payable as follows:

₹30 on application; ₹40 on allotment (including premium); and ₹50 on first and final call.

Applications were received for all the debentures along with the application money and allotment was made Call money was also received on due date. Pass necessary journal entries to record the issue of debentures.

What will be the entries if the entire amount is received on application?

Solution:

(a)

When debentures were issued in instalment

In the books of P Ltd.

Journal

Date	Particulars	Dr. ₹	Cr. ₹
	Bank A/c …………………Dr.	15,00,000	
	To Debenture Application A/c		15,00,000
	(Being application money received)		
	Debenture Application A/c ……………………. Dr.	15,00,000	
	To Debentures A/c		15,00,000
	(Being application money transferred to Debentures as per board's resolution no ….. dated…)		

	Debenture Allotment A/c ……………………………Dr. To Debenture Capital A/c To Securities Premium A/c (Being allotment money due as per board's resolution no ….. dated…)	20,00,000	 10,00,000 10,00,000
	Bank A/c ………………………..Dr. To Debenture Allotment A/c (Being allotment money received)	20,00,000	 20,00,000
	Debenture First and Final Call A/c……………. Dr. To Share Capital A/c (Being first and final call money due as per board's resolution no ….. dated…)	25,00,000	 25,00,000
	Bank A/c ………………………..Dr. To Debenture First and Final A/c (Being first and final call money received)	25,00,000	 25,00,000

(b)

When debentures were issued at lumpsum

In the books of P Ltd.
Journal

Date	Particulars	Dr. ₹	Cr. ₹
	Bank A/c …………………Dr. To Debenture Application A/c (Being application money received)	60,00,000	 60,00,000
	Debenture Application A/c ……………………. Dr. To Debenture Capital A/c To Securities Premium A/c (Being application money transferred to Debentures as per board's resolution no ….. dated…)	60,00,000	 50,00,000 10,00,000

1.2.2.2 Accounting for Issue of Debentures – Special Cases

I. When terms of redemption are known and debentures are redeemable at premium

In this case the premium payable on redemption may be provided at the time of issue itself, by passing the following additional entry –

Loss on Issue of debentures A/c……………….... Dr.

To Premium on Redemption of Debentures A/c

Students may pass a combined entry at the time of allotment to record the above. Consider the following alternative situations (other entries remain the same).

Situation	Combined entry on allotment
Issue at par, redemption at premium	Debenture Application A/c ………..Dr. Loss on Issue of debentures A/c………... Dr. To Debentures A/c To Premium on Redemption of Debentures A/c
Issue at premium, redemption at premium	Debenture Application A/c ………..Dr. Loss on Issue of debentures A/c………... Dr. To Debentures A/c To Securities Premium A/c To Premium on Redemption of Debentures A/c
Issue at discount, redemption at premium	Debenture Application A/c ………………………Dr. Loss on Issue of Debentures A/c …………... Dr. To Debentures A/c To Premium on Redemption of Debentures A/c Note: Here, Loss on Issue of Debentures A/c includes both discount on issue of debentures and premium on redemption of debentures

Consider the following illustration.

Illustration 46

Journalize the following transactions. Narration is not required:

Issue of 12% 1,00,000 debentures of ₹100 each

1. at par and redeemable at par.
2. at 10% discount and redeemable at par.
3. at 10% premium and redeemable at par.
4. at 10% premium and redeemable at a premium of 5%.
5. at par and redeemable at a premium of 5%.
6. at 10% discount and redeemable at a premium of 5%.

Solution:

Journal

	Particulars		Dr. ₹ '000	Cr. ₹ '000
1.	Bank A/c	Dr.	10,000	
	To 12% Debentures A/c			10,000
2.	Bank A/c	Dr.	9,000	
	Discount on Issue of Debentures A/c	Dr.	1,000	
	To 12% Debentures A/c			10,000

3.	Bank A/c To 12% Debentures A/c To Securities Premium A/c	Dr.	11,000	 10,000 1,000
4.	Bank A/c Loss on issue of debenture A/c To 12% Debentures A/c To Securities Premium A/c To Prem. on redemption of debentures A/c	Dr. Dr.	11,000 500	 10,000 1,000 500
5.	Bank A/c Loss on issue of Debentures A/c To 12% Debentures A/c To Prem. on redemption of DebenturesA/c	Dr. Dr.	10,000 500	 10,000 500
6.	Bank A/c Loss on Issue of Debentures A/c ** To 12% Debentures A/c To Prem. on redemption of Debentures A/c	Dr. Dr.	9,000 1,500	 10,000 500

** This amount includes ₹1,000 discount on issue of debentures and ₹500 premium on redemption.

II. Issue of Debenture for Consideration other than Cash

Debentures may also be issued for consideration other than cash. Examples include allotment of debentures for purchase of asset or for technical services received. The accounting entries in such a case will be as follows:

(i) On purchase of assets

Sundry Assets A/c …………………Dr.

To Vendor A/c

(ii) On issue of debentures

Vendor A/c …………………………Dr.

Discount on Issue of Debentures A/c …………... Dr. (if issued at discount)

To Debenture Capital A/c

To Securities Premium A/c (if issued at premium)

Consider the following illustration.

Illustration 47

Z Ltd. took over the assets of ₹6,00,000 and liabilities of ₹80,000 of C Ltd. for an agreed purchase consideration of ₹5,40,000 to be satisfied by the issue of 10% Debentures of ₹1,000 each.

Required: Show the necessary journal entries in the books of *Z* Ltd, assuming that—

Case (a) Such Debentures are issued at par;

Case (b) Such Debentures are issued at 20% premium; and

Case (c) Such Debentures are issued at 10% discount;

Solution:

In the Books of *Z* Ltd.

Journal

Particulars		Dr. (₹)	Cr. (₹)
Entry in all cases			
Sundry Assets A/c	Dr.	6,00,000	
Goodwill A/c	Dr.	20,000	
To Sundry Liabilities A/c			80,000
To C Ltd.A/c			5,40,000
(Being the purchase of assets and liabilities from B Ltd. as per agreement dated...)			
Case (a) If Debentures are issued at par			
C Ltd. A/c	Dr.	5,40,000	
To 15% Debentures A/c			5,40,000
(Being the issue of 5,400 debentures at par to B Ltd. as per Board's resolution dated....)			
Case (b) If Debentures are issued at 20% premium			
C Ltd. A/c	Dr.	5,40,000	
To 10% Debentures A/c			4,50,000
To Securities Premium A/c			90,000
(Being the issue of 4,500 debentures at a premium of 20% to B Ltd. as per Board's resolution dated...)			
Case (c) If Debentures are issued at 10% discount			
C Ltd. A/c	Dr.	5,40,000	
Discount on Issue of Debentures A/c	Dr.	60,000	
To 10% Debentures A/c			6,00,000
(Being the issue of 6,000 debentures at a discount of 10% to B Ltd. as per Board's resolution dated...)			

Working Notes:

(i) The amount by which the purchase consideration exceeds the value of the net assets (i.e. the difference between the agreed value of the assets taken over and the agreed amount of liabilities taken over) has been debited to Goodwill Account.

(ii) Calculation of No. of Debentures to be issued in each case.

Particulars	(a) At par	(b) At 20% Premium	(c) At 10% Discount
A. Issue Price per Debenture (₹)	100	120	90
B. Purchase Consideration (₹)	5,40,000	5,40,000	5,40,000
C. No. of Debentures to be issued (B/A)	5,400	4,500	6,000

III. Debentures Issued as Collateral Security

The term 'collateral' means additional or secondary. When debentures are issued as additional security against a loan (for which there exists a primary security) it is called issue of debentures as collateral security. This type of issue is generally made when the lender feels that the primary security is inadequate. The borrower company, however, is not required to pay any interest on the debenture which are issued as collateral security. On full repayment of the loan, the debentures issued as collateral security are returned by the lender. However, if the company fails to repay the loan, the lender exercises its right on the debentures issued as collateral security.

Debentures issued as a collateral security can be dealt with in two ways in the books:

a. **First Method**

No entry is made in the books. On the liability side of the balance sheet below the item of loan a note that it has been secured by the issue of debentures is to be given.

b. **Second method**

Sometimes issue of debentures as collateral security is recorded by making a journal entry as follows:

Debenture Suspense A/c ……………. Dr.

To Debenture A/c

Note: Debenture Suspense A/c is shown as a deduction from Debenture A/c in the balance sheet. When the loan is paid the above entry is cancelled by means of a reverse entry.

IV. Interest on Debentures

The periodical interest paid on debentures is included in the Finance Cost in the Statement of Profit and Loss as it is a charge against profit. The accounting entries are:

(i) On payment of interest

Interest A/c …………………Dr.

To Bank A/c

(ii) On issue of debentures

Profit and Loss A/c ………………………. Dr.

To Interest A/c

Note: When the due dates for payment of debenture interest does not match with the accounting period, the following two concepts emerge:

(1) **Debenture interest accrued and due:** The portion of the total amount of debenture interest for which due date(s) has/have fallen within the accounting period is referred to as 'Debenture interest accrued and due; and

(2) **Debenture interest accrued but not due:** The portion of the total amount of debenture interest that has arisen but for which due date(s) has/have not fallen within the accounting period is referred to as 'Debenture interest accrued but not due'.

In the Balance Sheet, both 'Debenture interest accrued and due' as well as 'Debenture interest accrued but not due' are shown under 'Other current liabilities'.

Consider the following illustration

Illustration 48

C Ltd. secured a loan of ₹ 8,00,000 from the Axis Bank by issuing 1,000, 12% Debentures of ₹ 1000 each as collateral security.

Required: How will you treat the issue of such debentures?

Solution:

1. First Method

An Extract of Balance Sheet of C Ltd. as at...

Liabilities	₹	Assets	₹
Non-Current Liabilities: Loan from Axis Bank (Secured by the issue of 1,000, 12% Debentures of ₹ 1000 each as collateral security)	8,00,000		

2. Second Method

In the books of C Ltd.

Journal

Particulars	Dr. (₹)	Cr. (₹)
Debentures Suspense A/c Dr.	10,00,000	
To 12% Debentures A/c		10,00,000
(Being the issue of 1,000, 12% debentures of ₹1000 each as collateral security for a loan from a bank as per Board's resolution dated...)		

An Extract of Balance Sheet of C Ltd. as at...

Liabilities	₹	Assets	₹
Non-current Liabilities: Loan from Axis Bank (Secured by the issue of 1,000, 12% debentures of ₹1,000 each as collateral security)	8,00,000		

1.2.2.3 Accounting for Redemption of Debentures

Redemption of debentures refers to the repayment of borrowed capital raised by a company through debentures. The condition of redemption is clearly specified in the prospectus inviting application for the issuance of debentures.

The common sources that may be utilized by the companies for the purpose of redemption of debentures are –

a. **Redemption out of proceeds of fresh issue of shares/ debentures:** Here the company issues fresh equity/ preference shares or debentures or bonds for raising the money required for redemption of debentures. This may amount tom change in the capital structure.

b. **Redemption out of profits:** A company may utilize a portion of its profit which otherwise were available for distribution of dividend to redeem the debentures. This may be done by transferring a portion of profits to Debenture Redemption Reserve. The profits so transferred may be retained within the company or may be invested outside in readily marketable securities.

c. **Redemption out of capital:** Here the company does not set aside any profits for redemption purpose. Thus, eventually, the amount is paid out of capital.

In India, redemption of debenture is guided by Section 71 of the Companies Act, 2013 and Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014 which require mandatory creation of Debenture Redemption Reserve. Hence, the redemption happens to be partly out of profits and partly out of capital.

⊙ Provisions on Creation of Debenture Redemption Reserve (DRR)

As per Section 71(4) of the Companies Act, 2013, where debentures are issued by a company under this section, the company shall 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 shall not be utilized by the company except for the redemption of debentures.

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

(a) the Debenture Redemption Reserve shall be created out of the profits of the company available for payment of dividend;

(b) the limits with respect to adequacy of Debenture Redemption Reserve and investment or deposits, as the case may be, shall be as under;-

(i) Debenture Redemption Reserve is not required for debentures issued by All India Financial Institutions regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures;

(ii) For other Financial Institutions within the meaning of clause (72) of section 2 of the Companies Act, 2013, Debenture Redemption Reserve shall be as applicable to Non - Banking Finance Companies registered with Reserve Bank of India.

(iii) For listed companies (other than All India Financial Institutions and Banking Companies as specified in sub-clause (i)), Debenture Redemption Reserve is not required in the following cases -

(A) in case of public issue of debentures -

A. for NBFCs registered with Reserve Bank of India under section 45- IA of the RBI Act, 1934 and for Housing Finance Companies registered with National Housing Bank;

B. for other listed companies;

(B) in case of privately placed debentures, for companies specified in sub items A and B.

(iv) for unlisted companies, (other than All India Financial Institutions and Banking Companies as specified in sub-clause (i))-

(A) for NBFCs registered with RBI under section 45-IA of the Reserve Bank of India Act, 1934 and for Housing Finance Companies registered with National Housing Bank, Debenture Redemption Reserve is not required in case of privately placed debentures.

(B) for other unlisted companies, the adequacy of Debenture Redemption Reserve shall be ten percent, of the value of the outstanding debentures;

(c) every company required to create Debenture Redemption Reserve shall on or before the 30th day of April in each year, invest or deposit, as the case may be, a sum which shall not be less than fifteen percent, of the amount of its debentures maturing during the year ending on the 31st day of March of the next year, in any one or more of the following methods, namely:-(i) in deposits with any scheduled bank, free from any charge or lien; (ii) in unencumbered securities of the Central Government or of any State Government; (iii) in unencumbered securities mentioned in sub-clauses (a) to (d) and (ee) of section 20 of the Indian Trusts Act, 1882; (iv) in unencumbered bonds issued by any other company which is notified under sub-clause (f) of section 20 of the Indian Trusts Act, 1882; (v) the amount invested or deposited as above shall not be used for any purpose other than for redemption of debentures maturing during the year referred above:

Provided that the amount remaining invested or deposited, as the case may be, shall not at any time fall below fifteen per cent of the amount of the debentures maturing during the year ending on the 31st day of March of that year;

(d) in case of partly convertible debentures, Debenture Redemption Reserve shall be created in respect of non-convertible portion of debenture issue in accordance with this sub-rule.

(e) the amount credited to the Debenture Redemption Reserve shall not be utilized by the company except for the purpose of redemption of debentures.

The above provisions may be summarized in the following points:

a. DRR is required to be created only in case of 'Non-convertible Debentures' and 'Non-convertible portion of Partly Convertible Debentures'.

b. The DRR shall be created out of the profits of the company that are available for payment of dividend i.e., out of the divisible profits of the company.

c. A company shall create DRR before starting the redemption of debentures.

d. An eligible company (i.e., an unlisted company other than AIFI, Banking Compnaies and NBFCs registered with RBI and Housing Finance Companies registered with NHB) shall create DRR of an amount equal to at least 10% of the nominal (face) value of the outstanding debentures.

e. Listed Companies (other than AIFIs and Banking companies) are not required to create DRR for publicly and privately placed debentures.

f. NBFCs and other financial institutions covered u/s 2(72) of Companies Act, 2013 are not required to create DRR for publicly and privately placed debentures.

g. Every company which is required to create DRR shall on or before April 30 each year, must invest or deposit a specified sum of not less than 15% of the amount of debentures maturing during the year ending on the March 31, in any of the specified modes.

h. After the redemption of debentures, such DRR a/c is closed by transfer to General Reserve A/c.

Methods of Redemption of Debentures

I. Redemption of Debentures in Lump Sum

Here debentures are redeemed at the expiry in one lump-sum. The redemption can be made at par, at premium or at discount. The company, as per the statutory provisions discussed earlier, needs to make statutory transfer to DRR and also to make necessary investment. After redemption DRR A/c should be closed to General Reserve.

The accounting entries are as follows:

Particulars	Journal Entries	Remarks
Before Redemption		
Transfer to DRR	Surplus A/c …………………Dr. To DRR A/c Note: Here Surplus refers to profits under Statement of Profit and Loss	At least 10% of face value of debentures issued at any time before expiration
Making Investment	Deb. Red. Investment A/c ………Dr. To Bank A/c	At least 15% of the face value debentures to be redeemed. The investment has to be made on or before 30th April of the financial year in which the debentures are redeemed.
On redemption		
Sale of Investment	Bank A/c ……………………..Dr. To Deb. Red. Investment A/c	

Due entry for redemption	Debenture A/c…………………..Dr. Premium on Redemption of Debentures A/c ………………..Dr. To Debenture-holders A/c	Face value Premium payable Total amount payable
Payment entry	Debenture-holders A/c …………Dr. To Bank A/c	
Transfer of DRR	DRR A/c ………………………Dr. To General Reserve A/c	

Note: When the company maintains a Sinking Fund (for redemption of debentures)

Sometimes companies maintain a Sinking Fund for the purpose of repayment of the liability and invest the amount in readily marketable securities. The fund (called Sinking Fund) is created by annual contribution out of profits. The annual contribution is determined based on Annuity Table. The investment out of the fund is termed as Sinking Fund Investment.

This method is in practice for many years. Section 71(4) of the Companies Act, 2013 has provided a statutory recognition to it.

The accounting process, in this case, is as follows:

Transaction	Journal Entry	Remarks
In the year of Debenture issue		
Annual contribution	Surplus A/c ....Dr To Sinking Fund A/c	Annual Contribution is calculated with the help of the Annuity Table.
Investment of the amount	Sinking Fund Investment A/c ....Dr. To Bank A/c	Either equal to or less the amount of contribution.
In all subsequent years (except the last year)		
Receipt of Interest on Investment	Bank A/c ....Dr. To Interest on Sinking Fund Investment A/c	Interest is earned on the 'Nominal (Face) Value' of Sinking Fund Investment.
Transferring of interest to Sinking Fund	Interest on Sinking Fund Investment A/c ....Dr. To Sinking Fund A/c	
Providing Annual contribution	Surplus A/c ....Dr. To Sinking Fund A/c	
Investment of the amount	Sinking Fund Investment A/c .... Dr. To Bank A/c	Amount invested in Sinking Fund Investment = Annual Contribution + Interest on Sinking Fund Investment
In the year of redemption		
Receipt of Interest	Bank A/c ....Dr. To Interest on Sinking Fund Investment A/c	This is reinvested as it is the last year.
Annual contribution	Surplus A/c ....Dr. To Sinking Fund A/c	The balancing figure to get the required amount of fund.

Disposal of Sinking Fund Investment	Bank A/c ....Dr. To Sinking Fund Investment A/c	The sale proceeds
	Sinking Fund Investment A/c …………..Dr. To Sinking Fund A/c	Profit on sale
	Bank A/c ……………………Dr. Sinking Fund A/c ……………..Dr. To Sinking Fund Investment A/c	Sale at a loss
Due entry for redemption	Debenture A/c…………………..Dr. Premium on Red. of Debentures A/c…..Dr. To Debenture-holders A/c	
Payment entry	Debenture-holders A/c …………Dr. To Bank A/c	
Transfer of Sinking Fund balance	Sinking Fund A/c …………..Dr. To General Reserve A/c	Face value of debentures redeemed

Consider the following illustrations.

Illustration 49 (Redemption out of profits)

P Ltd. had issued ₹15,00,000, 10% Debentures which are due to be redeemed out of profits on Nov. 1, 2020 at a premium of 5%. The company had a Debenture Redemption Reserve of ₹6,21,000. It was decided to invest the required amount in Debenture Redemption Investment on 15.4.2020. Pass necessary journal entries for recording the transactions relating to redemption of debentures.

Solution:

In the books of P Ltd.
Journal

Date	Particulars	Dr. ₹	Cr. ₹
31.03.20	Surplus A/c …………………Dr. To Debenture Redemption Reserve A/c (Being amount of profits transferred to DRR as per Board's Resolution no…. Dated…)	8,79,000	 8,79,000
15.04.20	Debenture Redemption Investment A/c ………… Dr. To Bank A/c (15,00,000 x 15%) (Being statutory minimum investment made in DRI)	2,25,000	 2,25,000
01.11.20	Bank A/c ………………………Dr. To DRI A/c (Being amount encashed from DRI for redemption)	2,25,000	 2,25,000
01.11.20	10% Debentures A/c…………………..Dr. Premium on Redemption of Debentures A/c ……..Dr. To 10% Debenture-holders A/c (Being amount due on redemption.)	15,00,000 75,000	 15,75,000

01.11.20	10% Debenture-holders A/c To Bank A/c (Being payment made.)	15,75,000	15,75,000
01.11.20	DRR A/c ……………………Dr. To General Reserve A/c (Being DRR transferred on redemption.)	15,75,000	15,75,000

Working Note:

Transfer of profits to DRR = Face value of debentures redeemed – Existing DRR

= 15,00,000 – 6,21,000

= ₹8,79,000

Illustration 50 (Redemption of debentures of capital)

A company issued 100,000 15% debentures of ₹ 100 each at par redeemable at a premium of 15%. After 8 years the company served notice of redemption and redeemed all debentures as per the terms of issue. You are required to make entries at the time of issue and at the time of redemption.

Solution:

In the books of ....

Journal

Date	Particulars		Dr. ₹ '000	Cr. ₹ '000
1st year	Bank A/c	Dr.	10,000	
	Loss on issue of debentures A/c	Dr.	1,500	
	To 15% Debentures A/c			10,000
	To Premium on redemption A/c			1,500
8th year end	15% Debentures A/c	Dr.		
	Premium on redemption A/c	Dr.	10,000	
	To Debenture Redemption A/c		1,500	11,500
	Debenture redemption A/c	Dr.		
	To Bank A/c		11,500	11,500

Illustration 51 (Redemption partly out of profit and partly out of capital)

The Balance Sheet of AB Ltd. as on March 31, 2020 reflected 10,000, 12% Debentures of ₹100 each outstanding. These debentures were due for redemption on July 31, 2021. The company decided to transfer ₹5,00,000 to Debenture Redemption Reserve on March 31, 2021 and invest ₹1,50,000 in fixed deposits with Bank of India on April 8, 2021. The investment was encashed as the debentures were redeemed on due date. Pass journal entries to record the above transactions (Ignore transactions relating to interest on debentures).

Solution:

In the books of AB Ltd.
Journal

Date	Particulars	Dr. ₹	Cr. ₹
31.03.2021	Surplus A/c …………………Dr. To Debenture Redemption Reserve A/c (Being amount of profits transferred to DRR as per Board's Resolution no…. Dated…)	5,00,000	 5,00,000
08.04.2021	Debenture Redemption Investment A/c …………. Dr. To Bank A/c (Being statutory minimum investment made in DRI)	1,50,000	 1,50,000
31.07.2021	Bank A/c …………………………Dr. To DRI A/c (Being amount encashed from DRI for redemption)	1,50,000	 1,50,000
31.07.2021	12% Debentures A/c…………………..Dr. To 12% Debenture-holders A/c (Being amount due on redemption.)	10,00,000	 10,00,000
31.07.2021	12% Debenture-holders A/c To Bank A/c (Being payment made.)	10,00,000	 10,00,000
31.07.2021	DRR A/c ……………………Dr. To General Reserve A/c (Being DRR transferred on redemption.)	5,00,000	 5,00,000

Illustration 52 (Issue and Redemption at premium, Redemption partly out of profit and partly out of capital)

K Ltd. issued ₹6,00,000,13% Debentures of ₹100 each on April 1, 2017 at a premium of 6% redeemable at a premium of 10% on March 31, 2021. The debentures were redeemed on due date. Assume that the required minimum investment was made by the company in 10% Government Securities on the last due date meant for the purpose of this redemption. Pass journal entries to record the issue and redemption of debentures. (Ignore transactions relating to interest on debentures and writing-off loss on issue of debentures).

Solution:

In the books of K Ltd.
Journal

Date	Particulars	Dr. ₹	Cr. ₹
01.04.2017	Bank A/c ……………………Dr. Loss on Issue of Debentures A/c To 13% Debentures A/c To Securities Premium A/c (600000 x 6%) To Premium on Redemption of Debentures A/c (Being issue of debentures at premium and premium on redemption is provided for.)	6,36,000 60,000	 6,00,000 36,000 60,000
30.04.2020	Debenture Redemption Investment A/c …………. Dr. To Bank A/c (Being statutory minimum investment made in DRI)	90,000	 90,000

31.03.2021	Surplus A/c …………………Dr. To Debenture Redemption Reserve A/c (Being amount of profits transferred to DRR as per Board's Resolution no…. Dated…)	60,000	 60,000
31.03.2021	Bank A/c …………………………Dr. To DRI A/c To Interest on DRI A/c (90000 x 10% x 11/12) (Being amount encashed from DRI for redemption)	98,250	 90,000 8,250
31.03.2021	13% Debentures A/c…………………..Dr. Premium on Redemption of Debentures A/c …….Dr. To 13% Debenture-holders A/c (Being amount due on redemption.)	6,00,000 60,000	 6,60,000
31.03.2021	13% Debenture-holders A/c To Bank A/c (Being payment made.)	6,60,000	 6,60,000
31.03.2021	DRR A/c ……………………Dr. To General Reserve A/c (Being DRR transferred on redemption.)	60,000	 60,000
31.03.2021	Interest on DRI A/c …………Dr. To Profit and Loss A/c (Being interest on DRI transferred.)	8,250	 8,250

Illustration 53 (Redemption at lump-sum with Sinking Fund)

On 1st April 2017. H Ltd. issued 442, 10% Debentures of ₹1000 each at a discount of 10% redeemable at a premium of 5% after 4 years. It was decided to create a Sinking Fund for the purposes of accumulating sufficient funds to redeem the Debentures and to invest in some radily convertible securities yielding 10% interest p.a. Reference to the table shows that ₹1.00 p.a. at 10% compound interest amounts to ₹4.641 in 4 years. Investments are to be made in the Bonds of ₹1000 each available at par.

On 31st March 2021, the investments realised ₹3,40,000 and debentures were redeemed. The bank balance as on that date was ₹50,000.

Required: Prepare Debenture Redemption Fund Account and Debenture Redemption Fund Investments Account for 4 years.

Solution:

DRF = Debenture Redemption Fund, DRFI = Debenture Redemption Fund Investment

Debenture Redemption Fund Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.03.2018	To Balance c/d	1,00,000	31.03.2018	By P&L App.A/c	1,00,000
31.03.2019	To Balance c/d	2,10,000	01.04.2018	By Balance b/d	1,00,000
			31.03.2019	By Interest on DRFI A/c	10,000
				By P&L App. A/c	1,00,000
		2,10,000			2,10,000
31.03.2020	To Balance c/d	3,31,000	01.04.2019	By Balance b/d	2,10,000

			31.03.2020	By Interest on DRFI A/c	21,000
			31.03.2020	By P&L App. A/c	1,00,000
		3,31,000			3,31,000
31.03.2021	To Loss on issue of Debentures/ Premium on redemption of Debentures A/c	22,100	01.04.2020	By Balance b/d	3,31,000
	To Debenture Redemption Reserve A/c	4,51,000	31.03.2021	By Interest on DRFI A/c	33,100
			31.03.2021	By P&L App. A/c	1,00,000
				By Debenture Redemption Fund Investment A/c (Profit)	
		4,73,100			4,73,100

Debentures Redemption Fund Investment (DRFI) Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.03.2018	To Bank A/c	1,00,000	31.03.2018	By Balance c/d	1,00,000
01.04.2018	To Balance b/d	1,00,000	31.03.2019	By Balance c/d	2,10,000
31.03.2019	To Bank A/c	1,10,000			
		2,10,000			2,10,000
01.04.2019	To Balance b/d	2,10,000	31.03.2020	By Balance c/d	3,31,000
31.03.2020	T Bank A/c	1,21,000			
		3,31,000			3,31,000
01.04.2020	To Balance b/d	3,31,000	31.03.2021	By Bank A/c (Sales)	3,40,000
31.03.2021	To Debenture Redemption Fund A/c (Profit)	9,000			
		3,40,000			3,40,000

Working Note:

(i) Calculation of the amount of profit set aside

		₹
a.	Face Value of Debentures	4,42,000
b.	Premium Premium Payable on Redemption	22,100
c.	Depreciable Cost (A + B)	4,64,100
d.	Value of annuity per ₹ 1	4,641
e.	Annual amount to be charged (C/D)	1,00,000

(ii) Calculation of the amount of investments and interest

Year a	Opening Balance b	Interest c= b×10/100	Saving d	Investments e=c+d	Closing Balance f=b+e
2017-18	—	—	1,00,000	1,00,000	1,00,000
2018-19	1,00,000	10,000	1,00,000	1,10,000	2,10,000
2019-20	2,10,000	21,000	1,00,000	1,21,000	3,31,000
2020-21	3,31,000	33,100	1,00,000	—	—

Or, Calculate the interest on opening balance of DRFI A/c.

II. Redemption of Debentures in Instalments by Drawing Lots

Under this method redemption is done in parts. When it is done in every year, it is called Redemption by Annual Drawing. Redemption may be done at par, at premium or at discount.

Under this approach, the statutory requirements are exactly similar to that discussed under lump-sum method.

The recording of transactions is also similar to that explained under lump-sum method.

Consider the following illustration.

Illustration 54

X Ltd., a pharmaceutical company, has 20,000, 9% Debentures of ₹100 each outstanding. These are due for redemption in lots as follows:

On March 31, 2019 – 4,000 debentures; On March 31, 2020 – 6,000 debentures; On March 31, 2021 – Balance debentures.

You are required to ascertain the amount of balance that is required to be maintained in DRR A/c for each redemption. Also state the balance required to be transferred from DRR to General Reserve after each redemption.

Solution:

X Ltd., assuming an eligible unlisted company, is mandatorily required, to create Debenture Redemption Reserve (DRR) as per Sec, 71(4) of Companies Act, 2013. A company is required to create DRR of an amount equal to at least 10% of the nominal (face) value of the debentures issued. In this case, face value of outstanding 9% Debentures = 20,000 x ₹100 = ₹20,00,000.

The time limit and amount of DRR required is presented below:

Date	Time limit for creating DRR	Minimum DRR required	Number of debentures redeemed	Transfer of DRR to General Reserve
On 31.3.19	Before 31.3.19	20,000 x ₹100 x 10% = ₹2,00,000	4,000 debentures [Given]	₹40,000 (2,00,000 x 4,000/20,000)
On 31.3.20	Before 31.3.20	(20,000 - 4,000) x ₹100 x 10% = ₹1,60,000	6,000 debentures [Given]	₹60,000 (2,00,000 x 6,000/20,000)
On 31.3.21	Before 31.3. 19	(16,000- 6,000) x ₹100 x 10% = ₹1,00,000	10,000 debentures [20,000-4,000-6,000]	₹1,00,000 (2,00,000 x 10,000/ 20,000)

Note: Alternatively, entire balance of Debenture Redemption Reserve A/c (₹2,00,000) may be transferred to General Reserve after all the debentures have been redeemed i.e., after 31.3.2021.

Note: For each debenture redemption, the entries to be passed are:

a. Creation of DRR

b. Creation of DRI

c. Realization of DRI

d. Redemption due entry

e. Redemption payment entry

f. Transfer of DRR to General Reserve

III. Redemption of Debentures by Conversion

Under this method debentures are converted into new debentures or equity shares or preference shares. However, in most of the cases, they are convertible into equity shares. Debentures may be fully convertible or partly convertible. New securities may be issued at par, at premium or at discount.

Since, DRR is required only for non-convertible debentures or non-convertible part of partly convertible debentures, under this method the provisions for DRR and DRI are not applicable.

The accounting entries are as follows:

Particulars	Journal Entry	Remarks
Redemption due entry	Debentures A/c . ... Dr. Prem. on redemption of Debentures A/c ....Dr. To Debenture-holders A/c	Face value Premium payable, if any Total amount due
On issue of new securities 'at Par'	Debenture-holders A/c ...Dr. To Eq. Shares/ Pref. Shares/ Debentures A/c	Total amount redeemed FV of new securities issued
On issue of new securities 'at a premium'	Debenture-holders A/c ....Dr. To Eq. Shares/ Pref. Shares/ Debentures A/c To Securities Premium A/c	Total amount redeemed FV of new securities issued Premium on issue
On issue of new debentures at a discount'	Debenture-holders A/c ....Dr. Discount on issue of Debentures A/c ....Dr. To (New) Debentures A/c	Total amount redeemed Discount on issue FV of new securities issued

Consider the following illustration.

Illustration 55

B Ltd. issued notice of its intention to redeem its outstanding ₹12,00,000, 8% Debentures at 102% and offered the holders the following options to apply for the redemption moneys:

(i) 6% Cumulative Preference shares of ₹20 each at ₹22.50 per share; and

(ii) 10% Debentures of ₹100 each at ₹96.

The holders of ₹4,80,000 debentures accepted proposal (i), and ₹7,20,000 debenture-holders accepted proposal (ii).

Pass necessary journal entries to record the above-mentioned transactions.

Solution:

In the books of B Ltd.

Journal **Dr.** **Cr.**

Date	Particulars	₹	₹
	8% Debentures A/c ... .Dr. Premium on Redemption of Debentures A/c . . . .Dr. To 8% Debenture-holders A/c [12,00,000 × 102%] (Being amount due to 8% Debenture-holders on redemption at 2% premium)	12,00,000 24,000	 12,24,000
	8% Debenture-holders A/c . . .Dr. To 6% Cumulative Preference Share Capital A/c [21,760 × 20] To Securities Premium A/c [21,760 × 2.50] (Being holders of ₹4,80,000, 8% Debentures discharged by issue of 21,760, 6% Cumulative Preference Shares of ₹20 each, at ₹22.50 per share)	4,89,600	 4,35,200 54,400
	8% Debenture-holders A/c . . . .Dr. Discount on issue of Debentures A/c [7,650 × 4] ....Dr. To 10% Debentures [7,650 × 100] (Being holders of ₹7,20,000, 8% Debentures discharged by issue of 7,650, 10% Debentures of ₹100 each, at ₹96 per debenture)	7,34,400 30,600	 7,65,000

Working Notes:

1. Conversion of ₹4,80,000, 8% Debentures into 6% Cumulative Preference shares

   Face value of 8% Debentures opting for Proposal (i) = ₹4,80,000 (Given)

   Amount due on redemption – ₹4,80,000 × 102% = ₹4,89,600.

   Value of each 6% Cumulative Preference share issued on conversion = ₹22.50 (Given)

   No. of 6% Cumulative Preference shares issued on conversion = 4,89,600/ 22.5 = 21,760 shares.

2. Conversion of ₹7,20,000, 8% Debentures into 10% Debentures

   Face value of 9% Debentures opting for Proposal (ii) = ₹7,20,000 (Given)

   Amount due on redemption = 7,20,000 × 102% = ₹7,34,400.

   Value of each 6% Cumulative Preference share issued on conversion = ₹96 (Given)

   No. of 6% Cumulative Preference shares issued on conversion = 7,34,400/ 96 = 7,650 debentures.

   Note: In the absence of specific information, accounting regarding writing off amount of Premium on Redemption of Debentures A/c has been ignored.

IV. Redemption of Debentures by Purchase in the Open Market

A company may redeem the debentures by buying them form the open market (i.e., from the existing debenture-holders). The debentures so purchased may be immediately cancelled or may be held as investment and cancelled later. In the former, the debentures are immediately redeemed while in case of the latter they are redeemed after some time. Till the redemption, the debentures are considered as Investment.

If debentures are redeemed under this method, Debenture Redemption Investment (DRI), proportionate to the number of debentures purchased should be encashed. On cancellation of own debentures, minimum DRR associated with number of debentures cancelled should be transferred to General Reserve.

Note: Ex-interest and Cum-interest purchase price

If price quotation in the open market is available in form of ex-interest or cum-interest and debentures are purchased by the company on dates other than the interest date, consideration paid on purchase shall be segregated into price and interest and shall be recorded accordingly.

The accounting entries will be as follows.

a. When own debentures are purchased and immediately cancelled

(i) Own debentures purchased and cancelled

Debentures A/c ……………………….............Dr.

Loss on Cancellation of Debentures A/c ……..Dr. (if there is a loss)

To Bank A/c

To Profit on Cancellation of Debentures A/c (if there is a profit)

(ii) Transfer of profit or loss on cancellation

Profit on Cancellation of Debentures A/c ……………..Dr.

To Capital Reserve A/c

Or

Profit and Loss A/c …………………….Dr.

To Loss on Cancellation of Debentures A/c

Note: Profit or loss on cancellation is the difference between the face value of debentures cancelled and the purchase price of the debentures.

b. When own debentures are purchased and held as investment

(i) Purchase of own debentures

Investment in Own Debentures A/c ………………..Dr.

To Bank A/c

(ii) Interest payment on debentures including own debentures

Debenture Interest A/c ………………..Dr.

To Bank A/c

To Interest on Own Debentures A/c

(iii) Resale of own debentures held as investment

Bank A/c ………………………………………….Dr.

Loss on Sale of Own Debentures A/c …………….Dr.

To Investment in Own Debentures A/c

To Profit on Sale of Own Debentures A/c

(iv) Cancellation of own debentures

Debentures A/c ……………………………………Dr.

Loss on Cancellation of Debentures A/c ……..Dr.

To Investment in Own Debentures A/c

To Profit on Cancellation of Own Debentures A/c

(v) Transfer of profit or loss on cancellation

Profit on Cancellation of Debentures A/c ……………..Dr.

To Capital Reserve A/c

Or

Profit and Loss A/c ……………………Dr.

To Loss on Cancellation of Debentures A/c

Note: When the company maintains a Sinking fund for redemption of debentures

A company which maintains a sinking fund and investment the proceeds to a Sinking Fund Investment may consider its own debentures as an investment avenue. The own debentures purchased may again be either retained as investment or cancelled immediately.

Illustration 56 (Purchase of own debentures and immediate cancellation)

A company purchased its own 12% Debentures in the open market for ₹25,00,000 (cum-interest). The interest amount included in the purchase price is ₹75,000. The face value of the debentures purchased is ₹26,00,000. The company immediately cancelled the debentures so purchased. Pass journal entries to record the purchase and immediate cancellation (ignoring transactions relating to Debenture Redemption Reserve and Debenture Redemption Investment).

Solution:

In the books of ………..

Journal **Dr.** **Cr**

Date	Particulars	₹	₹
	Debenture Interest A/c . . . .Dr. To Bank A/c (Being debenture interest paid)	75,000	 75,000
	12 % Debentures A/c . . . .Dr. To Bank A/c (25,00,000 -75,000) To Profit on Cancellation of Debentures A/c [Bal. Fig.] (Being ₹26,00,000 own 12% Debentures purchased @ ₹24,25,000 for immediate cancellation and profit on cancellation recognized)	26,00,000	 24,25,000 1,75,000
	Profit on Cancellation of Debentures A/c . . . .Dr. To Capital Reserve A/c (Being profit on cancellation of debentures transferred to Capital Reserve)	1,75,000	 1,75,000

Illustration 57 (Purchase of own debentures and cancellation on a later date)

Draft journal entries in respect of the following since March 1, 2021:

In 2014 XY Ltd had issued 5,000, 7.5% Debentures of ₹100 each. On 1st March, 2018, the company purchased 500 of its own 7.5% Debentures at ₹ 47,500 cum-interest.

The debentures were held as investment until 30th June, 2021 when it was decided to cancel them. Interest is payable half yearly on 30th June and 31st December and the books are closed on 30th June each year. Assume absence of sinking fund.

Solution:

In the books of XY Ltd.

Journal **Dr.** **Cr**

Date	Particulars		₹	₹
	Investment in Own Debentures A/c (Note 1) Debenture Interest A/c To Bank A/c (Being the purchase of 500 debentures for ₹47,500 cum-interest which will be held as investment)	Dr. Dr.	46,875 625	 47,500
	Debenture Interest A/c (Note 2) To Bank A/c (Being interest paid to outside debenture-holders for 4,500 debentures for 6 months)	Dr.	16,875	 16,875
	Debenture Interest A/c To Interest on Own Debentures A/c (Being adjustment for interest on 500 own debentures for 4 months)	Dr.	1,250	 1,250
	7.5% Debentures A/c To Investment in Own Debentures A/c To Profit on Cancellation of Debentures A/c (Being cancellation of 500 own debentures)	Dr.	50,000	 46,875 3125
	Profit on Cancellation of Debentures A/c To Capital Reserve A/c (Being profit on cancellation of debentures transferred to capital reserve)	Dr.	3,125	 3,125
	Profit and Loss A/c To Debenture Interest A/c (Being debenture's interest transferred to Statement of Profit and Loss)	Dr.	18,750	 18,750
	Interest on Own Debentures A/c To Profit and Loss A/c (Being interest on own debentures transferred to Statement of Profit and Loss)	Dr.	1,250	 1,250

	Profit and Loss A/c To General Reserve A/c (Being the amount equal to the face value of debentures transferred to general reserve)	Dr.	50,000	 50,000

Working Notes:

(1) Total amount paid ₹ 47,500; Less Interest for 2 months ₹ 625, Therefore, amount to be debited to Own Debentures Account = ₹46,875.

(2) Interest payable to outside Debenture-holders = ₹ 4,50,000 × 7.5/100 × ½ = ₹16,875.

Illustration 58

On 01.01.2015 E Ltd. issued 500, 10% Debentures of ₹100 each, at a discount of 10% redeemable at a premium of 10%.

Required: Show the 'Loss on Issue of Debentures A/c', if (i) such debentures are redeemable after 4 years, and (ii) such debentures are redeemable by equal annual drawings in 4 years. E Ltd. follows calendar year as it accounting year.

Solution:

Loss on Issue at Discount = 10%; Loss on Redemption at premium = 10%

∴ Total Loss = 20%

A. When such debentures are redeemable after 4 years:

A.	Total Loss (₹ 50,000 × 20/100)	= ₹ 10,000
B.	Period for which debentures are held	= 4 Years
C.	Amount of discount to be written off to P & L A/c every year (A/B)	= ₹ 2,500

Loss on Issue of Debentures Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
01.01.2018	To 10% Debentures A/c	5,000	31.12.2018	By P& L A/c	2,500
	To Premium on redemption A/c	5,000		By Balance c/d	7,500
		10,000			10,000
01.01.2019	To Balance b/d	7,500	31.12.2019	By P&L A/c	2,500
				By Balance c/d	5,000
		7,500			7,500
01.01.2020	To Balance b/d	5,000	31.12.2020	By P&L A/c	2,500
				By Balance c/d	2,500
01.01.2021	To Balance b/d	2,500	31.12.2021	By P&L A/c	2,500
		2,500			2,500

B. When such debentures are redeemable by equal annual drawings in 4 years:

Statement Showing the Debentures Discount to be Written Off Each Year

Year ended on A	Face Value of Deb. used B	Period of Use (Month) C	Product D = B × C, D	Ratio E	Amount of Discount to be w/o 10,000 × E/10
31.03.18	1,00,000	12 months	6,00,000	4	4,000
31.03.19	75,000	12 months	4,50,000	3	3,000
31.03.20	50,000	12 months	3,00,000	2	2,000
31.03.21	25,000	12 months	1,50,000	1	1,000

Discount on Issue of Debentures Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
01.01.2018	To 10% Debentures A/c	5,000	31.12.2018	By P&L A/c	4,000
	To Premium on Redemption A/c	5,000		By Balance c/d	6,000
		10,000			10,000
01.012019	To Balance b/d	6,000	31.12.2019	By P&L A/c	3,000
				By Balance c/d	3,000
		6,000			6,000
01.01.2020	To Balance b/d	3,000	31.12.2020	By P&L A/c	2,000
				By Balance c/d	1,000
01.01.2021	To Balance b/d	1,000	31.12.2021	By P& L A/c	1,000
		1,000			1,000