

CLASS NOTES

Class: XII

Subject: Accountancy

Topic: Issue of Debenture: Meaning, Features and Types of Debentures, Issue of Debentures for Cash, Issue of Debentures for consideration other than cash, Issue of Debentures as Collateral Security, Various cases for Issue of debentures considering the terms of redemption. Interest on debentures and Writing off Discount on Issue of Debentures.

Introduction

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

Features of Debentures

- It is an instrument acknowledging a debt.
- It is a long-term debt instrument usually issued by large, financially strong companies for the purpose of raising funds.
- Debentures are unsecured debt backed by the credit-worthiness and reputation of the company.
- It is issued under the common seal of the company.
- Debentures are redeemable after a fixed period during the life time of the company.
- Generally it creates a charge on the assets of the company.
- Interest is paid to the debenture-holder at fixed rate whether firm is in profit or loss.

Important terms related to Debentures

Bonds: It is also an instrument of acknowledgment of debt. It is similar to debenture in terms of content and texture. However, bonds can be issued without predetermined rate of interest. Traditionally, the government issued bonds but these days, bonds are issued by semi-government and non-governmental organizations.

Examples: Zero coupon bond

Zero Coupon Bond: These are issued at a discount and redeemed at par. No interest payment is made on such bonds at periodic intervals before maturity.

Debenture Trust Deed: It is a document created by the company whereby trustees are appointed to protect the interest of debenture holders before they are offered for public subscription. The main purpose of appointing trustees is to protect the interest of debenture holders.

Charge: According to section 2(16) of Companies Act, 2013, “Charge means an interest created on the property or assets of the company or any of its undertaking or both, as security and includes a mortgage.”

Following are included in the category of charge:

Fixed Charge: When the charge is created against specific assets of the enterprise, then such a charge is called a fixed charge. This charge is created against those assets which are held by the company for use in operations and are not meant for sale.

Floating Charge: It is a charge created on the group of assets whose value is subjected to a change in quantity and value. i.e. charge created on the stock or debtor.

Types of Debentures

From the point of view of security:

1. **Secured or Mortgage Debenture:** Debentures are secured by a charge on the fixed assets of the company. If the company fails on payment of the Principal amount or interest amount, assets under charge are sold to repay the amount due to debenture holders.

2. **Unsecured Debentures:** These debentures are not secured by any charge on asset. They do not have a security.

From the point of view of Tenure:

1. **Redeemable Debentures:** These are debentures which are to be repaid within a stipulated period.

2. **Irredeemable Debentures:** These debentures do not have any fixed period of redemption. These debentures are redeemable at the time of winding up.

From the Point of view of Convertibility:

1. **Convertible Debentures:** These are the debentures which can be converted into equity shares or other securities after a specified period, at the option of the debenture holders.

This can be further categorize into two parts:

a. **Partly Convertible Debentures:** These are the debentures where only a part of the debenture amount is convertible into equity shares.

b. **Fully Convertible Debentures:** These are the debentures where whole amount of debenture is convertible into equity shares.

2. **Non-Convertible Debentures:** The holders of these debentures have no right to convert them into equity shares.

From the point of view of Registration:

1. **Registered Debentures:** These debentures have a record of name, address and particulars of

holdings of debenture holders in the register of the company. These debentures are not freely transferable.

2. **Bearer Debentures:** These debentures are transferable by mere delivery. The company keeps no records of such debenture holders. Payment will be made only to the bearer of the debenture. Coupons are provided by the company with these debentures for the payment of interest.

From the point of view of Coupon Rate:

1. **Specific Rate (Coupon rate) Debentures:** These debentures are issued with a specific rate of interest, which is called the coupon rate. The specified rate may either be fixed or floating. The floating interest rate is usually tagged with the bank rate.

2. **Zero Coupon Debentures:** These debentures do not carry a specific rate of interest. Such debentures are issued at substantial discount and the difference between the nominal value and the issue price is treated as the amount of interest related to the duration of the debentures.

Disclosure of Debentures in the Balance Sheet

As a Non-current Liability: Debentures are shown in the balance sheet under the head **Non-Current Liabilities** and the sub-head **long-term borrowings**, when they are due for redemption **after 12 months from the date of issue or after the period of operating cycle**.

As a Current Liabilities: Debentures which are shown under the head Non-current liabilities in the balance sheet and part of it become due for **redemption within 12 months from the date of balance sheet**, then these debentures will be shown under the head **current liabilities and sub head short-term borrowings**.

Issue of Debentures

The procedure of issue of debenture is same as that of issue of shares. Prospectus is issued and intending investors apply for debentures. The company may either ask for entire amount to be paid on application or by means of installment on application, allotment, and on various calls.

Debentures like shares may be issued:

A. **For Cash** B. **For consideration other than cash** and also C. **as Collateral security** (Only debentures)

Debentures may be issued: A **At par** B **At premium** and C **At discount**

Issue of Debenture as Collateral Security

A company may issue its debentures in addition to the Primary Security when it takes loan from bank or any financial institution. It is called 'issue of debenture as collateral security'. The lender may take possession only if company is not able to repay the loan amount and the Principal security is exhausted. In this case company pays interest on loan, thus no interest will be paid on the debentures issued as collateral security.

There are two methods to record the debentures issued as collateral security.

First Method: Under this method, journal entries are not recorded in the books of accounts.

An extract of Balance Sheet As at.....

Particulars	Note No.	Amount (C.Y)	Amount (P.Y)
I. EQUITY AND LIABILITIES			
1. Non-Current Liabilities:			
Long Term Borrowings	1	*****	

Notes to Accounts:

1. Long Term Borrowing: Bank Loan (Loan taken from On collateral security of , % Debentures)		*****
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Second Method: Under this method following entry will be recorded in the books of accounts:

Debenture Suspense A/c Dr.

To % Debentures A/c

(Being debentures are issued as collateral security)

- Debentures Suspense Account will be shown in the Balance Sheet as deduction from Debentures.
- Loan from Bank is shown in the Balance Sheet under the head "Long-Term Borrowings"

An extract of Balance Sheet As at.....

Particulars	Note No.	Amount (C.Y)	Amount (P.Y)
I. EQUITY AND LIABILITIES			
1. Non-Current Liabilities:			
Long Term Borrowings	1	*****	

Notes to Accounts:

1. Long Term Borrowing: % Debentures (..... Debentures of Rs. each)		*****	
Less: Debenture Suspense		(*****)	*****
Bank Loan (Loan taken from On collateral security of , % Debentures)			*****

Issue of Debentures for Consideration other than cash

Case:1 When assets are purchased from the Vendor Co.

Assets A/c Dr.

To Vendor's A/c

Case:2 When other business is purchased

Assets A/c Dr.

Goodwill A/c Dr. (Balancing figure)

To Liabilities A/c

To Vendor's A/c (Purchase consideration)
To Capital Reserve A/c (Balancing figure)

Net worth (Purchase consideration) = Assets – Liabilities

For Example: Assets = 1,00,000; Liabilities= 45,000

Net worth =55,000 (Purchase consideration)

Purchase consideration > Net worth = Goodwill

Purchase consideration < Net worth = Capital Reserve

Entry for issue of Debentures: (At Par)

Vendor's A/c Dr.

To % Debentures A/c (No. of Debentures × face value)

No. of Debentures = [Total amount due to Vendor/Issue Price(face value)]

Entry for issue of Debentures: (At Premium)

Vendor's A/c Dr.

To % Debentures A/c (No. of Debentures × face value)

To Securities Premium Reserve A/c (No. of debentures × premium amount)

No. of Debentures = [Total amount due to Vendor/Issue Price(face value+ premium amount)]

Entry for issue of Debentures: (At Discount)

Vendor's A/c Dr.

Discount on issue of debenture A/c Dr. (No. of debentures × discount amount)

To % Debentures A/c (No. of Debentures × face value)

No. of Debentures = [Total amount due to Vendor/Issue Price(face value- discount amount)]

Various Cases From The Point Of View of Redemption

Entries for the issue of debentures considering the terms and conditions of Redemption

1. When Debentures are Issued at Par and Redeemable at Par

Bank A/c Dr. (No. of debentures × Issue price)

To Debenture Application and Allotment A/c
(Being application money received)

Debenture Application and Allotment A/c Dr.

To % Debenture A/c (No. of Debenture × Face value)

2. When Debentures are Issued at Par and Redeemable at Premium

Bank A/c Dr. (No. of debentures × Issue price)

To Debenture Application and Allotment A/c
(Being application money received)

Debenture Application and Allotment A/c Dr.
Loss on issue of Debenture A/c Dr. (Balancing figure)
 To % Debenture A/c (No. of Debenture × Face value)
 To Premium on Redemption of Debenture A/c (No. of debenture × premium amount)

3. When Debentures are Issued at Discount and Redeemable at Par

Bank A/c Dr. [(No. of debentures × Issue price (Face value- discount))]
 To Debenture Application and Allotment A/c

Debenture Application and Allotment A/c Dr.
Discount on issue of debenture A/c Dr. (Balancing figure)
 To % Debenture A/c (No. of Debenture × Face value)

4. When Debentures are Issued at Discount and Redeemable at Premium

Bank A/c Dr. [(No. of debentures × Issue price (Face value- discount))]
 To Debenture Application and Allotment A/c

Debenture Application and Allotment A/c Dr.
Loss on issue of debenture A/c Dr. (Balancing figure)
 To % Debenture A/c (No. of Debenture × Face value)
 To Premium on Redemption of debenture A/c (No. of debenture × premium amount)

5. When Debentures are Issued at Premium and Redeemable at Par

Bank A/c Dr. [(No. of debentures × Issue price (Face value + premium))]
 To Debenture Application and Allotment A/c

Debenture Application and Allotment A/c Dr.
 To % Debenture A/c (No. of Debenture × Face value)
 To Securities premium Reserve A/c [(No. of debenture × premium amount (issue))]

6. When Debentures are Issued at Premium and Redeemable at Premium

Bank A/c Dr. [(No. of debentures × Issue price (Face value+ premium))]
 To Debenture Application and Allotment A/c

Debenture Application and Allotment A/c Dr.
Loss on issue of debenture A/c Dr. (Balancing figure)
 To % Debenture A/c (No. of Debenture × Face value)
 To Securities premium Reserve A/c [(No. of debenture × premium amount (issue))]
 To Premium on Redemption of debenture A/c [(No. of debenture × premium amount (redemption))]

Interest on Debenture and Tax (TDS)

Interest on debenture is calculated at a fixed rate on its face value and is usually payable half-yearly. Debenture interest is charge against profit. Hence, interest on debenture is payable even if the

company suffer a loss.

According to Income Tax Act 1961, a company paying interest on debentures is required to deduct income tax at the prescribed rate from the gross amount of debenture interest before any payment is made to the debenture holder and it is called Tax deducted at source (TDS)

Accounting treatment of interest on Debenture

1. When interest is due and Tax is deducted at source:

Debenture Interest A/c Dr. (with gross interest amount)
 To Debenture holder A/c (balancing figure)
 To Income Tax Payable A/c (with income tax amount)

2. When interest is paid

Debenture holder A/c
 To Bank/ Cash A/c

3. When TDS is deposited in government account

Income Tax Payable A/c Dr.
 To Bank A/c

4. On transfer of Debenture Interest to Statement of Profit and Loss:

Statement of Profit and Loss A/c Dr.
 To Debenture Interest A/c

Writing Off Discount/Loss on Issue Of Debentures

As per the latest guidelines issued by CBSE, Discount/Loss on issue of debentures is to be written off as soon as possible in the year in which they occur.

Discount/ Loss on issue of debenture can be written off against Securities Premium Reserve, General Reserve, other free Reserve and Statement of Profit and Loss.

The following journal entry will be passed in the books of accounts to write off the Discount/Loss on issue of Debentures:

Securities Premium Reserve A/c Dr.
 OR
General Reserve A/c Dr.
 OR
Statement of Profit and Loss A/c Dr.
 To Discount/Loss on issue of Debentures
(Being Discount/Loss on issue of debenture written off)