

1.5 Redemption of Debentures

Debentures are the long term borrowing having fixed financial charges. So interest rate payable to the debenture holders is fixed. However these are to be redeemed after a certain period is expired.

ISSUE OF DEBENTURES

Entry for the issue of debentures is passed keeping in view the redemption. The following probabilities may arise.

1) Issued at par & redeemable at par		Issued at discount redeemable at par	
Bank A/c	Dr.	Bank A/c	Dr.
To Debentures		Loss on issue of Deb.	Dr.
		To Debentures	
2) Issued at par redeemable at prem.		Issued at discount redeemable at prem.	
Bank A/c	Dr.	Bank A/c	Dr.
Loss on issue	Dr.	Loss on issue	Dr. (D+P)
To Debentures		To Debentures	
To Prem. on redemption		To Prem. on redemption	
3) Issued at prem. redeemable at par		Issued at prem. redeemable at prem.	
Bank A/c	Dr.	Bank A/c	Dr.
To Debentures		Loss on issue	Dr.
To Securities Premium		To Debentures	
		To Securities Premium	
		To Prem. on redemption	

Loss on issue of deb. is to be written off in any of the following two ways.

- If the debentures are to be repaid after a specified years then the loss on issue of debentures can be written off equally through the life of debentures.
- If the debentures are repaid by annual drawings, then loss is to be written off in the ratio of amount of face value of debentures used over the years.

REDEMPTION OF DEBENTURES

There are a number of methods of redemption of debentures which are discussed as follows.

1) *Lumpsum redemption* .

On amount due		On payment	
Debentures A/c	Dr.	Debenture Holders	Dr.
Premium on redemption	Dr.	To Bank A/c	
To Debenture Holders			
On transfer of Premium on redemption			
P&L A/c	Dr.		
General Reserve	Dr.		
To Premium on redemption			

(If premium on redemption is already provided at the time of issue, the last entry is not required.)

2) Redemption through Sinking Fund/ Concept of DRR and DRI

Under this method a fixed amount is set aside from profits to the same be invested. Further any income earned from each investment is also invested along with the set-aside amount. When the debentures become due for payments the investment one sold and this money is utilized to repay the Debenture holders.

Sinking Fund is also named as Debenture Redemption Reserve

Sinking Fund Investment is also named as Debenture Redemption Investment

JOURNAL ENTRIES	
First year	
i) On setting aside	
Profit & Loss A/c	Dr.
To Sinking Fund (DRR)	
ii) On investment	
Sinking Fund Investment (DRI)	Dr.
To Bank A/c	
Second & Subsequent years	
i) Profit & Loss A/c	
To Sinking Fund (DRR)	Dr.
ii) Receiving Interest on investment	
Bank A/c	Dr.
To Interest on Sinking Fund Investment	
iii) Transferring the interest to Profit & Loss A/c	
Interest on Sinking Fund Investment	Dr.
To Profit & Loss A/c	
On transferring the above from Profit & Loss to Sinking Fund	
Profit & Loss A/c	Dr.
To Sinking Fund (DRR)	
iv) On Investment	
Sinking Fund Investment (DRI)	Dr. (Set aside amount + interest)
To Bank A/c	
Last year	
Entry no. i, ii and iii are same	
iv) On sale of investment	
Bank A/c	Dr.
Profit & Loss A/c	Dr. (Loss on sale)
To Sinking Fund Investment. (DRI)	
To Profit & Loss A/c (Profit on sale)	
The above loss or gain shall be transferred to Sinking Fund from Profit & Loss A/c	
v) On amount due	
Debentures	Dr.
Premium on redemption	Dr.
To Debenture Holders	
vi) Transferring Premium on redemption to Sinking Fund	
Sinking Fund	Dr.
To Premium on Redemption	
vii) On Payment	
Debenture Holders	Dr.
To Bank A/c	
viii) On transferring Sinking Fund to General Reserve	
Sinking Fund	Dr.
To General Reserve	

3) Redemption by own debentures:

A company is authorized to purchase its own debentures from the market either for cancellation immediately or for cancelling on a subsequent date. Now these debentures can be purchased either ex-interest or cum-interest.

a) Purchase and immediate cancellation

Debentures	Dr. (Nominal value of debentures)
Premium on redemption	Dr. (Premium on redemption if provided earlier)
Debenture interest	Dr. (Interest accrued on the date)
Profit & Loss A/c	Dr. (Loss on cancellation)
To Bank	(Amount paid for purchase)
To Capital reserve	(Profit on cancellation) redemption
(If sinking fund is there profit/loss shall be transferred to Sinking fund.)	

If there is sinking fund, transfer nominal value of debentures redeemed to General reserve. Or if the debentures are redeemed out of profits then such amount shall be transferred from Profit & Loss A/c to DRR A/c.

b) Purchased for subsequent cancellation

a) For purchase	
Own Debentures	Dr.
Interest on own debenture	Dr.
To Bank	
b) For payment of interest	
Debenture interest	Dr.
To Interest on own debenture	
To Bank	
c) For cancellation	
Debentures	Dr.
Premium on redemption	Dr. (If provided earlier)
Profit & Loss A/c	
To Own Debentures	
To Capital Reserve	

ASSIGNMENTS FOR CLASS

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 ₹98.00 (cum interest)
Aug. 1	₹10,000 at ₹100.25 (cum interest)
Dec. 15	₹2,500 at ₹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 first year, ignoring income-tax.

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.

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 31st 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.

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.

5).

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

Liabilities	₹	Assets	₹
Share Capital:		Freehold property	1,15,000
Authorised:		Stock	1,35,000
30,000 Equity Shares of ₹10 each	3,00,000	Trade receivables	75,000
Issued and Subscribed:		Cash	30,000
20,000 Equity Shares of ₹10 each fully paid	2,00,000	Balance at Bank	2,00,000
Profit and Loss Account	1,20,000		
12% Debentures	1,20,000		
Trade payables	1,15,000		
	5,55,000		5,55,000

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 being taken up by all 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.

6).

The summarized Balance Sheet of Convertible Limited, (unlisted company other than AIFI, Banking company, NBFC and HFC), as on 30th June, 20X1, stood as follows:

Liabilities	₹
Share Capital: 5,00,000 equity shares of ₹10 each fully paid	50,00,000
General Reserve	90,00,000
Profit & Loss A/c	10,00,000
Debenture Redemption Reserve	10,00,000
13.5% Convertible Debentures, 1,00,000 Debentures of ₹100 each	1,00,00,000
Other loans	65,00,000
Current Liabilities and Provisions	<u>1,25,00,000</u>
	<u>4,50,00,000</u>
Assets	₹
Fixed Assets (at cost less depreciation)	1,60,00,000
Debenture Redemption Reserve Investments	15,00,000
Cash and bank Balances	75,00,000
Other Current Assets	<u>2,00,00,000</u>
	<u>4,50,00,000</u>

The debentures are due for redemption on 1st July, 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 realized at par on sale; and
- (iii) All the transactions are put through, without any lag, on 1st July, 20X1.

Redraft the balance sheet of the company as on 1st July, 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.

7).

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.

8).

Libra Limited 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).

9).

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).

10).

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 1st 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 31st March, 20X2, the investments were realised at par and the debentures were redeemed. 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.