

ISSUE OF DEBENTURES

DEBENTURE : It is a document issued by a company under its common seal acknowledging the debt and it also contains the terms of repayment of debt and payment of interest at a specified rate.

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

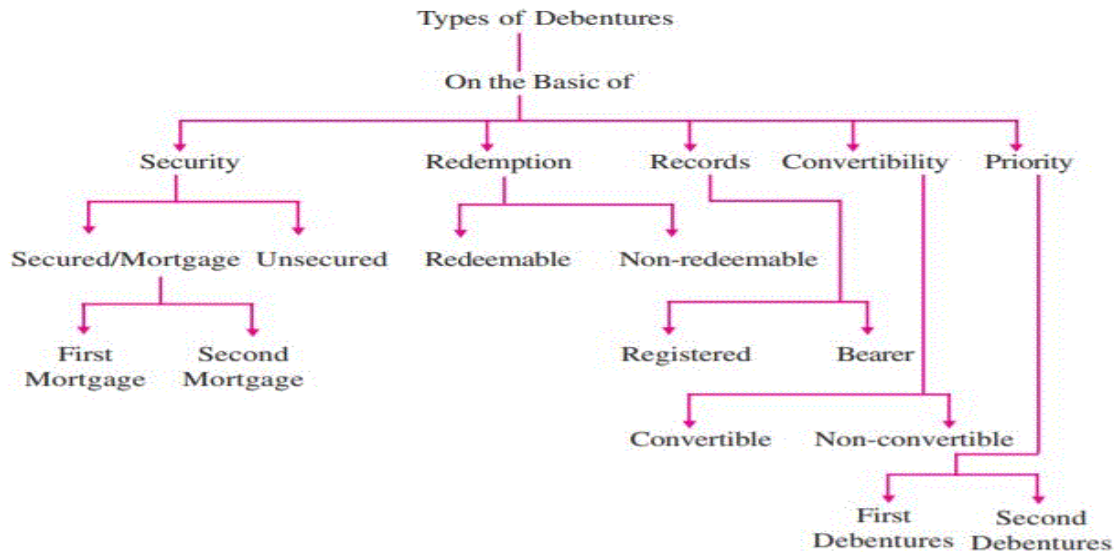
CHARACTERISTICS/ FEATURES OF A DEBENTURE:

- ✓ Is a written document/certificate acknowledging debt of a Company.
- ✓ Mode and period of repayment of principal and interest is fixed.
- ✓ Rate of interest is fixed.
- ✓ Shown as Long-term borrowings/ Short term borrowings.
- ✓ Int. on Debentures is a charge against profit.

DIFFERENCE BETWEEN SHARES AND DEBENTURES:

Basis	Share	Debenture
Ownership	Shareholders are the owners of company	Debenture holders are the lenders of company
Form of return	Share holder gets dividend	Debenture holder gets Interest
Security	Not secured	May or may not be Secured by a charge on assets
Voting right	Equity shareholders have the voting right	No voting right in normal course of business
Risk	more risk as compared to Debentures	Risk free due to Secured Debentures
Issue on Discount	cannot be issued at discount except sweat Equity Shares	can be issued at discount
Convertibility	cannot be converted to any other security	can be converted into shares

TYPES OF DEBENTURES



❖ **Convertibility point of view:** There are two types of debentures:

- **Convertible debentures:** which can be converted into equity shares of the issuing company after a predetermined period of time.

These may be Partly Convertible Debentures (PCD): A part of these instruments are converted into Equity shares in the future at notice of the issuer. The issuer decides the ratio for conversion. This is normally decided at the time of subscription.

Fully convertible Debentures (FCD) : These are fully convertible into Equity shares at the issuer's notice. The ratio of conversion is decided by the issuer. Upon conversion the investors enjoy the same status as ordinary of the company.

- **Non-convertible Debentures-** which are simply regular debentures, cannot be converted into equity shares. These are debentures without the convertibility feature these usually carry higher interest rates than their convertible counterparts.

❖ **Basis of Security, debentures are classified into:**

- **Secured Debentures:** These instruments are secured by a charge on the fixed assets of the issuer company. So, if issuer fails to pay of either the principal or interest amount, its assets can be sold to repay the liability towards debenture holders.
- **Unsecured Debentures:** These instruments are unsecured in the sense that if the issuer defaults on payment of the interest or principal amount, the investor is treated like other unsecured creditors of the company.

❖ **From Redemption point of view**

- **Redeemable Debentures:** Redeemable debentures are those which are redeemed or paid off after the termination of fixed term. The amount paid off includes the principal amount and the current year's interest. The company always has the option of either to redeem a specific number of debentures each year or redeem all the debentures at specified date.
- **Irredeemable or Perpetual Debentures:** Irredeemable debentures are those debentures which do not have any fixed date of redemption. They are redeemed either in the event of winding up or at a very remote period. Irredeemable or perpetual debenture holders can never force the company to redeem their debentures.

❖ **From Records point of view:**

- **Registered Debentures:** These Debentures are registered in the company's records. Principal and interest are paid to the registered debenture holders. The transfer requires the execution of transfer deed.
- **Bearer Debentures:** These debentures are not recorded in the records of the company. They are transferable by mere delivery. Interest is paid to the person who produces coupons attached to the debenture.

❖ **From Coupon rate point of view:**

- **Specific Coupon rate debentures:** These debentures are issued with a specified interest rate also called coupon rate. e.g- 10% Debentures.
- **Zero Coupon rate Debentures:** These debentures do not carry a specific interest rate. To compensate the investors these debentures are issued at a discount. The difference between face value and issue price is the total amount of interest related to duration of debentures.

ISSUE OF DEBENTURES:

As per SEBI guidelines, 75% of the issue should be subscribed before a company allots debentures. Debentures can be issued in following ways:

- for cash
- for consideration other than cash
- As collateral security

Terms of Issue:

Debentures can be issued in following ways:

- Issue of Debentures at Par
- Issue of Debenture at Premium
- Issue of Debentures at Discount

Debenture Payable in Installments:

- First instalment paid along with application is called as application money.
- Second instalment paid on allotment is called as allotment money.

- Subsequent instalments paid are called as call money calls can be more than one and called First call, second call or as the case may be.

Issue of Debentures for Cash.

(a) When Debentures amount received in lump sum with the application:

On receipt of application money	Bank A/c Dr. To Debenture Application and Allotment A/c	With the appl money received
On acceptance of Application money	Debenture Appl and Allot A/c Dr.	With the appl money received
	To X% Debentures A/c	Appl. Money on Deb. Allotted
	To Bank A/c	Excess Appl. money refunded

When Debentures amount received in installments.

In this case accounting entries will be same as at the time of issue of shares in instalments with small change in the name of term like-the share capital word replaced with the ___% Debentures A/c , and Share word replaced with Debentures e.g. Equity share capital into 8% Debentures, Equity share application into Debentures Application and follows on.

On receipt of application money	Bank A/c Dr. To Debenture Application A/c	With the appl money received
On allotment of Debentures	Debenture Appl Dr. To X% Debentures A/c	With Application Money on allotted deb.
On refund of Excess Application Money	Debenture Appl Dr. To Bank A/c	With the appl money refunded on rejected applications
On adjustment of excess App. Money with allotment	Debenture Appl Dr. To Debentures Allotment A/c	With surplus money adjusted with allotments
On Allotment being called	Debenture Allot A/c Dr. To X% Debentures A/c	With the Allotment money due on allotments
On receipt of allotment money	Bank A/c Dr To Debenture Allot A/c	With the Allotment money received on allotments
On calls being made	Debenture calls A/c Dr. To X% Debentures A/c	With the call money due on allotments
On receipt of calls money	Bank A/c To Debenture calls A/c	With the call's money received

Issue of Debentures for Consideration other than Cash:

When Debentures Issued for purchases Asset at par	1	Sundry Asset A/c Dr. To Vendor A/c	With the purchase consideration
	2	Vendor Dr. A/c To Debenture Account	With the purchase consideration

When Debentures are issued for purchases of asset at premium	1	Sundry Asset A/c Dr. To Vendor A/c	With the purchases Consideration
	2	Vendor Dr. A/c To Debenture A/c To Security Premium Reserve A/c	With the purchases Consideration No. of debentures x par value No. of debentures x par value
When Debentures are issued for purchases of asset at Discount	1	Sundry Asset A/c Dr. To Vendor	With the purchases Consideration
	2	Vendor Dr. Discount on issue of Debenture A/c DR. To Debenture A/c	With the purchases Consideration No. of debentures x Discount No. of debentures x par value
When Business is Purchased	1	When Purchase consideration is equal to net value of assets Sundry Assets A/c Dr. To Sundry Liabilities A/c To Vendor A/c	Value of asset Value of liabilities Purchases consideration
	2	When Purchase consideration is more than net value of assets Sundry Assets A/c Dr. Goodwill Account Dr To Sundry Liabilities A/c To Vendor A/c	Value of asset Balancing Figure Value of liabilities Purchases consideration
	3	When Purchase consideration is Less than net value of assets Sundry Assets A/c Dr. To Sundry Liabilities A/c To Vendor A/c To Capital Reserve	Value of asset Value of liabilities Purchases consideration Balancing Figure

COLLATERAL SECURITY :

- Collateral security means security provided to lender in addition to the principal security.
- Whenever a company takes loan from bank or from any financial institution it may issue its debentures as secondary security which is in addition to the principal security
- The lender will have a right over such debentures only when company fails to pay the loan amount and the principal security is exhausted
- In case the need to exercise the right does not arise debentures will be returned to the company.
- No interest is paid on the debentures issued as collateral security

In the accounting books of the company issue of debentures as collateral security can be credited in two ways

- I. **First method** : No Journal entry to be made in the books of accounts of the company for debentures issued as collateral security. A note of this fact is given in this case.
- II. **Second method : Entry to be made** in the books of accounts of the company.
- III.

Particulars	DR	CR
Debiture Suspense A/c Dr To % Debentures A/c (Being the issue of Debentures of Rs.... each issued as collateral security)

Note:

- 1) When the loan is paid off to the lender, the above entry is cancelled by passing a reverse entry.
- 2) If the Company fails to pay off the loan along with interest, the lender can recover the due amount by selling primary security or by redeeming the collateral Security. (Debentures)

Particulars	DR	CR
__ % Debentures A/c Dr. To Debiture Suspense A/c Dr Being the cancellation of above entry
Loan A/c Dr. Outstanding Interest A/c To __ % Debentures A/c being conversion of debenture issued as collateral security into debenture Liability

****In the BS, the debentures issued as collateral security are shown separately from other Debentures.**

INTEREST ON DEBENTURES:

Interest on Debentures is calculated at a fixed rate on its face value and is usually payable half yearly & **is paid even company is suffering from loss because it is charge on profit.**

Income Tax (TDS) is deducted from interest before payment to debenture holders.

1	When interest is Due	
	Debitures Interest A/c Dr.	(Gross Interest)
	To Debitures holder A/c To Income Tax/ TDS Payable A/c	(Net Interest) (Income Tax Deducted)
2	When Interest is paid	
	Debitures Holder A/c Dr. To Bank A/c	(With Interest)

3	On payment of Income Tax to Government	(TDS Amount)
	Income Tax /TDS Payable A/c Dr. To Bank A/c	
4	On Transfer of Interest on Debenture to statement of profit and Loss A/c	(Amount of gross Interest)
	Statement of Profit and Loss Dr. To Debenture Interest A/c	

CASES OF ISSUE OF DEBENTURES WITH CONDITIONS STIPULATED TO THEIR REDEMPTION

Debentures issued at par, premium or discount may be redeemed either at par or at premium. If the debentures are redeemed at premium, premium payable at the time of redemption is provided in the books of accounts at the time of issue only (Prudence concept).

case	Conditions of Issue	Conditions of Redemption	Loss for company at redemption
1	Issued at par	Redeemable at par	No loss
2	Issued at discount	Redeemable at par	No loss
3	Issued at Premium	Redeemable at par	No loss
4	Issued at par	Redeemable at premium	Yes (Note 1)
5	Issued at discount	Redeemable at premium	Yes (Note 2)
6	Issued at Premium	Redeemable at premium	Yes (Note 3)

Note 1 (Issued at par, redeemable at premium)

- Difference between Redeemable value and the issue price is a loss for the company, which is debited to Loss on issue of Debentures Account at the time of allotment of debentures.

On receipt of application money	Bank A/c Dr. To Debenture Application & Allotment A/c	With the appl money received
On allotment of Debentures	Debenture Application & Allotment A/c	With the appl money received
	Loss on issue of Debentures A/c Dr.	With Prem payable at redemption
	To ...% Debentures A/c	With Nominal Value of Debenture
	To Premium on redemption of Deb A/c	With Prem payable at redemption

Note 2 (issued at discount, redeemable at premium)

- The Company incurs losses both at issue and redemption. Both these losses are accounted at the time of issue of debentures only.

On receipt of application money	Bank A/c Dr. To Debenture Application Allotment A/c	With the appl money received
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On allotment of Debentures	Debenture Application & Allotment A/c Discount on issue of Debentures A/c Loss on issue of Debentures A/c Dr. To ...% Debentures A/c To Premium on redemption of Deb A/c	With the appl money received With Discount on issue With Prem payable at redemption With Nominal Value of Debenture With Prem payable at redemption
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Note 3 (issued at Premium, redeemable at premium)

- Premium received by the company at the time of issue of debentures is a capital receipt and is credited to Securities premium A/c. Premium payable at the time of redemption is a loss.

On receipt of application money	Bank A/c Dr. To Debenture Application & Allotment A/c	With the appl money received
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On allotment of Debentures	Debenture Application & Allotment A/c Loss on issue of Debentures A/c Dr. To ...% Debentures A/c To Securities premium A/c To Premium on redemption of Deb A/c	With the appl money received With Premium payable on redemption With Nominal Value of Debenture With premium received on issue With Prem payable at redemption
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