

# ISSUE OF DEBENTURES

When a company requires funds on long-term basis then the company raises capital by issue shares or may borrow money for long-term. Sometimes long-term money is borrowed by issuing debentures on the same way as issuing shares.

A debenture issued by a company is usually in the form of a certificate, given under the seal of the company. Debenture is the acknowledgment of the debt given under the seal of the company and containing a contract for the repayment of the principle sum at a specified date and for the payment of interest (usually half yearly) at a fixed rate percent until the principal sum is repaid.

In short, **debenture is a proof of company's indebtedness.**

**According to Section 2(30) of the Companies Act,** "Debenture includes debenture, stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not".

**According to Topham,** "A debenture is a document given by a company as evidence of debt to the holder usually arising out of a loan and most commonly secured by a charge".

## **Main features or Characteristics of Debentures**

- Debentures are the instruments of loan capital.
- It is issued by a company under the common seal of the company.
- It is contract for the repayment of principle and its interest at a specified date and rate.
- Normally debentures are secured.
- It is considered as long-term borrowing or as an external equity of the company.
- As money collected from the debenture is a loan for the company therefore the holders of debentures are creditors of the company.
- A debenture is generally redeemable i.e. amount of loan has to be refunded by the company after a certain period.
- Funds raised are long-term so is also called "loan capital".
- As per section 39 of the companies act 2013 condition of minimum subscription applies on every type of security.

## **Meaning of Bond**

It is also like debentures, is an acknowledgement of debt issued under the common seal of a company and signed by an authorized signatory. Traditionally, bonds had been issued by the government, but now a-days semi-government and non-government organizations are also issuing bonds. The major difference between debenture and bond is regarding the rate of interest.

Debentures are issued with a fixed rate of interest whereas bonds can issued without predetermined rate of interest which are called Deep discount bonds or Zero coupon bonds. In such bonds no prefixed rate of interest is mentioned at the time of issue but issue price is heavily discounted. And the difference between issue price and the

redemption price represents the total interest which is spread over the life time of the bond.

## 2. KINDS OR TYPES OF DEBENTURES

A company can issue the following types of debentures:

### From security point of view

**1. Secured or Mortgaged Debentures.** When debentures are secured by the assets of the company they are called secured or mortgaged debenture. In case of second debentures if company is unable to repay the debentures if company is unable to repay the debentures on the maturity, the debenture holders can realize their money from the assets mortgaged by the company.

**2. Unsecured or Simple or Naked debentures.** When no security is given against debentures. They are called unsecured debentures. So debenture holders are unsecured creditors of the company. These types of debentures are not commonly used.

### From transfer (records) point of view

**1. Registered debentures.** When name and address the debenture holders are entered in the register kept by the company. They are called registered debentures. In this case only that person will be entitled to get interest whose name is written in the register. Transfer of debentures also requires regular transfer deed.

**2. Bearer debentures.** In such case the amount of debentures and interest will be given to the bearer of the debentures. It can be transferred merely by the delivery. No records of such debenture holders are kept by the company.

### From convertibility point of view

**1. Convertible debentures.** When debenture holders are given option to convert debentures into shares after expiry of an agreed period then they are called convertible debentures. When full amount of debenture is convertible into equity share, such debentures are known as 'fully convertible debentures', but if a part of debenture amount is convertible with equity share then those debenture are known as 'partly convertible debentures'.

**2. Non-Convertible debentures.** When debenture holders have no right to convert their debentures into equity shares, those debentures will be known as 'non-convertible debentures'.

### From redemption point of view

**1. Redeemable debentures.** When debentures are repayable after a specified period or by installments during the lifetime of the company they are called redeemable debentures. Most of the debentures are generally of this type.

**2. Irredeemable Debentures.** When debentures are repayable only when the company goes into liquidation they are called irredeemable debentures such debentures are not repayable during the lifetime of company.

### **From priority point of view**

- 1. First debentures.** Those debentures which are to be repaid before other debentures are called as first debentures.
- 2. Second debentures.** Those debentures which are to be repaid after the first debentures are called as second debentures.

### **From the point of view of coupon rate.**

- 1. Specific coupon rate debentures.** When debentures are issued with a pre-determined rate of interest i.e. called the coupon rate they are called specific coupon rate debentures, this rate may be fixed or floating. The floating interest rate is generally linked with the bank rate. These type of debentures are generally issued by the companies.
- 2. Zero coupon rate debentures (Bonds).** When debentures do not carry any pre-determined rate of interest. But debentures are heavily discounted at the time of issue they are called zero coupon rate debentures. The difference between the face value and the issue price is the total amount of interest related to the total duration of the debentures.

### **"Debenture Trust Deed"**

Usually there are large numbers of debenture holder of a company. So to protect their interest, debenture holders may appoint some persons as trustees. For this purpose company executes a trust deed.

A trust deed is an agreement between the company and the trustees to look after the interests of the debenture holders. Trustees make sure that company is fulfilling its obligations under the trust deed properly. Trust deed is prepared before the issue of prospectus or before the letter of offer to the public for the subscription of debentures.

### **ISSUE OF DEBENTURES**

The process and procedure of issue of debentures is almost similar to that of issue of shares. A prospectus is issued in which terms and conditions of the issue of debentures are given. Full amount of debentures may be called on application itself or it may be called in installments, in the same way as in case of shares. That means some amount may be called on application, some amount of allotment and the balance may be called in one or more calls.

We should know this thing that if a debenture holder fails to pay the amount of allotment or call, his debentures cannot be forfeited. The amount can be recovered only by fulfilling a suit the court of law.

Accounting treatment will be same in case of debentures as in case of issue of shares. The only difference is that 'Debenture' in place of 'Share' and 'debenture account' in place of 'share capital account' are substituted. It is usual to prefix the rate interest to the debentures. Thus, if the debentures carry interest @10% p.a., the name given will be 10% (p.a.) debentures.

**METHODS OF ISSUE OF DEBENTURES:** - The issue of debentures will be done in the same way as to issue of shares. Debentures can also be used:

- (1) At Par or
- (2) At Premium
- (3) At discount

**ISSUE OF DEBENTURES AT PAR:** - When debentures are issued for the value equal to the face value of debentures it is said to be issued at par. For example, if debenture valuing Rs.100 is issued at Rs.100, it will be issue of debentures at par.

**ISSUE OF DEBENTURES AT PREMIUM:** -When debentures are issued for an amount more than their face value, then it is said debentures are issued at premium. For example, if debenture of the face value Rs.100 is issued for Rs.120, it will be issued at debentures issued at premium. The difference of 20 will be premium which will be a capital gain to the company.

It will be credited separately to securities premium may be called at any time but usually recorded at the time of allotment.

The premium is not a revenue profit, it is a capital profit so it should be used in writing off the capital losses, such as discount on issue of shares and debentures, premium on redemption of debentures, preliminary expenses, goodwill etc. this **"Securities premium reserve Account"** is shown on the equity and liabilities side of the balance sheet under the head **"Reserves and Surplus"**.

**ISSUE OF DEBENTURES AT DISCOUNT:-**When debentures are issued for value less than its face value is called debentures issued at discount. For example, if debentures of Rs.100 are issued t Rs.90. There is no restriction on companies for amount of discount to be offer to the public at the time of issue of debentures.

<b>ISSUE OF IRREDEEMABLE DEBENTURES FOR CASH</b>		
<b>If the whole amount of Debentures received in LUMP SUM</b>		
<b>SITUATION</b>	<b>ENTRY</b>	<b>NARRATION</b>
For receipt of application money	<b>If the Debentures issued at PAR</b> Bank A/C Dr. To Debenture Application A/C	Being the application money received for ..... debentures @ Rs..... each)
	<b>If the Debentures issued at a PREMIUM</b> Bank A/C Dr. To Debenture Application A/C To Securities Premium Reserves a/c	
	<b>If the Debentures issued at DISCOUNT</b> Bank A/C Dr. Discount on issue of Debentures A/C Dr. To Debenture Application A/C	

For Allotment of Debentures	Debenture Application and Allotment A/C.....Dr To % Debentures a/c	(Being the issue of debentures against debenture application and allotment)
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<b>ISSUE OF IRREDEEMABLE DEBENTURES FOR CASH</b>		
<b>If the whole amount of Debentures received in INSTALMENTS</b>		
<b>ENTRIES ON APPLICATION</b>		
SITUATION	ENTRY	NARRATION
For receipt of application money	Bank A/C Dr. To Debenture Application A/C	Being the application money received for ..... debentures @ Rs..... each)
For transfer of application money to debentures a/c	Debenture Application A/C Dr. To % Debentures A/C	Being the transfer of debenture application money towards debentures account )
For money refunded to rejected debentures	Debenture Application A/C Dr. To Bank A/C	(Being the money refunded to the debentures)
For adjustment of excess application money towards allotment and calls	Debenture Application A/C Dr. To Debenture Allotment A/C To Calls-in-advance A/C	(Being the adjustment of excess amount received on application to allotment and calls in advance a/c)
<b>ENTRIES ON ALLOTMENT</b>		
For amount due on allotment	<b>If the debentures are allotted at PAR</b> Debenture Allotment A/C Dr. To % Debentures A/C	(Being the allotment money due on ..... debentures @ Rs. .... each)
	<b>If the debenture are allotted at a PREMIUM</b> Debenture Allotment A/C Dr. To % Debentures A/C To Securities premium A/C	(Being the allotment money due on ..... debentures @ Rs. .... each including premium of Rs. .. each)
	<b>If the debenture are allotted at DISCOUNT</b> Debenture Allotment A/C Dr. Discount on issue of Deb. A/C To % Debentures A/C	(Being the allotment money due on ..... debentures @ Rs. .... each at a discount of Rs. .. each)
For receipt of allotment money	Bank A/C Dr. Calls in arrear A/C Dr(if so) To Debenture Allotment A/C	(Being the receipt of allotment money)
<b>ENTRIES ON FIRST CALL</b>		
For amount due on FIRST call	Debenture First Call A/C Dr. To % Debentures A/C	(Being the first call money due on ..... debentures @ Rs. .... each)
For receipt of FIRST call money	Bank A/C Dr. Calls in arrear A/C Dr(if so) To Debenture first call A/C	(Being the receipt of first call money)
<b>ENTRIES ON SECOND/FINAL CALL</b>		

For amount due on SECOND/FINAL call	Debenture Second/ Final Call A/C Dr. To % Debentures A/C	(Being the first/final call money due on ..... debentures @ Rs. .... each)
For receipt of SECOND/FINAL call money	Bank A/C Dr. Calls in arrear A/C Dr(if so) To Debenture Second/ Final Call A/C Dr	(Being the receipt of first/final call money)

### TREATMENT OF WRITING OFF DISCOUNT/LOSS ON ISSUE OF DEBENTURES:

Discount or Loss on Issue of Debentures is a capital loss for a company, **which is written off in the year it is incurred, i.e., in the year the debentures are allotted from:**

- 1. Securities Premium Reserve, if it exists, i.e., has a balance, as per Section 52(2) of the Companies Act, 2013, and
- 2. Statement of Profit and Loss

Discount or Loss on Issue of Debentures is written off from Securities Premium Reserve first and if Securities Premium does not exist, it is written off from Statement of Profit and Loss. In case, balance in Securities Premium Reserve is not adequate to write off the full amount of discount or loss then the balance left is written off from Statement of Profit and Loss.

Accounting Treatment		
SITUATION	ENTRY	NARRATION
For writing-off of discount/loss on issue of Debentures	Securities Premium Reserve A/C Dr Statement of Profit and Loss Dr. To Discount of loss on issue of Debentures A/C	Being the writing-off of Loss or discount on issue of Debentures

### ISSUE OF DEBENTURES FOR CONSIDERATION OTHER THAN CASH

Just like shares, debentures can also be issued for consideration other than cash. For example, if some asset is purchased from the vendor then, instead of paying in cash, company can issue fully paid debentures to vendors.

Debentures can be issued to vendors at par as well as for premium or even at a discount. But it should be remembered that payment to Vendors will be equal to its purchase price whether debentures are issued at par, at premium or at discount. That is why in case of debentures issued at premium number of debentures will be less as debenture value will be more. In case of debentures issued at discount number of debentures will be more as debenture value is less.

Accounting treatment

Two cases will be there

1. When some asset is purchased
2. When a business is purchased

01	<b>On purchase of ASSET</b>	Sundry Assets (with agreed value assets taken over) To Vendors A/C (with agreed value of Purchase Consideration)
	<b>On</b>	Sundry Assets (with agreed value assets taken over)

	<b>purchase of entire BUSINESS</b>	Goodwill A/C Dr. (with the excess of P.C. over of net assets) To S. Liabilities (with agreed value liabilities taken over) To Vendors A/C (with agreed value of Purchase Consideration) To Capital Reserves A/C (with the excess of value of net Assets over P.C.)	
<b>02</b>	<b>ON ISSUE OF DEBENTURES TO VENDORS</b>	If the Debentures are issued at PAR	Vendor A/C Dr. To % Debentures A/C
		If the Debentures are issued at PREMIUM	Vendor A/C Dr. To % Debentures A/C To Securities Premium A/C
		If the Debentures are issued at DISCOUNT	Vendor A/C Dr. Discount on issue of Debentures A/C Dr. To % Debentures A/C
Calculation of No. of debentures to be issued to Vendor	<b><u>Amount payable to Vendor through Debentures</u></b> <b><u>Debenture value at Par/Premium/Discount</u></b>		

### ISSUES OF DEBENTURES AS A COLLATERAL SECURITY

Sometimes company takes loan from bank or some other financial institution. Company gives some asset for security as a prime security. But at the same time company may issue debentures also as a second security or as a subsidiary security. So when debentures are issued as a secondary security or in addition to prime security this will be considered as issue of debentures as a collateral security. The persons or bank to whom debentures are issued as a collateral security will not be entitled to get interest on these debentures as they are entitled to get interest on the original

Loan advanced by them. That means liability of the company is for the amount of loan and not for the face value of debentures issued.

It should be remembered that incase company makes any default in the repayment of loan in time, then also lender will first realize its amount from the principal security but if the full amount is not realized from the principal security, the lender in that case will become the debenture holder of the company and will get all the rights of a debenture holder. On the repayment of loan on due date, debentures issued as a collateral security will be returned back to the company.

#### Accounting Treatment

There are two methods in case of debentures issued as a collateral security.

**FIRST METHOD.** No entry for debentures is passed as debentures are issued only as a collateral security. The entry is passed only for taking a loan. Like if loan is taken from a bank, the entry will be

SITUATION	ENTRY	NARRATION
On taking loan from a Bank	Bank A/C Dr. To Bank Loan A/C	(Being the loan taken from bank and Rs..... debentures ..... As collateral security)

While showing this bank loan in the equity and liabilities side of balance-sheet a note is also appended below which shows loan is secured by the issue of debentures as a collateral security.

**BALANCE-SHEET OF ..... LTD.AS AT.....**

PARTICULARS	Note No	Amount (Rs.) Current Year	Amount (Rs.) Previous Year
<b>EQUITY AND LIABILITIES</b>			
<b>Non-Current liabilities</b>			
(a) Long term borrowings	01	XXXX	

**Notes to Accounts –**

PARTICULARS	Amount (Rs.)
<b>1. Long-term Borrowings</b>	
Bank loan	
(On collateral security of Debentures of Rs.....)	<u>XXXX</u> <u>XXXX</u>

**SECOND METHO:** In this method on addition to entry for bank loan, the entry for issuing debentures is also passed. So entries will be as follows:

SITUATION	ENTRY	NARRATION
On taking loan from a Bank	Bank A/C Dr. To Bank Loan A/C	(Being the loan taken from bank and Rs..... debentures ..... As collateral security)
On issuing Debentures	Debentures Suspense A/C Dr. To % Debentures A/C	(Being the issue of Debentures as collateral security to secure a loan Rs..... from the bank)

Now this debentures suspense account will be shown as deductions from the debenture A/c on the Equity and liabilities side of balance sheet.

**BALANCE-SHEET OF ..... LTD.AS AT.....**

PARTICULARS	Note No	Amount (Rs.) Current Year	Amount (Rs.) Previous Year
<b>EQUITY AND LIABILITIES</b>			
<b>Non-Current liabilities</b>			
(a) Long term borrowings	01	XXXX	



## Notes to Accounts –

PARTICULARS	Amount (Rs.)
<b>1. Long-term Borrowings</b>	
% Debentures	xxxxx
Less Debentures Suspense A/C	<u>xxxxx</u>
Bank loan	<u>XXXX</u>
(On collateral security of Debentures of Rs.....)	<u>XXXX</u>

(C) On repayment of loans and on release of debentures there will be reverse entry

SITUATION	ENTRY	NARRATION
On repayment of loan from Bank	Loan A/C Dr. To Bank A/C	(Being the loan repaid)
On issuing Debentures	% Debentures A/C Dr. To Debentures Suspense A/C Dr.	(Being the taking back of debentures which were issued as a collateral security)

### ISSUE OF DEBENTURES FROM THE POINT OF VIEW OF REDEMPTION

As we know a company may issue its debentures at par, premium or at discount. In the same way a company can redeem (repay) its debentures at par, at premium or at discount. However it should be known that Debentures can be redeemed at a discount and this situation will be possible only when terms and conditions of redemption are laid down in advance. And this discount at the time of redemption will be gain for the company as amount payable at the time of redemption will be less than its face value.

But according to conservatism (prudence principle) convention expected losses are to be taken into account but not the expected gains. That is the reason, there will be no change in the journal entries passed, it will be passed in the same manner as if debentures are redeemed at par.

**Various cases from the point of view of redemption** will be as follows:

Sl. No/Case	Terms of Issue	Terms of Redemption
1	Issued at PAR	Redeemable at PAR
2	Issued at PAR	Redeemable at PREMIUM
3	Issued at PREMIUM	Redeemable at PAR
4	Issued at PREMIUM	Redeemable at PREMIUM
5	Issued at DISCOUNT	Redeemable at PAR
6	Issued at DISCOUNT	Redeemable at PREMIUM

Issued at	Redeemable at	ENTRY AT THE TIME OF ISSUE	ENTRIES AT THE TIME OF REDUMPTION	
			For amount due to Debenture holders	On making the payment to Debenture holders
PAR	PAR	Bank A/C Dr. To % Debentures A/C	Debentures A/C Dr. To Deb. Holders A/c	Deb. Holders A/c Dr To Bank A/C
	PRE	Bank A/C Dr. Loss on issue of Debentures AC Dr To % Debentures A/C To Premium on redemption of Debentures AC	Debentures A/C Dr. Premium on redemption of Debentures AC Dr. To Debenture Holders A/c	Deb. Holders A/c Dr To Bank A/C
PRE	PAR	Bank A/C Dr. To % Debentures A/C To Securities Premium Reserve A/C	Debentures A/C Dr. To Debenture Holders A/c	Deb. Holders A/c Dr To Bank A/C
	PRE	Bank A/C Dr. Loss on issue of Debentures AC Dr. To % Debentures A/C To Securities Premium Reserve A/C To Premium on redemption of Debentures AC	Debentures A/C Dr. Premium on redemption of Debentures AC Dr. To Debenture Holders A/c	Deb. Holders A/c Dr To Bank A/C
DIS	PAR	Bank A/C Dr. Discount on issue of Debentures AC Dr. To % Debentures A/C	Debentures A/C Dr. To Debenture Holders A/c	Deb. Holders A/c Dr To Bank A/C
	PRE	Bank A/C Dr. Loss on issue of Debentures AC Dr. To % Debentures A/C To Premium on redemption of Debentures AC	Debentures A/C Dr. Premium on redemption of Debentures AC Dr. To Debenture Holders A/c	Deb. Holders A/c Dr To Bank A/C

## INTEREST ON DEBENTURES

**MEANING.** Issue of Debentures is the money raised by the company for its use. So interest on debenture is the amount which is paid by the company as cost of using money.

**Nature of Interest on Debentures.** Students should remember that interest paid on debenture is a charge against the profits of the company and so payable irrespective of the profits of the company. That means company will have to pay interest even if company suffers loss.

**Calculation of interest.** Interest on debentures is calculated at a fixed rate that too on the face value of debentures not on the issue price.

**Tax Deducted at Source (TDS).** It should be remembered that interest on debentures paid by the company is required to deduct income tax at the rate specified from the total amount of debenture interest before any payment is given to debenture holders.

## SOME IMPORTANT POINTS TO BE NOTED RELATED TO INTEREST ON DEBENTURES

- The balance of interest on debentures account is transferred to Statement of Profit and Loss at the end of the year.
- No Interest is payable on debentures issued as a collateral security.
- Interest acquired and due on debentures' will be shown under the head Current liabilities.
- Interest account but not due on debentures appears under the subhead 'current liabilities'.

SITUATION	ENTRY	NARRATION
When interest is due	Debenture interest A/C Dr. To Debenture holders A/C To TDS A/C	(Being the interest on debentures due)
When interest is paid	Debenture holders A/C Dr. To Bank A/C Dr.	(Being the interest paid to debenture holders)
On payment of TDS	TDS/Income Tax A/C Dr. To Bank A/C Dr.	(Being the payment of TDS)
On transfer of interest on Debentures to Statement of Profit and Loss	Statement of Profit & Loss A/C Dr. To Debenture interest A/C	(Being the transfer of interest on debentures to Statement of Profit and Loss)

## Treatment of Discount on issue of Debentures

Discount on Loss on Issue of Debentures is a capital loss for a company, **which is written off in the year it is incurred, i.e., in the year the debentures are allotted** from

1. Securities Premium Reserve, if it exists, i.e., has a balance, and
2. Statement of Profit and loss

Discount or Loss on issue of Debentures is written off from Securities premium Reserve first and if Securities Premium Reserve does not exist, it is written off from Statement of Profit and Loss. In case, balance in Securities Premium Reserve is not adequate to write off the amount of discount or loss, it is written off from Securities Premium Reserve to the extent of balance available in Securities Premium Reserve and the balance left is written off from Statement of profit and Loss. Securities Premium Reserve can be used for writing off Discount or Loss on Issue of Debentures being allowed by Section 52(2) of the Companies Act, 2013.

SITUATION	ENTRY	NARRATION
On writing off discount or loss on issue of Debentures	Securities Premium Reserve A/C Dr. Statement of Profit and Loss Dr. To Discount/Loss on issue of Debentures A/C Dr.	(Being the discount or loss on issue of debentures written off )