

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."

Debentures are generally freely transferable by the debenture holder. Debenture holders have no rights to vote in the company's general meetings of shareholders. The interest paid to them is a charge against profit in the company's financial statements.

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 shareholders 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.

On 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 instrument 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 of time. Irredeemable or perpetual debenture holders can never force the company to redeem their debentures.

Distinguish Between a Share and Debenture

| Basis | Share | Debenture |
|----------------|---|--|
| Ownership | Shareholders are the owners of company | Debenture holders are the lenders of company |
| Form of return | Dividend | Interest |
| Security | Not secured | 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 of Debentures:

Debentures can be issued in following ways:

1. for cash
2. for consideration other than cash
3. As collateral security

Terms of Issue

Debentures can be issued in following ways:

1. Issue of Debentures at Par

Chapter 9 Issue of Debentures(Notes)

2. Issue of Debenture at Premium
3. Issue of Debentures at Discount.

Debenture Payable in Installments

1. First instalment paid along with application is called as application money.
2. Second instalment paid on allotment is called as allotment money.
3. 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 application money received |
| On acceptance of application money | Debenture Application and Allotment A/c Dr. To X% Debentures A/c To Bank A/c | With Amount of application money on allotted debentures, and Excess amount refunded. |

(B) 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 X% 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.

AT Par: means debentures are issued at face value.

Issue of Debentures for Consideration other than Cash

When Debentures are issued for purchased of asset

Chapter 9 Issue of Debentures(Notes)

| When Debentures Issued for purchases Asset at par | Sundry Asset A/c Dr. To Vendor | With the purchases consideration |
|--|--|--|
| When Debentures are issued for purchases of asset at premium | Sundry Assets A/c Dr. To Vendor Vendor Dr. To Debenture A/c To Security Premium Reserve A/c | With the purchases Consideration No. of debentures par value No. of debentures x premium |
| When business is Purchased | When Purchase consideration is equal to net value of assets Sundry Assets A/c Dr. To Sundry Liabilities A/c To Vendor When Purchases consideration more than net value of assets Goodwill Account Dr. To Sundry Liabilities A/c To Vendor | Value of asset Value of liabilities Purchases consideration Excess of Purchase Value (B/F) Value of Liabilities Purchases Consideration |

Chapter 9 Issue of Debentures(Notes)

| When Debentures Issued for purchases Asset at par | Sundry Asset A/c Dr. To Vendor | With the purchases consideration |
|---|--|---|
| | Vendor Dr. To Debenture Account | |
| | When Purchase Consideration is less than net value of asset Sundry Assets Account Dr. To Sundry Liabilities A/c To Capital Reserve To Vendor | Value of Asset Value of liabilities Difference (B/F) Purchases Consideration |

Collateral Security : Collateral security means security provided to lender in addition to the principal security. It is a subsidiary or secondary 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. Such an issue of debentures is known as 'issue of debentures as collateral 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 back to the company. No interest is paid on the debentures issued as collateral security because company pays interest on loan.

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

1. **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.
2. **Second method :** Entry to be made in the books of accounts of the company.

Chapter 9 Issue of Debentures(Notes)

A journal entry is made on the issue of debentures as a collateral security, Debentures Suspense Account is debited because no cash is received for such issue.

Following journal entry will be made

Journal

| Date | Particulars | LF. | Debit (Rs.) | Credit (Rs.) |
|------|---|-----|-------------|--------------|
| | Debenture Suspense A/c Dr. To % Debentures A/c (Being the issue of Debentures of Rs.... each issued as collateral security) | | | |

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 is deducted from interest before payment to debenture holders. It is called T.D.S. (Tax deducted at source).

JOURNAL ENTRIES

| | | |
|----|-----------------------------|-----------------------|
| 1. | When interest is Due | |
| | Debentures Interest A/c Dr. | (Gross Interest) |
| | To Debentures holder A/c | (Net Interest) |
| | To Income Tax Payable A/c | (Income Tax Deducted) |

Chapter 9 Issue of Debentures(Notes)

| | | |
|----|--|-----------------------------|
| 1. | When interest is Due | |
| 2. | When Interest is paid | |
| | Debentures Holder A/c Dr. | (With Interest) |
| | To Bank A/c | |
| 3. | On payment of Income Tax to Government | |
| | Income Tax Payable A/c Dr. | (Amount of Income) |
| 4. | On Transfer of Interest on Debenture to statement of profit and Loss A/c | (Tax deducted at source) |
| | Statement of Profit and Loss Dr. | |
| | To Debenture Interest A/c | |