



WELCOME

SUBJECT- CORPORATE ACCOUNTING PAPER- I

MODULE- I (B)

ISSUE AND REDEMPTION OF DEBENTURES (SINKING FUND METHOD)

BY

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DEBENTURES – MEANING AND DEFINITION

The word ‘debenture’ has been derived from a Latin word ‘debere’ which means to borrow. Issue of debentures is a method of raising loan from the public. Thus, a debenture may be defined as an instrument acknowledging a debt by a company to some person or persons which may or may not be secured by a charge on its assets.

1. According to Mr. Topham “A debenture is a document given by a company as evidence of a debt to the holder usually arising out of a loan and most commonly secured by a charge”.

2. Section 2(30) of the Companies Act, 2013 “Debenture includes debenture stocks, bonds and any other securities of the company whether constituting a charge on the company’s assets or not”.

Bond is also an instrument of acknowledgement of debt. Traditionally, the Government issued bonds, but these days, bonds are also being issued by semigovernment and non-governmental organizations. The terms ‘debentures’ and ‘Bonds’ are now being used interchangeably.

❖ FEATURES OF DEBENTURES:

1. A debenture in the form of a certificate like a share certificate.
2. It is issued under the common seal of the company.
3. This certificate is an acknowledgement of debt by the company to its holder.
4. A debenture usually provides for the repayment of a specified principal sum on a specified date. However, there is no restriction on issue of irredeemable debentures.
5. It usually provides for the payment of interest at regular intervals at fixed dates until the principal sum is completely paid back.
6. It is normally secured by a floating charge on the assets of the company.

DIFFERENCE BETWEEN SHARES AND DEBENTURES

1. Ownership

A 'share' represents ownership of the company whereas a debenture is only acknowledgement of Debt.

2. Return (Income)

The return on shares is known as dividend while the return on debentures is called interest.

3. Repayment

shares is not returned during the life of the company, whereas, generally, the debentures are issued for a specified period.

4. Voting Rights

Shareholders have voting rights & debenture holders have not voting right.

5. Rate of Discount on issue

In case of shares rate of discount must not exceed 10% of the face value while debentures can be issued at any rate of discount.

6. Security/ mortgage

Shares are not secured by any charge whereas the debentures are generally secured and carry a fixed or floating charge over the assets of the company

7. Convertibility

Shares cannot be converted into debentures whereas debentures can be converted into shares (Convertible debentures)

TYPES OF DEBENTURES

1. Redeemable Debentures-

issued for a specified period after which the company must repay the amount of debentures on a specified date.

2. Irredeemable Debentures

For which no fixed date is specified for repayment and the holders of which cannot demand payment as long as the company is functioning.

3. Registered Debentures

Registered in the name of the holder by the company in the Register of Debenture holders.

4. Bearer Debentures

Bearer debentures are those which are transferable by mere delivery.

5. Secured Debentures

which are secured either by the mortgage of a particular asset of the company.

6. Unsecured Debentures

Which are not secured by any charge or mortgage on any property of the company.

7. Convertible Debentures

are those debentures wherein the debenture holder is given an option to exchange a part or whole of the debenture amount for equity shares.

8. Non-Convertible Debentures

The debenture holder does not have any right for conversion into equity shares.

ISSUE OF DEBENTURES

Issue of debentures is similar to the issue of shares. Like shares the debentures can be issued at Par, Premium and Discount. Debenture account must be credited with the face value irrespective of the fact whether they are issued at discount or at premium and that value must be appearing as a liability in the balance sheet. If debentures are issued at premium, the amount of premium is credited to Debentures Premium A/c. It was used to make expenses of issued of the Debentures.

If the debentures are issued at discount, the amount of discount is debited to Discount on Debentures Account. Discount on debentures is like financial charge and it is not written off it is spread over a number of years for which the debentures are issued. The balance after writing off every year is shown in the Balance sheet under the heading Other Current Assets. In short, Premium of issue is profit and Discount of issue is loss. Profit is always credited and loss is always debited.

The price of the debentures can be demanded in number of installments like shares i.e. Application money, Allotment, First call and final call or it can be demanded in one installment only. If it is demanded in number of installments the entries passed are similar to those which are passed for issue of shares, such as-

A) If it is demanded in Installment-

1. Bank A/c Dr.

 To Debentures Application A/c

2. Debenture Application A/c Dr.

 To Debentures A/c

B) If the full price is called up in one Installment-

If the full price of the debenture is demanded or called up in one installment on issue of debentures the entries are passed as under

1. If Debentures are issued at discount and repayable at par

Bank A/c Dr. (Amount Received)

Discount on issue of Debentures A/c Dr. (Discount Allowed)

 To Debentures A/c (Face Value)

2. If Debentures are issued at par and repayable at a premium

Bank A/c Dr. (Amount Received)

Loss on issue of Debentures A/c Dr. (Amount of Premium)

 To Debentures A/c (Face Value)

 To Premium on Redemption of Debentures A/c (Amount of Premium)

3. If Debentures are issued at a discount and repayable at a premium

Bank A/c Dr. (Amount Received)

Discount on issue of Debentures A/c Dr. (Discount Allowed)

Loss on issue of Debentures A/c Dr. (Amount of Premium)

 To Debentures A/c (Face Value)

 To Premium on Redemption of Debentures A/c (Amount of Premium)

REDEMPTION OF DEBENTURES

Redemption of debentures means repayment of the liability of the debenture holders or the discharge of the liability of the debenture holders. There is no restriction by law regarding the redemption of debentures. If the debentures are irredeemable then company is not under the obligation to repay them except on the happening of any contingency. The terms and conditions of the redemption of debentures are generally determined by the company and it was mentioned in the prospectus inviting applications for debentures. Debentures can be redeemed by the following ways

1. Out of profits of the company
2. Out of the working capital (cash)
3. Through the sales proceeds of debenture redemption fund investment
4. Through the sale of fixed assets
5. Through the amount received on insurance policy taken
6. Through the sale of fresh shares/ debentures
7. By giving the shares or new debentures in exchange (conversion of debentures into shares or new debentures)

Generally, company redeems the debentures through the sales proceeds of debenture redemption fund investment (Sinking Fund Method/ Debenture Redemption Fund Method)⁹

METHODS OF REDEMPTION OF DEBENTURES:

1. Redemption by payment in lump sum
2. Redemption by purchasing debentures in the open market
3. Redemption by Annual Drawings
4. Redemption by Conversion
- 5. Redemption by creating sinking fund (Sinking fund method)**

If the debentures are to be repaid on a fixed date the company may create a special fund for the purpose of redemption it is termed as sinking fund or debentures redemption fund. This fund is created by setting aside a certain fixed amount every year from the profits. The amount set aside is invested in securities in open market. The interest received on securities investment is also reinvested. For the redemption of the debentures the securities are sold out. The profit or loss on sale of investment is transferred to the Debenture Redemption Fund A/c. If debentures are redeemed in installments, then the amount equal to the face value of the debentures redeemed is transferred to General Reserve. The profit or loss on redemption of debentures is also transferred to debenture redemption fund A/c. If all the debentures are redeemed on particular date, then the final balance on Debenture redemption fund is transferred to General Reserve A/c and the Debenture Redemption Fund A/c is closed.

SEBI'S GUIDELINES

Securities and Exchange Board of India (SEBI) has issued guidelines for redemption of debentures. The salient points of these guidelines are:

1. Every company shall create Debenture Redemption Reserve in case of issue of debenture redeemable after a period of more than 18 months from the date of issue.
2. The creation of Debenture Redemption Reserve is obligatory only for non-convertible debentures and non-convertible portion of partly convertible debentures.
3. A company shall create Debenture Redemption Reserve equivalent to at least 50% of the amount of debenture issue before starting the redemption of debenture.
- (4) Withdrawal from Debenture Redemption Reserve is permissible only after 10% of the debenture liability has already been reduced by the company.

SEBI guidelines would not apply under the following situations:

- a) Infrastructure company (A company wholly engaged in the business of developing, maintaining and operating infrastructure facilities)
- b) A company issuing debentures with a maturity period of not more than 18 months.

SPECIMEN JOURNAL ENTRIES (SINKING FUND METHOD)

A) At the End of First Year of Issue of Debentures:

1. Amount set aside form Profit

Profit and Loss Surplus A/c Dr.

 To Debenture Redemption Fund A/c

2. Purchase of Investment

Debenture Redemption Fund Investment A/c Dr.

 To Bank A/c

B) At the End of Second and Subsequent Years:

1. Interest Received

Bank A/c Dr.

 To Interest on DRF Investment A/c

2. Interest Received Transferred to Debenture Redemption fund A/c

Interest on DRF Investment A/c Dr.

 To Debenture Redemption Fund A/c

3. Amount set aside form Profit

Profit and Loss Surplus A/c Dr.

 To Debenture Redemption Fund A/c

4. Purchase of Investment

Debenture Redemption Fund Investment A/c Dr.

 To Bank A/c

C) At the End of the Last Year:

1. Interest Received

Bank A/c Dr.

 To Interest on DRF Investment A/c

2. Interest Received Transferred to Debenture Redemption fund A/c

Interest on DRF Investment A/c Dr.

 To Debenture Redemption Fund A/c

3. Amount set aside form Profit

Profit and Loss Surplus A/c Dr.

 To Debenture Redemption Fund A/c

4. Investment Sold

Bank A/c Dr.

 To Debenture Redemption Fund A/c

5. Profit/ Loss on Sale of Investment Transferred to Debenture Redemption Fund A/c

If Profit-

Debenture Redemption Fund Investment A/c Dr.

 To Debenture Redemption Fund A/c

If Loss- (A reverse entry will be passed as below)

Debenture Redemption Fund A/c Dr.

 To Debenture Redemption Fund Investment A/c

6. Repayment of Debentures

Debentures A/c Dr.

 To Bank A/c

7. Balance on Debenture Redemption Fund A/c Transferred to General Reserve A/c

Debenture Redemption Fund A/c Dr.

 To General Reserve A/c



THANK YOU