

# VIDYA BHAWAN BALIKA VIDYA PITH

शक्तिउत्थानआश्रमलखीसरायबिहार

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## Issue and Redemption of Debentures (H.W)

Question 1: Explain the different types of debentures?

### ANSWER:

Debentures are issued by a company for acquiring long-term borrowings.

They can be classified on the following basis.

#### 1. On the basis of Security

a. **Secured Debentures**- Mortgaged Debentures are those debentures that are secured against asset/s of a company. These are also known as secured debentures. In case the company fails to pay back the principal amount of debenture or fails to meet its interest obligations on the due date, then the debenture holders have the right to sell the mortgaged asset in order to realise their amount due to the company.

b. **Unsecured Debentures**- These debentures are treated as unsecured creditors. They do not have any security. These are uncommon now days.

#### 2. On the basis of Tenure

a. **Redeemable Debenture**- These debentures are payable after the expiry of a specific period. These debentures can be redeemed at par or premium either in lump sum or in installment. Generally all debentures are redeemable.

b. **Irredeemable Debenture**- Irredeemable Debentures are those debentures that cannot be repayable or redeemable by a company during its life time. These are repayable only at the time of winding up of the company. These are also known as Perpetual Debentures that means debentures having indefinite life. In India, now days, no company can issue irredeemable debentures.

#### 3. On the basis of Mode of Redemption

a. **Convertible Debentures**- Convertible Debentures are those debentures that can be converted into equity shares after a specified period of time. These are of following two types:

i. **Fully Convertible Debentures**: When the whole amount of a debenture is convertible into equity shares of equivalent amount, then these debentures are called Fully Convertible Debentures. There is no need to maintain Debenture Redemption Reserves for such debentures.

ii. **Partly Convertible Debentures**: When only a part of the amount of a debenture is convertible into equity shares, then these debentures are called Partly Convertible

Debentures. In this regards, the Debenture Redemption Reserve is maintained only for the non-convertible part of the debenture.

b. **Non-Convertible Debenture**- These debentures cannot be converted into shares. Generally debentures are non convertible.

#### 4. On the basis of Coupon Rate

a. **Zero Coupon Rate**- These debentures do not contain a specific rate of interest and can be issued at discount. The excess of the face value of the debenture over its issue price is considered as interest amount.

b. **Specific Rate**- These debentures carry a specific rate of interest which may be fixed or floating.

#### 5. On the basis of Registration

a. **Registered Debenture**- While issuing such debentures, the company maintains a record regarding name, address and number of holding of debentures in the Register of Debenture Holders of the company.

b. **Bearer Debentures**- When a company does not maintain any record of the debenture holders and the debenture is transferable mere by delivery, then the type of the debenture held by the holders is termed as Bearer Debenture. Interests on such debentures are paid to the persons who produce the interest coupons that are attached with these debentures in a specified bank.

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#### Question 2:

Distinguish between a debenture and a share. Why is debenture known as loan capital? Explain.

**ANSWER:**

| Basis of Difference  | Shares  | Debenture   |
|----------------------|---|---|
| 1. Owner or Creditor | Share holders are the owners since shares forms a are part of owned capital | Debenture holder are Creditors since debentures are a part of loan  |
| 2. Voting Rights     | Share holders have the voting rights  | Debenture holders do not have any voting rights.                    |
| 3. Returns           | Share holders are entitled for returns in the form of dividend.             | Debenture holders are entitled for returns in the form of interest. |
| 4. Rate of Return    | The rate of dividend is not fixed and varies from year to year.             | The rate of interest is fixed and do not vary from year to year.    |

|                          |  |   |
|--------------------------|--|---|
| 5. Obligations of Return | Dividend is appropriation of profit. Dividend will not be paid if losses are incurred by the company             | Interest is charged against profit, interest is payable even if there is no profit. |
| 6. Repayment of Amount   | The amount of share is not returned during the life time of the company  | The amount of debenture is returned according to the term of issue.                 |
| 7. Issue                 | The issue of shares at discount need adherence to the restrictions imposed by the Section 79 of the Company Act. | There are no such restrictions for issuing debentures on discount.                  |
| 8. Conversion            | Shares cannot be converted into debentures.  | Debentures can be converted into shares.  |
| 9. Risk                  | Shares are more risky than debenture as these are unsecured.   | If debentures are secured against asset, the risk involved is the minimal.          |
| 10. Repayment Priority   | Payment to the share holders is made after settlement of all external liabilities, i.e. after debenture holders. | Payment to the debenture holders is made before the share holders.                  |

Issue of debentures implies incurring long-term indebtedness. Generally, a company issues debentures for acquiring long-term borrowings to achieve its long-run targets and growth. Like the owner's capital, interest is also payable on the principal amount of the debenture. The interest paid is regarded as an expense for the company and is deductible under Income Tax Act. Therefore, debentures are also known as loan capital because they are redeemable after a long period of time.

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*Question 3:*

Describe the meaning of 'Debenture Issued as Collateral Securities'. What accounting treatment is given to the issue of debentures in the books of accounts?

**ANSWER:**

The term collateral security means additional or secondary security in addition to the primary security. Sometimes, when a company takes loan from a financial institution, then besides the primary security, the company may issue debenture for additional security (as collateral security). The lender who receives debenture as collateral security is not entitled for interest on these debentures. If any default is made by the company in paying back the principal amount (i.e. the loan amount) or interest on the loan, then the lender has the full right to recover his/her

dues from the sale of primary security. But, if the primary security is not sufficient to recover the amount of debt, then the debentures issued as collateral may be used for recovery of the remaining amount.

### Accounting Treatment

There are two ways to record issue of debentures as collateral security:

#### 1. No Entry

As no liability has been created so no Journal entry is recorded in the books of account. As per the Revised Schedule-VI of the Companies Act, the issue of debenture as collateral security is shown as a Long-Term Borrowings under the heading of Non-Current Liabilities on the Equity and Liabilities side of the Balance Sheet. In the Notes to Accounts of Long-Term Borrowings, the Loan so taken is shown. And in the Notes to Accounts of Cash and Cash Equivalents, the amount of loan so received (in cash) is shown. This can be better understood with the help of the below explained example.

Example- Suppose Best Bus Ltd. issued 4,000 9% Debentures of Rs 100 each as collateral security to NBP bank for a loan of Rs 3,00,000.

#### Best Bus Ltd. Balance Sheet

| Particulars                      | Note No. | Amount (Rs)     |
|----------------------------------|----------|-----------------|
| <b>I. Equity and Liabilities</b> |          |                 |
| 1. Shareholders' Funds           |          |                 |
| 2. Non-Current Liabilities       |          |                 |
| a. Long-Term Borrowings          | 1        | 3,00,000        |
| 3. Current Liabilities           |          |                 |
| <b>Total</b>                     |          | <b>3,00,000</b> |
| <b>II. Assets</b>                |          |                 |
| 1. Non-Current Assets            |          |                 |
| 2. Current Assets                |          |                 |
| a. Cash and Cash Equivalents     | 2        | 3,00,000        |
| <b>Total</b>                     |          | <b>3,00,000</b> |
|                                  |          |                 |

#### NOTES TO ACCOUNTS

| Note No. | Particulars          | Amount (Rs) |
|----------|----------------------|-------------|
| 1        | Long-Term Borrowings |             |

|   |  |              |
|---|--|--------------|
|   | Loan (Secured by issue of 9% Debentures of Rs 4,00,000 as Collateral Security) | 3,00,000     |
| 2 | <b>Cash and Cash Equivalents</b><br>Cash at Bank                               | <br>3,00,000 |

## 2. By Making Entry

In order to record the issue of debentures as collateral security, the following necessary Journal entries are made in the books of account.

### At the time of Issue of Debentures as Collateral Security

|                        |     |
|------------------------|-----|
| Debenture Suspense A/c | Dr. |
| To Debenture A/c       |     |

(Debentures issued as collateral security)

In this case, as per the Revised Schedule VI of the Companies Act, Debentures so issued as collateral security will be shown as Long-Term Borrowings under the head of Non-Current Liabilities of the Equity and Liabilities side of the Company's Balance Sheet. Unlike Method-1, in this method, Debentures Suspense Account is deducted from the Debentures Account in the Notes to Accounts of Long-Term Borrowings.

### Best Bus Ltd. Balance Sheet

| Particulars                      | Note No. | Amount (Rs)     |
|----------------------------------|----------|-----------------|
| <b>I. Equity and Liabilities</b> |          |                 |
| 1. Shareholders' Funds           |          |                 |
| 2. Non-Current Liabilities       |          |                 |
| a. Long-Term Borrowings          | 1        | 3,00,000        |
| 3. Current Liabilities           |          |                 |
| <b>Total</b>                     |          | <b>3,00,000</b> |
| <b>II. Assets</b>                |          |                 |
| 1. Non-Current Assets            |          |                 |
| 2. Current Assets                |          |                 |
| a. Cash and Cash Equivalents     | 2        | 3,00,000        |
| <b>Total</b>                     |          | <b>3,00,000</b> |

### NOTES TO ACCOUNTS

| Note No. | Particulars | Amount (Rs) |
|----------|-------------|-------------|
|----------|-------------|-------------|

|   |  |  |
|---|--|--|
| 1 | <p><b>Long-Term Borrowings</b></p> <p><i>Secured:</i></p> <p>Loan (Secured by issue of 9%<br/> Debitures of<br/> Rs 4,00,000 as Collateral Security)<br/> 9% Debitures (Issued as<br/> Collateral Security to 4,00,000<br/> Bank against loan)</p> <p><i>Less:</i> Debiture (4,00,000)<br/> Suspense Account</p> <hr/> | <p>3,00,000</p> <p>-</p> <hr/> <p>3,00,000</p> <hr/> |
| 2 | <p><b>Cash and Cash Equivalent</b></p> <p>Cash at Bank</p>   | <p>3,00,000</p>                                      |