REDEMPTION OF DEBENTURES

A) REDEMPTION OUT OF CAPITAL

When debentures are redeemed out of capital, no debenture redemption reserve is created out of the divisible profits of the company.

(1) On debentures becoming due for redemption

(1) Debentures A/c ----Dr.
Premium on redemption of debentures (if any)---Dr.
To Debentureholders A/c--Cr.
To Capital Reserve A/c --Cr.
(with the amount of discount, if any)

(2) On payment to debentureholders

Debentureholders A/c --Dr.
To Bank A/c ------Cr.

(3) On writing off the premium on redemption

Security premium A/c--Dr.
Any free reserve A/c--Dr.
To Premium on redemption of debentures A/c ---Cr.

P.T.O.

B) REDEMPTION OUT OF PROFITS

When debentures are redeemed out of profits, the Company shall transfer adequate amount covering the principal and interest accrued thereon to Debenture Redemption Reserve (DRR).

(1) On debentures becoming due for redemption

Debentures A/c ---Dr.
Premium on redemption of debentures (if any) --Dr.
To Debentureholders A/c --Cr.
To Capital reserve A/c --Cr.
(with the amount of discount, if any)

(2) For transfer of surplus or divisible profits to Debenture Redemption Reserve

Surplus/Divisible profits A/c --Dr.
To Debenture Redemption Reserve A/c ----Cr.

(3) On payment to debentureholders

Debentureholders A/c --Dr.
To Bank A/c ----Cr.

P.T.O.

(4) On writing off premium on redemption

Security premium A/c -- Dr.
Profit and Loss A/c -- Dr.
General Reserve A/c -- Dr.
To premium on redemption of debentures A/c --- Cr.

(5) On transferring the balance in the D.R.R. A/c to General Reserve when the debentures are redeemed

Debenture Redemption Reserve A/c - --- Dr.
To general reserve A/c - Cr.

(C) REDEMPTION THROUGH CONVERSION

A company can issue convertible debentures. It means that the debentures would be redeemed by converting them into new class of debentures or shares. The new class of debentures or shares can be issued at par or premium or discount. When originally the debentures were issued at par or premium, only the nominal value of the debentures would be converted into shares or new debentures. However, if the debentures were originally issued at a discount, only the net amount of debentures received (after discount) at the time of issue would be converted into shares or new debentures. In this case, while the Debentures A/c will be debited at its nominal value, Discount on the issue of debentures A/c will be credited with the amount of discount allowed at the time of issue of these debentures.

Accounting treatment

Debentures A/c -- Dr.
Discount on issue of shares (if allowed) - Dr.
To S. Capital A/c --- Cr.
To Security premium A/c - Cr. (if allowed on issue of shares).
To Discount on issue of debentures A/c -- Cr. (if allowed earlier at the time of issue of debentures to be redeemed)

ACCOUNTING TREATMENT OF SINKING FUND CREATED TO REDEEM DEBENTURES

At the end of first year

(i) For setting aside the required amount for sinking fund

Surplus A/C ---Dr.
To Sinking Fund A/C--Dr.

(ii) For investing the surplus appropriated or set aside

Sinking fund investment A/C---Dr.
To Bank A/C ---- Cr.

At the end of second and every subsequent year (except the last year)

(i) For receiving interest on sinking fund investments made in the previous year

Bank A/C ---Dr.
To Interest on S.F.I. A/C --- Cr.

(ii) For transferring interest to Sinking Fund A/C

Interest on S.F.I. A/C--Dr.
To Sinking Fund A/C--Cr.

(iii) For annual appropriation of profit

Surplus A/C ----Dr.
To Sinking Fund A/C-Cr.

P.T.O.

(iv) For investing the appropriated profit plus interest received on sinking fund investments

S. F. I. A/c ---Dr.
To Bank A/c ---Cr.

At the end of last year

(i) For receiving interest on S.F. investments in made in the previous year

Bank A/c---Dr.
To Interest on S. F. investment A/c--Cr.

(ii) For transferring interest to Sinking Fund A/c

Interest on S.F. Investment A/c --Dr.
To Sinking Fund A/c --Cr.

(iii) For annual appropriation of profit

Surplus A/c ---Dr.
To Sinking Fund A/c--Cr.

(iv) For sale or realisation of S.F. investments to provide for cash on redemption

Bank A/c ----. Dr.
Sinking Fund A/c--Dr. (with loss on sale, if any)
To S.F. Investment A/c--Cr.
To Sinking Fund A/c--Cr. (with profit on sale, if any)

of debentures ---
(with the difference)

(v) For amount payable on redemption

Debentures A/c --- Dr.
Premium on redemption of debentures A/c -- Dr. (if any)
To Debentureholders A/c --- Cr.

(vi) Security premium A/c --- Dr.
~~Any~~ F.R.R. A/c --------- Dr.
To P. on R.O.D. A/c -------- Cr.

(vii) For payment to debentureholders

Debentureholders' A/c -- Dr.
To Bank A/c ---- Cr.

(viii) For transferring the Sinking Fund balance to General Reserve A/c

Sinking Fund A/c -- Dr. ✻
To General Reserve A/c -- Cr.

✻ Profit on sale of investment included in S.F. A/c must be transferred to G.R. A/c

ACCOUNTING TREATMENT FOR PURCHASE OF DEBENTURES FOR IMMEDIATE CANCELLATION Where no Sinking Fund exists

(i) On purchase of debentures for immediate cancellation

Debentures A/c -- Dr.
Loss on redemption of debentures A/c -- Dr. (with loss, if any)
To Bank A/c ---- Cr.
To profit on redemption of debentures -- Cr. (with profit if any)

(ii) For profit on cancellation of debentures

Profit on redemption of debentures A/c --- Dr.
To Capital Reserve A/c -- Cr.

OR

For loss on cancellation of debentures

Capital Reserve A/c - Dr. (if available)
Security Premium A/c - Dr (if available)
To Loss on redemption of debentures A/c -- Cr.

(I)

ACCOUNTING TREATMENT FOR INVESTMENT IN OWN DEBENTURES & INTEREST THEREON

(A) Where no Sinking Fund exists

(i) For the purchase of own debentures
Own debentures A/c -- Dr
To Bank A/c .... Cr.

(ii) For interest becoming due on debentures

(b) Discount on Issue of Debentures

(c) Expenses on Issue of Debentures

(d) Loss on Issue of Debentures

However the unamortized (unwritten) amount of above items to be written off in the next financial or accounting period will be shown in the balance sheet as follows:

Current Assets

Other Current Assets

Balance of the amounts of the foregoing items to be written off thereafter will be shown in the balance sheet as follows:

Non-Current Assets

Other non current assets

Illustration 1

Amritsar Cotton Ltd. issued ₹ 5 crores 10% debentures of ₹ 1,000 each at ₹ 940 per debenture.

The debentures are redeemable in five annual instalments of ₹ 200 each. It is decided to write off discount in proportion to the amount of debentures money usage over the various years.

(i) Pass appropriate journal entries in year 1 and 2.

(ii) Prepare a statement for write off discount over the five year period.
(iii) Assume that the redemption is out of capital.

Amritsar Cotton Ltd.
Journal Entries

	Particulars		Debit Amount	Credit Amount
			₹	₹
Year I (i)	Bank Account	Dr.	4,70,00,000	
	Discount on Issue of Debentures	Dr.	30,00,000	
	To 10% Debentures Account			5,00,00,000
	(Being issue of 50,000, 10% Debentures of ₹ 1,000 each @ ₹ 940)			
	10% Debentures Account	Dr.	1,00,00,000	
(ii)	Debenture Interest Account	Dr.	50,00,000	
	To Debentureholders Account			1,50,00,000
	(Being interest payable)			
(iii)	Debentureholders Account	Dr.	1,50,00,000	
	To Bank Account			1,50,00,000
	(Being payment of interest)			
(iv)	Profit and Loss Account	Dr.	60,00,000	
	To Debenture Interest Account			50,00,000
	To Discount on Issue of Debentures			10,00,000
	(Being transfer of debenture interest and discount on issue of debentures to statement of profit and loss)			
Year II (i)	10% Debentures Account	Dr.	1,00,00,000	
	Debenture Interest Account	Dr.	40,00,000	
	To Debentureholders Account			1,40,00,000
(ii)	Debentureholders Account	Dr.	1,40,00,000	
	To Bank Account			1,40,00,000
(iii)	Profit and Loss Account	Dr.	48,00,000	
	To Debenture Interest Account			40,00,000
	To Discount on Issue of Debentures			8,00,000

STATEMENT SHOWING DISCOUNT WRITTEN OFF

Total Discount $5,00,00,000 \times \frac{60}{1,000} = ₹\ 30,00,000$

Proportion of Fund Utilised

I Year 5,00,00,000; II Year 4,00,00,000; III Year 3,00,00,000; IV Year 2,00,00,000; V Year 1,00,00,000.

Ratio 5: 4: 3: 2: 1

4 23 Imp.

Illustration 14 (Redemption of Debentures)

Seawage Ltd. had ₹ 18,00,000 14% Debentures outstanding on 1 April 2011 redeemable on 31 March 2012. On 1 April 2011, the debenture redemption fund stood at ₹ 14,98,000 represented by own debentures of the face value of ₹ 2,00,000 purchased at an average price of ₹ 99 per debenture and 10% stock acquired at par for ₹ 13,00,000. The annual instalment of transfer to the fund was ₹ 1,42,000. On 31 March 2012, investments were sold for ₹ 12,93,600 and the debentures were redeemed.

Show 14% Debentures Account, Debentures Redemption Fund Account and Debenture Redemption Fund Investments Account for the year and 31 March 2012.

Solution

Seawage Ltd.
14% Debentures Account

2012		₹	**2011**		₹
Mar. 31	Debenture Redemption Fund Investments **(Own Debentures)** Account	1,98,000	April 1	Balance b/d	18,00,000
	Capital Reserve A/c	2,000			
	Debentureholders Account	16,00,000			
		18,00,000			18,00,000

Debenture Redemption Fund Account

2012		₹	**2011**		₹
Mar. 31	Debenture Redemption Fund Investments Account **(loss on sales)**	6,400	April 1	Balance b/d	14,98,000
	General Reserve Account	17,91,600	**2012** Mar.31	Bank Account **(Interest)**	1,30,000
				Interest on own Debentures Account	28,000
				Surplus Account	1,42,000
		17,98,000			17,98,000

Debenture Redemption Fund Investments Account

2011		₹			₹
Apri. 1	Balance b/d :		**2012**		
	Own Debentures	1,98,000	Mar. 31	14% Debentures A/c **(Own Debentures)**	1,98,000
	10% Stock	13,00,000		Bank Account **(Sale)**	12,93,600
				Debenture Redemption Fund Account **(Loss on sale)**	6,400
		14,98,000			14,98,000