

- Meaning of Debentures
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## Meaning of Debentures

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Section 2 (30) of the 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 instruments evidencing a debt raised by a company and are generally freely transferable by the debenture holder. Debenture holders are creditors and do not have voting rights in the company's general meetings. The interest paid to debenture holders is a charge against the company's profits.

## Features of Debentures

- Debenture holders are creditors entitled to fixed interest.
- Debentures are redeemed after a fixed period.
- They may be secured or unsecured.
- Interest on debentures is payable even if the company incurs losses.
- Debenture holders have no voting rights.
- Interest paid is tax deductible for the company.
- Debenture holders can apply for winding up to protect their interests.

## Examples

A company issues debentures to raise long-term funds without diluting ownership. The debenture holders receive fixed interest but cannot vote in shareholder meetings.

## Practice Set

- **Level 1:** Define debentures and list three features.
- **Level 2:** Explain why debenture holders do not have voting rights.
- **Level 3:** Discuss the implications of interest on debentures being a charge against profits.

## Answer Key

- Debentures are debt instruments issued by companies to raise funds.
- Features include fixed interest, redemption after fixed period, and no voting rights.
- Debenture holders are creditors, not owners, hence no voting rights.
- Interest is payable even if company incurs losses, making it a fixed financial obligation.

## Quick Reference

Debentures = Debt instrument; Fixed interest; No voting rights; Redeemable.

## Glossary

- **Debenture:** A debt instrument issued by a company.
- **Creditor:** A person or entity to whom money is owed.
- **Redemption:** Repayment of the principal amount of debentures.

## Types of Debentures

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Companies issue various types of debentures to raise long-term funds. The main types are:

- **Ordinary Debentures:** Unsecured debentures without any asset mortgage.
- **Mortgage Debentures:** Secured by a charge on company assets.
- **Non-convertible Debentures:** Cannot be converted into equity shares.
- **Partly Convertible Debentures:** Part of the debenture can be converted into equity shares.
- **Fully Convertible Debentures:** Fully convertible into equity shares after a specified period.
- **Redeemable Debentures:** Redeemed after a fixed term.
- **Irredeemable or Perpetual Debentures:** No fixed redemption date; redeemed on winding up or remote date.
- **Registered Debentures:** Holder details recorded; not easily transferable.
- **Unregistered Debentures:** Also called bearer debentures; easily transferable.
- **Specific Coupon Rate Debentures:** Carry fixed or floating interest rate.
- **Zero Coupon Rate Debentures:** Issued at discount; no periodic interest.

## Examples

A company issues mortgage debentures secured by its factory building. Another company issues zero coupon debentures at a discount and pays no periodic interest.

## Practice Set

- **Level 1:** List five types of debentures.
- **Level 2:** Differentiate between registered and unregistered debentures.
- **Level 3:** Explain the advantages of issuing fully convertible debentures.

## Answer Key

- Types include ordinary, mortgage, convertible, redeemable, registered, unregistered, etc.
- Registered debentures have holder details recorded; unregistered do not.

- Fully convertible debentures allow holders to become shareholders, benefiting both parties.

## Quick Reference

Debenture types vary by security, convertibility, redemption, and registration.

## Glossary

- **Convertible Debentures:** Debentures that can be converted into equity shares.
- **Coupon Rate:** The interest rate payable on debentures.
- **Bearer Debentures:** Debentures payable to the holder without registration.

## Issue of Debentures

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The issue of debentures involves inviting investors to subscribe to the debenture issue. The company may receive applications exceeding the number of debentures offered, called over-subscription. The company refunds excess money to unsuccessful applicants and adjusts excess money from successful applicants against allotment or calls.

Debentures can be issued at par, premium, or discount. The issue may be for cash, as collateral security, or for consideration other than cash.

## Methods of Issue

- For cash: at par, discount, or premium.
- As collateral security: issued as additional security for a loan.
- For consideration other than cash: issued to vendors for assets or business purchase.

## Accounting Entries for Issue of Debentures for Cash

When debenture money is received in lump sum or installments, appropriate journal entries are passed to record application money, allotment, calls, and refunds.

## Issue as Collateral Security

Debentures issued as collateral security are not recorded as liabilities but disclosed by a note in the balance sheet. Alternatively, a Debenture Suspense Account is created to record the issue.

## Practice Set

- **Level 1:** Define over-subscription in debentures.
- **Level 2:** Explain the accounting treatment for issue of debentures at discount.
- **Level 3:** Describe the two options for accounting debentures issued as collateral security.

## Answer Key

- Over-subscription occurs when applications exceed the number of debentures offered.
- Discount on issue is recorded as a loss and charged to Securities Premium Account or Profit & Loss.
- Option 1: No entry, note disclosure only. Option 2: Record in Debenture Suspense Account and reverse on loan repayment.

## Quick Reference

Issue methods: cash, collateral, other consideration; Over-subscription refund rules; Accounting entries vary by issue price.

## Glossary

- **Over-subscription:** Applications exceeding the number of debentures offered.
- **Collateral Security:** Additional security offered for a loan.
- **Securities Premium Reserve:** Reserve created from premium on shares or debentures.

## Accounting Treatment of Interest on Debentures

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Interest on debentures is a fixed periodic charge paid to debenture holders as a reward for investment. It is treated as an expense and charged against profits.

### Journal Entries

#### Recording interest due:

Interest A/c Dr.  
To Debenture holders' A/c  
(Being interest due on debentures)

#### Payment of interest:

Debenture holders' A/c Dr.  
To Bank A/c  
(Being interest paid to debenture holders)

#### Transfer to Statement of Profit & Loss:

Statement of Profit & Loss Dr.  
To Interest A/c  
(Being interest charged to profit and loss account)

No interest is payable on debentures issued as collateral security.

### Presentation in Financial Statements

- Interest accrued and due appears under Secured Loans.

- Interest accrued but not due appears under Current Liabilities.

## Practice Set

- **Level 1:** Write journal entries for interest on debentures.
- **Level 2:** Explain why no interest is paid on debentures issued as collateral security.
- **Level 3:** Describe how interest on debentures is presented in the balance sheet.

## Answer Key

- Interest A/c Dr. To Debenture holders' A/c; Debenture holders' A/c Dr. To Bank A/c; Statement of Profit & Loss Dr. To Interest A/c.
- Collateral security debentures are a guarantee, not a loan, so no interest is paid.
- Interest accrued and due is shown under Secured Loans; accrued but not due under Current Liabilities.

## Quick Reference

Interest is a fixed charge, recorded as expense, no interest on collateral debentures.

## Glossary

- **Interest Accrued and Due:** Interest payable but not yet paid.
- **Current Liabilities:** Obligations payable within one year.
- **Secured Loans:** Loans backed by assets as security.

## Issue of Debentures for Consideration Other Than Cash

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Debentures may be issued to vendors against purchase of assets or business instead of cash payment. The issue can be at par, premium, or discount and is accounted accordingly.

## Accounting for Purchase of Assets

### Acquisition of Assets:

Sundry Assets A/c Dr.

To Vendor's A/c

(Being assets purchased)

### On Allotment of Debentures:

- At par:

Vendor's A/c Dr.

To Debentures A/c

- At premium:

Vendor's A/c Dr.

To Debentures A/c

To Securities Premium Reserve A/c

- At discount:

Vendor's A/c Dr.

Discount on Issue of Debentures A/c Dr.

To Debentures A/c

## Accounting for Purchase of Business

### When Purchase Consideration equals Net Assets:

Sundry Assets A/c Dr.

To Sundry Liabilities A/c

To Vendor's A/c

### When Purchase Consideration exceeds Net Assets (Goodwill):

Sundry Assets A/c Dr.

Goodwill A/c Dr.

To Sundry Liabilities A/c

To Vendor's A/c

## When Purchase Consideration is less than Net Assets (Capital Reserve):

Sundry Assets A/c Dr.  
To Sundry Liabilities A/c  
To Capital Reserve A/c  
To Vendor's A/c

## Practice Set

- **Level 1:** Write journal entries for issue of debentures at par for purchase of assets.
- **Level 2:** Explain treatment when purchase consideration is more than net assets.
- **Level 3:** Prepare journal entries when purchase consideration is less than net assets.

## Answer Key

- Assets A/c Dr. To Vendor's A/c; Vendor's A/c Dr. To Debentures A/c.
- Goodwill is debited to reflect excess payment over net assets.
- Capital Reserve credited when purchase consideration is less than net assets.

## Quick Reference

Debentures can be issued for assets or business purchase; goodwill or capital reserve arises on difference.

## Glossary

- **Goodwill:** Excess of purchase consideration over net assets.
- **Capital Reserve:** Reserve created from capital profits.
- **Vendor:** Seller of assets or business.