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Accounting for Redemption of Debentures

Redemption of Debentures:

It refers to repayment of amount of Debentures to Debentureholders for discharge of its Liability towards Debentures.

Points to be considered at the time of Redemption:

Debentures are normally redeemed on maturity date, However, it can be redeemed before maturity by Draw of lots, Purchase from Open Market for Cancellation or by Conversion into Shares or New Debentures; If Article of Association of Company authorises it and if the terms and conditions of Debentures permit it.

Debentures can be redeemed either at Par or Premium as per the terms of issue. In case of Purchase from Open Market for Cancellation, money paid for Purchase of Debentures is the amount of Redemption.

Sources of Redemption:

1. Out of Capital:

No transfer of adequate Fund to Debenture Redemption Reserve (DRR). However, Rule 18 (7) of Companies (Share Capital & Debentures) Rules of Indian Companies Act 2013; Every Company other than Companies exempted from creating DRR, to **transfer at least 25 % of Nominal Value** of total Redeemable Debentures of a particular Class to DRR out of Surplus available for Payment as Dividend to Shareholders.

2. Out of Profit:

Redemption solely out of Profits. **100 % Nominal value** of total Redeemable Debentures are

transferred to DRR out of Surplus available for Payment as Dividend to Shareholders.

3. Out of Profit & Capital Both:

Redemption of Debentures Partially out of Profit & Partially out of Capital. In this case, Company is not required to transfer 100 % of Face value of Debentures to DRR. At least 25 % is required to be transferred to DRR.

Notes:

Following points are noteworthy with respect to creation of DRR:

If Question is silent → Create DRR of 25 % of Face Value of Debentures

If Redemption is out of Profit → Transfer 100 % of Face Value of Debentures to DRR.

If amount of DRR is given in the question → If less than 25 %, value of Debentures is given in the Question, Transfer Balance amount in order to make it 25 %. If more than 25 % is given in the question, transfer that value to DRR.

Debenture Redemption Reserve (DRR)

Amount set aside out of amount available for Payment as Dividend to Shareholders of the Company.

DRR is created on Non Convertible Debentures or Non Convertible part of Debentures in case of Partially Converted Debentures.

Adequate Amount is required to be credited to DRR before Redemption begins.

Exemptions to Create DRR as Per Indian Companies Act, 2013:

1. All India Financial Institutions & Other Financial Institutions Controlled by RBI.
2. Banking Companies and
3. National Housing Bank.

Disclosure of DRR in Balance Sheet:

In Equity & Liability Part of Balance Sheet under the Head “Shareholders’ Fund” and Sub Head “Reserve & Surplus”.

Debenture Redemption Investment (DRI)

Along with DRR, Companies are required to invest 15 % in Specified Securities on or before 30 April of Current year, of Total Face value of Debentures to be redeemed by the next year.

For Example

X LTD is going to redeem 10000 Debentures of Rs 100 by 31 March 2018, then it has to invest 15 % of redeemable value in Specified Securities on or before 30 April, 2017.

Specified Security means:

Deposits with any Scheduled Bank, Unencumbered Securities of Central or State Government, Unencumbered Securities as per Section 20 Of Indian Trust Act. 1882 & Unencumbered Bonds issued by any other Company as per Section 20 of Indian Trust Act. 1882.

DRI is made by those Companies who are required to create DRR. Companies exempted to create DRR are also exempted to make DRI.

Methods of Redemption of Debentures

1. On Maturity in Lump Sum
2. On Installments by Draw of Lots
3. By Purchase From Open Market
4. By Conversion

1. Redemption Of Debentures in Lump Sum

All Debentures are redeemed on maturity date either at Par or Premium as per Terms of Issue.

Journal Entries under this method:

On Creation of DRR:

Balance in P & L A/C.....Dr

To DRR A/C

On Investment made in Specified Securities:

Debenture Redemption Investment A/C.....Dr

To Bank A/C

On Encashing Investment before Redemption of Debentures including Interest earned on it:

Bank A/C.....Dr (DRI Amount + Interest Earned – TDS Receivable)

TDS ReceivableDr

To Debenture Redemption Investment A/C

To Interest Earned A/C

On Interest being Due on Debentures:

Interest on Debentures A/C.....Dr

To Debentureholders A/C

To TDS Payable

On Debentures being Due For Payment:

Debenture A/C.....Dr

Premium on Redemption of Debentures A/c (If redeemed at Premium)

To Debentureholders A/C (Nominal Value + Premium Value if redeemed at Premium)

On Payment to Debentureholders including Interest Payment

Debentureholders A/C.....Dr

TDS Payable A/CDr

To Bank A/C

On Transfer of DRR to General Reserve:

DRR A/C.....Dr

To General Reserve A/C

Note:

All questions will not carry Interest entries either On Debenture or DRI. In such cases, exclude those entries while doing questions.

TDS Payable is always calculated on TDS Percentage of Interest amount to be paid on Debentures.

TDS Receivable is always calculated on TDS Percentage of Interest amount to be received on DRI.

For Example – 10 % TDS to be payable or Receivable on Interest and Interest amount comes Rs. 100000. In this case TDS will be $\rightarrow 10\% \text{ of } 100000 = \text{Rs. } 10000$.

For beginning Entries related to Redemption, Kindly Go through Notes of Accounting For Issue of Debentures.

2. Redemption of Debentures in Installments By Draw of lots

Part of debentures is being redeemed every year being selected by Draw at Par or premium according to the terms of Issue.

All entries remain same as we did for Lump Sum Method.

DRR is created before commencing Redemption of Debentures and DRI is also made in the way we did for Lump Sum Method.

Points to be considered while Doing Questions of Redemption of Debentures in Installments:

Until & Unless Question specifies, If Redemption of Debenture is done on yearly or Half Yearly Equal Installment basis, we do not need to write entry of creating DRR and DRI made every year. We can write Journal entry for DRR & DRI once for all subsequent years of redemption. In the Last year of Redemption, we can encash DRI and transfer DRR to General Reserve.

Sometimes Question specifies that we have to encash DRI each time Debentures will be redeemed. In this case, we have to write Journal entry for DRI made every year and Encashment of DRI as and when Debentures are redeemed.

3. Redemption of Debentures by Purchase from Open Market

It refers to purchasing own Debentures from open Market for immediate cancellation or for retaining as Investment and cancel them at a later date.

Before initiating the Purchase of debentures for Cancellation, the company must have DRR balance equal to 25 % of Face value of Outstanding Debentures being cancelled and also have made DRI equal to 15 % of Face value of Outstanding Debentures being cancelled.

Unless otherwise specified in the Question, it is assumed that the Company has adequate balance in DRR and DRI before initiating Purchase for Cancellation of Debentures.

Accounting Entries For Cancellation of Debentures

Two Cases:

Case I. When debentures are purchased from Open Market for Immediate Cancellation and are Redeemable at Par:

Case II. When Debentures are purchased from Open Market for immediate Cancellation and

Debentures are redeemable at Premium:

Case I. When debentures are purchased from Open Market for Immediate Cancellation and are Redeemable at Par:

Own Debentures can be purchased at a price which is **equal to, less than or greater than** Par Value.

A. When Debentures are purchased at a Price equal to Face Value of Debentures

1. On Purchase of Debentures:

Own Debentures A/C.....Dr

To Bank A/C

2. For Cancellation of Own Debentures:

Debentures A/C.....Dr

To Own Debentures A/C

B. When Debentures are purchased at a Price below the Nominal Value of Debentures:

1. On Purchase of Debentures:

Own Debentures A/C.....Dr (With Purchase Price)

To Bank A/C

2. For Cancellation of Own Debentures:

Debentures A/C.....Dr

To Own Debentures A/C

To Gain on Cancellation of Own Debentures A/C (Excess of Face Value over Cost of Own Debentures cancellation)

Gain on Cancellation of Debentures is a Capital Profit and, therefore, is transferred to Capital Reserve. Entry for the same is:

Gain on Cancellation A/C.....Dr

To Capital Reserve A/C

C. When Debentures are purchased at a price higher than the Nominal Value of Debentures:

1. On Purchase of Debentures:

Own Debentures A/C.....Dr (With Purchase Price)

To Bank A/C

2. For Cancellation of Own Debentures:

Debentures A/C.....Dr

Loss on Cancellation of Own Debentures A/C.....Dr

To Own Debentures A/C

Loss on Cancellation of Debentures is a Capital Loss and, therefore, is debited to Capital Reserve. Journal entry for the same is:

Capital Reserve A/C.....Dr

To Loss on Cancellation of Own Debentures A/C

In case there is no balance in Capital Reserve, Loss on Cancellation will be transferred to Statement of Profit & Loss A/C.

Journal entry for the same is:

Statement of Profit & Loss A/C.....Dr

To Loss on Cancellation of Own Debentures A/C

Case II. When Debentures are purchased from Open Market for immediate Cancellation and Debentures are redeemable at Premium:

Premium payable at Redemption of Debentures has been debited to Loss on Issue of debentures A/C at the time of issue, will now be credited to Premium on Redemption of Debentures A/c.

Premium on redemption of Debenture A/C is debited at the time of redemption.

Purchase cost of own debentures from Open Market can be equal to, more than or less than Face Value of Debentures.

A. when Debentures are purchased at a Price equal to Face Value:

1. On Purchase of Debentures:

Own Debentures A/C.....Dr

To Bank A/C

2. For Cancellation of Own Debentures:

Debentures A/C.....Dr

Premium on Redemption of Debentures A/C.....Dr

To Own Debentures A/C

To Gain on Cancellation of Own Debentures A/C

3. On transfer of Gain to Capital Reserve

Gain on Cancellation A/C.....Dr

To Capital Reserve A/C

B. when Debentures are purchased at a Price below Face Value:

1. On Purchase of Debentures:

Own Debentures A/C.....Dr

To Bank A/C

2. For Cancellation of Own Debentures:

Debentures A/C.....Dr

Premium on Redemption of Debentures A/C.....Dr

To Own Debentures A/C

To Gain on Cancellation of Own Debentures A/C

Note: Gain on cancellation in this case will be =Premium amount + Difference between Purchase Cost & Face value.

3. On transfer of Gain to Capital Reserve

Gain on Cancellation A/C.....Dr

To Capital Reserve A/C

C. When Debentures are purchased at a Price Higher than Face Value:

1. On Purchase of Debentures:

Own Debentures A/C.....Dr

To Bank A/C

2. For Cancellation of Own Debentures:

#. In Case of Gain:

Debentures A/C.....Dr

Premium on Redemption of Debentures A/C.....Dr

To Own Debentures A/C

To Gain on Cancellation of Own Debentures A/C

Note: Gain on cancellation in this case will be =Premium amount + Difference between Purchase Cost & Face value.

On transfer of Gain to Capital Reserve

Gain on Cancellation A/C.....Dr

To Capital Reserve A/C

#. In Case of Loss:

Debentures A/C.....Dr

Premium on Redemption of Debentures A/C.....Dr

Loss on Cancellation of Own debentures A/C.....Dr (Purchase Cost – Face value - Premium)

To Own Debentures A/C

Loss on Cancellation of Debentures is a Capital Loss and, therefore, is debited to Capital Reserve.

Capital Reserve A/C.....Dr

To Loss on Cancellation of Own Debentures A/C

Note:

When Question includes Expenses on Purchase of Own Debentures the we can modify our Journal Entries as follows:

1. On Purchase of Debentures:

Own Debentures A/C.....Dr

Expenses on Purchase of Own Debentures A/C.....Dr

To Bank A/C

2. On Cancellation of Own Debentures:

2.A.In case of Profit on Cancellation:

Debenture A/C.....Dr

Premium on Redemption of Debentures A/C....Dr (if any)

To Own debentures A/C (With Cost of Own Debentures excluding expenses on Purchase)

To Expenses on Purchase of Own Debentures A/C

To Gain on Cancellation of Own Debentures A/C

2.B.In case of Gain on Cancellation:

Debenture A/C.....Dr

Premium on Redemption of Debentures A/C....Dr (if any)

Loss on Cancellation of Own Debentures A/C....Dr

To Own debentures A/C (With Cost of Own Debentures excluding expenses on Purchase)

To Expenses on Purchase of Own Debentures A/C

4. Redemption of Debentures by Conversion

It refers to redemption of Debentures by converting into Shares or New form of Debentures.

Conversion can take place in two forms:

I. Fully Convertible Debentures

It means company has issued Debentures which will be fully convertible into Shares or New form of Debentures. In this Case, there is **no need to create DRR & DRI.**

II. Partly Convertible Debentures

It means, company has issue Debentures which is not fully convertible into new Shares or new forms of Debentures, but part of it will be converted into new Shares or new forms of Debentures. In this case, **DRR & DRI** will be created only for Non-Convertible Nominal Value of Debentures.

I. Accounting Entries for Fully Convertible Debentures (Conversion of Debentures into New Shares after Maturity Case)

1. For Amount Due to Debentureholders:

Debenture A/C.....Dr

Premium on Redemption of Debenture A/CDr (If Redemption is at Premium)

To Debentureholders A/C

2. For issuing Shares or New Debentures:

A. If Shares or New Debentures issued at Par

Debentureholders A/C.....Dr

To Share Capital A/C or New Debentures A/C

B. If Shares or New Debentures issued at Premium

Debentureholders A/C.....Dr

To Share Capital A/C or New Debentures A/C

To Security Premium Reserve A/C

C. If New Debentures issued at Discount

Debentureholders A/C.....Dr

Discount on Issue of Debentures A/C.....Dr

To Share Capital A/C or New Debentures A/C

II. Accounting Entries For Partly Convertible Debentures (Conversion of Debentures into New Shares after Maturity Case)

In this case, Convertible part of Debentures is converted into Shares or New Debentures. Entries for Convertible part of Debentures will be same as discussed above. Non Convertible part is paid in Cash or by Cheque.

Journal Entries related to Partly Convertible Debentures:

A. Creation of DRR for Non Convertible part of Debentures (25 % of value of Non Convertible part of Debentures or as the case may be):

Statement of P&L A/C.....Dr

To DRR A/C

B. For Investment made for Non Convertible part of Debentures (15 % of value of Non Convertible part of Debentures):

DRI A/C.....Dr

To Bank A/C

C. For Interest received on DRI & Realisation of DRI:

Bank A/C.....Dr

TDS Collected/ Receivable A/C.....Dr

To DRI A/C

To Interest Earned A/C

D. For Amount Due to Debentureholders:

Debenture A/C.....Dr (Nominal Value of Debentures)

Premium on Redemption of Debenture A/CDr (If Redemption is at Premium)

To Debentureholders A/C (Amount due to Debentureholders)

E. For issuing Shares or New Debentures and Part Payment in Cash

Shares or New Debentures can be issued at Par, Premium or Discount.

E. (1) For issuing Shares or New Debentures at Par and Part Payment in Cash

Debentureholders A/C.....Dr

To Share Capital A/C or New Debentures A/C

To Bank A/C (Payment for non convertible part of Debentures)

E. (2) For issuing Shares or New Debentures at Premium and Part Payment in Cash

Debentureholders A/C.....Dr

To Share Capital A/C or New Debentures A/C

To Bank A/C (Payment for non convertible part of Debentures)

To Security Premium Reserve A/C (With amount of Premium)

E. (3) For issuing New Debentures at Discount and Part Payment in Cash

Debentureholders A/C.....Dr

Discount on issue of New Debentures A/CDr

To New Debentures A/C

To Bank A/C (Payment for non convertible part of Debentures)

F. Transfer of DRR to General Reserve

DRR A/C.....Dr

To General Reserve A/C

Note:

There can be cases where Debentures have been converted into New Shares before Maturity Period:

Debentures can be converted into New Shares before Maturity Period under two situations:

I. when Debentures are issued at Par or Premium and redeemable at Par

In this case, Debentureholders will get New Shares for the amount paid by them at the time of Issue of Debentures. Premium on Redemption will not be paid to Debentureholders. We can even say that **Redemption Value should be ignored in this case.**

For Example:

1. Company Issued 1000 Debentures @ Rs. 10 each at Par redeemable at Par or Premium; amount payable to Debentureholders will be actual amount paid by them at the time of Issue → $1000 \times \text{Rs. } 10 = \text{Rs. } 10000$. New Shares will be issued to Debentureholders of a value of Rs.10000.

If new share face Value is Rs. 100 and issued at Par;

Number of New Shares to be issued = $\text{Rs. } 10000 \div 100 = 100$ New Shares

If new share face Value is Rs. 100 and issued at Premium of 25 %;

Number of New Shares to be issued = $\text{Rs. } 10000 \div 125 = 80$ New Shares

2. Company Issued 1000 Debentures @ Rs. 10 each at 25 % Premium redeemable at Par or

Premium; amount payable to Debentureholders will be actual amount paid by them at the time of Issue → $1000 \times \text{Rs. } 12.5 = \text{Rs. } 12500$.

New Shares will be issued to Debentureholders of a value of Rs.12500.

If new share face Value is Rs. 100 and issued at Par;

Number of New Shares to be issued = $\text{Rs. } 12500 \div 100 = 125$ New Shares

If new share face Value is Rs. 100 and issued at Premium of 25 %;

Number of New Shares to be issued = $\text{Rs. } 12500 \div 125 = 100$ New Shares

2. When Debentures are issued at Discount and Redeemable at Par or Premium:

In this case, Debentureholders will get New Shares for the amount paid by them at the time of Issue of Debentures.

For Example, Company Issued 1000 Debentures @ Rs. 10 each at 10 % Discount redeemable at Par or Premium; amount payable to Debentureholders will be actual amount paid by them at the time of Issue → $1000 \times \text{Rs. } 9 = \text{Rs. } 9000$.

New Shares will be issued to Debentureholders of a value of Rs.9000.

If new share face Value is Rs. 100 and issued at Par;

Number of New Shares to be issued = $\text{Rs. } 9000 \div 100 = 90$ New Shares

If new share face Value is Rs. 100 and issued at Premium of 25 %;

Number of New Shares to be issued = $\text{Rs. } 9000 \div 125 = 72$ New Shares.

Accounting Treatment for Discount or loss on Issue of Debentures

- Discount or Loss on Issue of Debentures can be written off from Security Premium Reserve A/C or from P&L A/C.
- Discount or Loss on Issue of Debentures is written back to P&L A/C as Other Income when Debentures are converted into Shares before maturity.
- Amount of Discount or Loss not written off appears is shown in Asset side of Balance Sheet.
- Amount of Discount or Loss on Issue of Debentures not written off, is written back to determine Net amount payable to Debentureholders.

Journal Entries related to Discount or Loss on Issue of Debentures:

When Discount or Loss on Issue of Debentures **written off** from P&L A/C is **written back**

Debenture A/C.....Dr

Premium on Redemption of Debentures A/C

To P&L A/C (Other Income) (with amount written back)

To Debentureholders A/C

OR

When Discount or Loss on Issue of Debentures **written off** from Security Premium Reserve is **written back**

Debenture A/C.....Dr

Premium on Redemption of Debentures A/C

To P&L A/C (Other Income) (with amount written back)

To Discount or Loss on Issue of Debentures A/C (With Amount not written off)

To Debentureholders A/C

For Example

Company issues 1000 Debentures of Rs. 100 at 10 % Discount and to be redeemable after 5 years at 20 % Premium. Loss on issue is to written off in 5 equal installments over 5 years maturity period.

In this case, Total Loss to Company on Issue = Rs.10 × 1000 (Discount on Issue) + Rs. 20 ×1000 (Premium on Redemption) = Rs. 3000.

Suppose Debentures are converted at the end of 3rd year, then in this case

Amount written off will be = $(3 \div 5) \times \text{Rs. } 3000 = \text{Rs. } 1800$ (This amount will be written back in P&L A/C as other Income)

Journal Entry for the same for writing off Debentures is:

P&L A/CDr

To Discount on Issue of Debentures A/C

Amount not written off will be = $(2 \div 5) \times \text{Rs. } 3000 = \text{Rs. } 1200$ (This amount will be credited as Discount or Loss on Issue of Debentures in above Journal entry)