

1. MEANING

A company can raise the capital from internal as well as external sources. Internal source comprise its paid-up share capital and retained earnings. This is often referred to as shareholders' or owners funds of the company. External source comprise the short-term and long-term borrowings of the company. These funds are referred to as 'owed funds' or 'loan capital'. Loan capital is usually raised by issuing debentures which is utilised for acquiring fixed assets.

Sec. 2 (30) of Companies Act, 2013 defines debenture as follows :

"Debenture" includes debenture stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not".

Palmer defines debenture as "any instrument under seal, evidencing a deed, the essence of it being admission of indebtedness."

A debenture is a document issued by the company as an evidence of its debt or loan. It is an acknowledgement of the debt under the seal of the company, acknowledging indebtedness in a specified sum and payable with interest on a specified date.

A company can borrow only if it is authorised by its A/A. The A/A specify the maximum amount that a company can borrow either by way of loans or by issue of debentures.

A debenture-holder is the creditor of the company. A debenture holder receives a fixed rate of interest irrespective of whether the company has made profits or not. Payment of interest on debentures is a fixed liability of the company. The debenture-holders do not enjoy any voting right. They are given the first preference in the payment of their interest as well as repayment of debenture loan.

1.1 Characteristics of Debentures

1. It is an acknowledgement of indebtedness by a company to its holder for the specified amount.
2. It is issued under the common seal of the company.
3. It provides for a fixed rate of interest.
4. It is repayable after a certain period.
5. It may or may not be secured.
6. It has no voting rights.

2. TYPES OF DEBENTURES

Debentures can be classified as under :

2.1 On the Basis of Transferability

1. Registered Debentures.
2. Bearer Debentures.

2.2 On the Basis of Security Offered

1. Secured Debentures
2. Unsecured Debentures.

2.3 On the Basis of Redeemability

1. Redeemable Debentures.
2. Irredeemable Debentures.

The chart given below shows the different types of debentures that may be issued by the company :

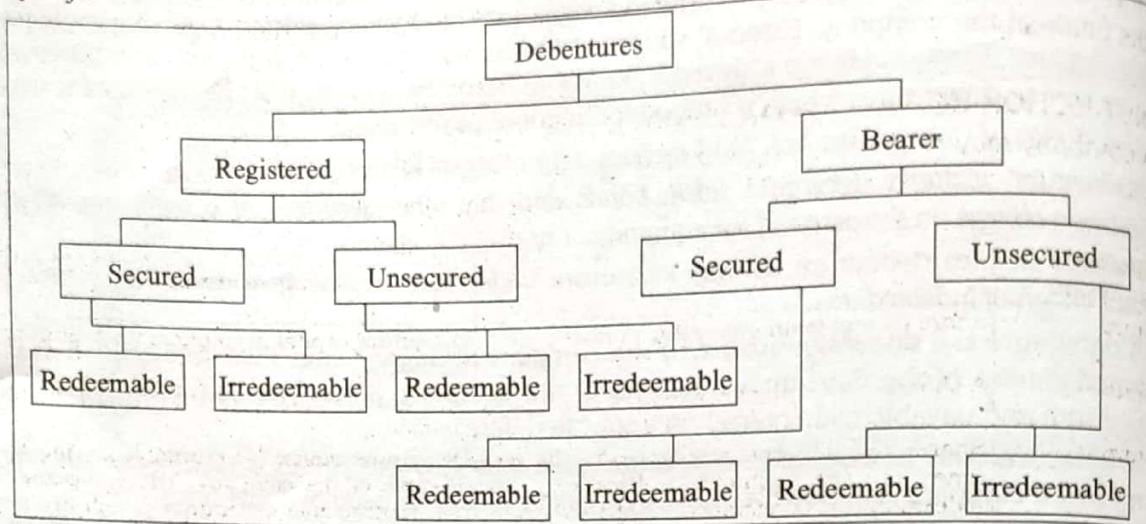


Fig. 2.1

2.1.1 Registered Debentures

Registered Debentures are those which are recorded in the register of debentures maintained by the company. **Registered debentures are not negotiable.** However, interest coupons, if transferable, can be payable to the bearer. In other words, for transfer of the registered debentures, the instrument of transfer has to be executed. The debenture will be transferred only if sanctioned or approved by the Board of Directors.

2.1.2 Bearer Debentures

Bearer debentures are those which are transferable by mere delivery. They are negotiable instruments. **They are not registered in the register of debentures.** For transfer of these debentures, it is not necessary to give a notice to the company. No stamp duty is required to be paid on bearer debentures on transfer.

2.2.1 Unsecured (Naked or Simple) Debentures

Unsecured debentures are those for which there is no security given for repayment of principal as well as interest. The only security for these debentures is the general solvency of the company. Therefore, the position of these debenture-holders at the time of winding up of the company will be just like the unsecured creditors. These debentures are also called "simple or naked debentures."

2.2.2 Secured Debentures (Mortgage Debentures)

Secured debentures are those which are secured by the assets or property of the company. A charge is created on such assets or property of the company. **Debenture holders have a right to recover the interest as well as the principal out of those assets of the company which are given as charge or security if interest or principal is not paid on due date.** For this purpose a 'Mortgage Deed' is executed laying down the terms of repayments, rate and date of interest, payment, nature and value of security, the right of debenture-holders in case of default in payment etc. These debentures are registered with the company, with the Registrar and the Sub-Registry.

There may be two kinds of charges (security) on the assets or property viz., (i) Fixed Charge and (ii) Floating Charge.

- i) **Fixed Charge** : In case of a fixed charge, the charge is on the specific assets of the company such as plant, machinery, building etc. and, in case of default in payment of interest or principal, the debenture-holders can take the possession of specific assets for payment to themselves.
- ii) **Floating Charge** : In this case the charge is not on any specific asset but on the general assets of the company. The assets that are presently available with the company and also those assets the company may acquire in future stand charged for the purpose.

2.3.1 Redeemable Debentures

These debentures are repayable either at the option of the company or the end of a specified period. The interest, however, is payable at regular intervals.

2.3.2 Irredeemable Debentures

These debentures are not refundable or repayable during the lifetime of the company. They remain as permanent borrowed capital of the company. They will be returned only on the winding up of the company.

3. DISTINCTION BETWEEN SHARES AND DEBENTURES

A company may raise capital by issuing ownership securities and creditorship securities. Shares are ownership securities whereas debentures are creditorship securities.

It is interesting to note the difference between the two as follows :

Point of Distinction	Shares	Debentures
1. Nature	Share capital is an ownership capital.	Debenture capital is creditorship capital i.e. borrowing.
2. Status	A shareholder is the owner of the company.	A debenture holder is the creditor of the company.
3. Return	Share capital is not returnable in the life-time of the company. However, the redeemable preference shares are refundable during the life time of the company.	Debenture capital is returnable during the life-time of the company. The exception is the irredeemable debentures which are not redeemable during the life-time of the company.
4. Voting Rights	Shareholders enjoy the voting rights.	Debenture holders do not have the voting rights.
5. Income	Dividend is paid on shares and it is an appropriation of profit.	Interest is paid on debentures and it is a charge on the revenue of the company.
6. Payment of Dividend	Dividend depends on the profits of the company and the recommendation of the Directors.	Interest on debentures is payable at a fixed rate on specified dates irrespective of the profits of the company.
7. Security	Shares are unsecured.	Debentures are generally secured.
8. Repayment on winding up	In the event of winding up of the company, shareholders are the last persons in refund of their capital.	Debenture holders being the creditors are paid prior to the shareholders. If secured they have priority even over the unsecured creditors.
9. Convertibility	Equity shares can never be convertible.	Debentures can be convertible.
10. Trust Deed	Share trust deed is not required to be executed.	Debenture trust deed is required to be executed.

Interest on Debentures

Debentures being loan capital, they carry a specified rate of interest payable on specified dates. Interest on debentures is a charge on revenue. It is the cost of using the money raised by debentures. It should be paid whether there is a profit or no profit. It is usually paid half yearly. The amount of interest has to be paid on its nominal or face value and not on the price for which it is issued. The burden of interest payable will be same on any debenture whether it is issued at par, premium or discount.

Calculation

Interest on debentures is always calculated as a certain rate on the **face value** and not on the issue price.

Tax Deducted as Source

The company is required to deduct income tax at a certain rate from the gross amount of interest. The amount so deducted is to be deposited within the stipulated time limit.

The following journal entries are passed in this connection :

1. When interest on debentures is due :

Debit Interest on Debentures A/c (gross amount)
 Credit Tax Deducted at Source A/c (with income tax)
 Credit Debenture holders A/c (with net payment)

2. When net amount due is paid :

Debit Debenture holder's A/c
 Credit Bank A/c

3. When IDS is deposited :

Debit IDS A/c
 Credit Bank A/c

4. When interest on debentures is transferred to Profit & Loss Account :

Debit Profit & Loss A/c

Credit Interest on Debentures A/c

Interest Accrued and Due

It is the interest accrued, due but it is not paid. It is also called as outstanding interest. It is added to Debentures in Balance Sheet under the head, 'secured loans'.

Interest Accrued and Not Due

In practice interest on debentures is paid on certain dates during the year say on 30th June and 31st December or on 1st October and 31st March. The date of payment of interest may not necessarily fall on the date of finalisation of accounts. In such a case interest may accrue but it may not become due.

Such accrued interest has to be recorded at the accounting date to maintain accounting records on accrual basis. Such interest appears in the Balance Sheet, under the head 'Current Liabilities'.

Illustration 1 :

Ideal Ltd. issued 2,000 15% debentures of ₹ 100 each on 1st July, 2008 (interest dates being 30th June and 31st December). No interest has been paid till 31st March, 2009.

Solution :

In this case, interest from 1st July, 2008 to 31st December, 2008 is called 'Interest Accrued and Due'. Interest from 1st January, 2009 to 31st March, 2009 is called 'Interest Accrued but not due' or 'Accrued Interest'.

4. ISSUE PRICE OF DEBENTURES

Debentures may be issued at par, premium or discount. If a debenture is issued at the amount equal to its nominal or face value, it is referred to as issue at par. If a debenture is issued at an amount lower than its nominal value, it is referred to as issue at a discount. Discount offered on the debenture is a loss to the company and has to be accounted for.

If a debenture is issued at a price higher than the nominal value, it is referred to as issue at premium. Such an excess amount of premium on debenture is a gain to the company. Likewise, repayment may be at par or at premium or at discount. The difference between issue price and redemption price is to be accounted as loss or gain.

4.1 Discount on Issue of Debentures

When debentures are issued at a discount, the amount of discount is debited to "Discount on Debentures Account". Discount on debentures is a capital loss to the company and is charged to the Profit & Loss Account over the period of its benefit to the company. Loss on issue of debentures is also a capital loss. Hence, both the items "Discount on issue of debentures" and "Loss on issue of debentures" are shown under the head, "Miscellaneous Expenditures" on asset side of the Balance Sheet.

4.2 Premium on Issue of Debentures

Premium received on issue of debentures is a capital gain and it is credited to "Securities Premium Account". Premium money cannot be utilised for distribution of dividend. It is to be utilised for writing off discount on issue of shares or debentures, or premium on redemption of debentures or fictitious assets. If it is not used for these purposes, it may be transferred to capital reserve and shown under the head "Reserves and Surplus".

Premium on redemption of debentures is a provision which is to be paid at the time of redemption and is shown under the head "Current Liabilities and Provisions" on the liability side of the Balance Sheet.

5. ISSUE OF DEBENTURES FOR CASH

When debentures are issued for cash, they may be issued at par, at discount or at premium. When the amount is payable in instalments entries will be similar to the issue of shares. Any premium or discount on issue of debentures is normally adjusted at the time of making allotment. Discount on debenture is a capital loss and premium received on debentures is a capital gain and have to be accounted for.

5.1 Amount receivable in instalment with different conditions

Transactions	Debit Bank A/c par, redeemable at par	Debit Bank A/c premium, redeemable at par	Debit Bank A/c discount, redeemable at par	Debit Bank A/c premium, redeemable at par	Debit Bank A/c discount, redeemable at par	Debit Bank A/c premium, redeemable at par
1. Receipt of Application Money	Debit Bank A/c Credit Debiture Application A/c	Same entry	Same entry	Same entry	Same entry	Same entry
2. Transfer of Application Money to Debentures Account	Debit Debiture Application A/c Credit Debiture A/c	Same entry	Same entry	Same entry	Same entry	Same entry
3. Allotment Money Due	Debit Debiture Allotment A/c Credit Debiture A/c	Debit Debiture Allotment A/c Credit Debiture A/c	Debit Debiture Allotment A/c Debit Discount on Issue of Debentures A/c	Debit Debiture Allotment A/c Debit Discount on Issue of Debentures A/c	Debit Debiture Allotment A/c Debit Discount on Issue of Debentures A/c	Debit Debiture Allotment A/c Debit Discount on Issue of Debentures A/c
4. Receipt of Allotment Money	Debit Bank A/c Credit Debiture Allotment A/c	Same entry	Same entry	Same entry	Same entry	Same entry
5. First Call Due	Debit Debiture First Call A/c Credit Debiture A/c	Same entry	Same entry	Same entry	Same entry	Same entry
6. Receipt of First Call	Debit Bank A/c Credit Debiture First Call A/c	Same entry	Same entry	Same entry	Same entry	Same entry

Illustration 2 : (Issue at par redeemable at par)

HD Ltd. issued 20,000 15% Debentures of ₹ 100 each at par redeemable at par after 5 years payable ₹ 60 on application and ₹ 40 on allotment. Debentures were fully subscribed and money was received.

Prepare Journal.

Solution :**Journal of HD Ltd.**

		Dr. ₹	Cr. ₹
Bank A/c			
To Debentures Applications A/c	Dr.	12,00,000	
(Being received debentures application money)			12,00,000
Debenture Applications A/c			
To 15% Debentures A/c	Dr.	12,00,000	
(Being transferred application money to Debentures A/c)			12,00,000
Debenture Allotment A/c			
To 15% Debentures A/c	Dr.	8,00,000	
(Being the amount due on allotment)			8,00,000
Bank A/c			
To Debenture Allotment A/c	Dr.	8,00,000	
(Being received Debenture allotment money)			8,00,000

Illustration 3 : (Debentures issued at premium but redeemable at par)

HD Ltd. issued 20,000 15% Debentures of ₹ 100 each at 10% premium redeemable at par after 5 years payable ₹ 60 on application and the balance on allotment. Debentures were fully subscribed and money was received.

Pass Journal Entries.

Solution :**Journal**

		Dr. ₹	Cr. ₹
Bank A/c			
To Debentures Applications A/c	Dr.	12,00,000	
(Being received debentures application money)			12,00,000
Debenture Applications A/c			
To Debentures A/c	Dr.	12,00,000	
(Being transferred debentures application money to Debentures Account)			12,00,000
Debenture Allotment A/c			
To 15% Debentures A/c	Dr.	10,00,000	
To Securities Premium A/c			8,00,000
(Being allotment money including premium due)			2,00,000
Bank A/c			
To Debenture Allotment A/c	Dr.	10,00,000	
(Being received debenture allotment money)			10,00,000

Illustration 4 : (Debentures issued at discount but redeemable at par)

HD Ltd. issued 20,000 15% debenture of ₹ 100 each at 6% discount, redeemable at par after 5 years payable ₹ 60 on application and the balance on allotment. All Debentures were subscribed and money was received.

Pass Journal Entries.

Solution :**Journal**

		Dr. ₹	Cr. ₹
Bank A/c			
To Debentures Applications A/c	Dr.	12,00,000	
(Being received debentures application money)			12,00,000