CHAPTER – 9

COMPANY ACCOUNTS

Unit 3

Redemption of Preference Shares

Learning Objectives

After studying this unit, you will be able to:

- understand the meaning of redemption and the purpose of issuing redeemable preference shares,
- learn various provisions of the Companies Act regarding preference shares and their redemption,
- familiarise yourself with various methods of redemption of fully paid-up preference shares: (i) Fresh issue of shares; (ii) Capitalisation of undistributed profits; (iii) Combination of (i) and (ii); and (iv) Raising funds through sale of investments,
- understand the logic behind the creation of capital redemption reserve account,
- learn the accounting treatment for redemption of partly called-up and fully called-up but partly paid-up preference shares.

1. INTRODUCTION

Redemption is the process of repaying an obligation, at prearranged amounts and timings. The conditions of the issue of preference shares include a call provision, i.e. a contract giving the right to redeem preference shares within or at the end of a given time period at an agreed price. These shares are issued on the terms that share holders will at a future date be repaid the amount which they invested in the company. The redemption date is the maturity date, which specifies when repayment takes place and is usually printed on the preference share certificate. Through the process of redemption, a company can also adjust its financial structure, for example, by eliminating preference shares and replacing those with other securities if future growth of the company makes such change advantageous.

2. PURPOSE OF ISSUING REDEEMABLE PREFERENCE SHARES

A company may issue redeemable preference shares because of the following:

1 It is a proper way of raising finance in a dull primary market.

2. A company may face difficulty in raising share capital, as its shares are not traded on the stock exchange. Potential investors, hesitant in putting money into shares that cannot easily be sold, may be encouraged to invest if the shares are redeemable by the company.

3 The preference shares may be redeemed when there is a surplus of capital and the surplus funds cannot be utilised in the business for profitable use.

4. A company may require additional capital in the medium term for a project, but the project is expected to generate sufficient funds to enable the preference shares to be reduced.

In India the issue and redemption of preference shares is governed by Section 80 of the Companies Act, 1956.

3. PROVISIONS OF THE COMPANIES ACT (SECTION 80)

A company limited by shares if so *authorised by its Articles*, may issue preference shares which at the option of the company, are liable to be redeemed. It should be noted that:

(a) no shares can be redeemed except out of profit of the company which would otherwise be available for dividend or out of proceeds of fresh issue of shares made for the purpose of redemption;

(b) no such shares can be redeemed unless they are fully paid;

(c) the premium, if any, payable on redemption must be provided for out of the profits of the company or out of the company's securities premium account before the shares are redeemed.

(d) where any such shares are redeemed, otherwise than out of the proceeds of a fresh issue, there shall, out of profits which would otherwise have been available for dividends, be transferred to a reserve account to be called Capital Redemption Reserve Account, a sum equal to the nominal amount of the shares redeemed; and the provisions of the Act relating to the reduction of the share capital of a company shall, except as provided in the section, apply as if the Capital Redemption Reserve (CRR) Account were the paid-up share capital of the company. The utilisation of CRR Account was further restricted to issuance of fully paid-up bonus shares only to complete the picture of capitalisation.

From the legal provision outlined above, it is apparent that on the redemption of redeemable preference shares out of accumulated profits it will be necessary to transfer to the Capital Redemption Reserve Account an amount equal to the amount repaid on the redemption of preference shares on account of face value less proceeds of a fresh issue of capital made for the purpose of redemption. The object is that with the repayment of redeemable preference shares, the security for creditors should not be reduced. At times, a part of the preference share capital may be redeemed out of accumulated profits and the balance out of a fresh issue.

After the commencement of the Companies (Amendment) Act, 1996, a company cannot issue any preference share, which is irredeemable or is redeemable after the expiry of a period of twenty years from the date of its issue.

4. REDEMPTION OF IRREDEEMABLE PREFERENCE SHARES (SECTION 80-A)

Section 80-A states that:

1. Notwithstanding anything contained in the terms of issue of any preference shares, every preference share issued before the commencement of the Companies (Amendment) Act, 1988.

   (a) which is irredeemable, shall be redeemed by the company within a period not exceeding five year from such commencement, or

   (b) which is not redeemable before the expiry of ten years from the date of issue thereon in accordance with the terms of its issue and which had not been redeemed before such commencement, shall be redeemed by the company on the date on which such share is due for redemption or within a period not exceeding ten years from such commencement, whichever is earlier.

Provided that where a company is not in a position to redeem any such share within the period aforesaid and to pay the dividend, if any, due thereon (such shares being hereinafter referred to as unredeemed preference shares), it may, with the consent of the Company Law Board, on a petition made by it in this behalf and notwithstanding anything contained in the Act, issue further redeemable preference shares equal to the amounts due (including the dividend thereon), in respect of the unredeemed preference shares, and on the issue of such further redeemable preference shares, the unredeemed shares shall be deemed to have been redeemed.

2. Nothing contained in other section of the Companies Act, shall be deemed to confer power on any class of shareholders by resolution or on any court or the Central Government or vary or modify the provisions of this section.

5. METHODS OF REDEMPTION OF FULLY PAID-UP SHARES

Redemption of preference shares means repayment by the company of the obligation on account of shares issued. According to the Companies Act, 1956, preference shares issued by a company must be redeemed within the maximum period allowed under the Act. Thus, a company cannot issue irredeemable preference shares. Section 80 of the Companies Act, 1956, deals with rules relating to redemption of preference shares. It ensures that there is no reduction in shareholders' funds due to redemption and thus the interest of outsiders is not impaired. For this, it requires that either fresh issue of shares is made or distributable profits are retained and transferred to 'Capital Redemption Reserve Account'.

The rationale behind these provisions is to protect the interest of outsiders to whom the amount is payable before redemption of preference share capital. The interest of outsiders is protected if the nominal value of capital redeemed is subsituted, thus, ensuring the same amount of shareholders fund. In case of redemption of preference shares out of proceeds of a fresh issue of shares, replacement of capital and tangible assets is obvious. But, if redemption is done out of distributable profits, replacement of capital is ensured in an indirect manner by retention of profit by transfer to Capital Redemption Reserve. In this case, the amount which would have gone to shareholders in the form of dividend is retained in the business and is used for settling the claim of preference shareholders. Thus, there is no additional claim on net assets of the Company. The transfer of divisible profits to Capital Redemption Reserve makes them non-distributable profits. As Capital Redemption Reserve can be used only for issue of fully paid bonus shares, profits retained in the business ultimately get converted into share capital.

Security cover available to outside stakeholders depends upon called-up capital as well as uncalled capital to be demanded by the company as per its requirements. To ensure that the interests of outsiders are not reduced, Section 80 provides for redemption of only fully paid-up shares.

From the above paras, it can be concluded that the 'gap' created in the company's capital by the redemption of redeemable preference shares much be filled in by:

(a) the proceeds of a fresh issue of shares;

(b) the capitalisation of undistributed profits; or

(c) a combination of (a) and (b).

5.1 REDEMPTION OF PREFERENCE SHARES BY FRESH ISSUE OF SHARES

One of the methods for redemption of preference shares is to use the proceeds of a fresh issue of shares. A company can issue new shares (equity share or preference share) and the proceeds from such new shares can be used for redemption of preference shares.

The proceeds from issue of debentures cannot be utilised for the purpose.

A problem arises when a fresh issue is made for the purpose of redemption of preference shares, at a premium. The point to ponder is that whether the proceeds of a fresh issue of shares will include the amount of securities premium for the purpose of redemption of preference shares.

For security premium account, Companies Act provides that:

The securities premium account may be applied by the company;

(a) in paying up un-issued shares of the company to be issued to members of the company as fully paid bonus shares;

(b) in writing off the preliminary expenses of the company;

(c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company; or

(d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company.

Any other way, except the above four prescribed ways, in which securities premium account is utilised will be in contravention of law. It is interesting to note that clause (d) above allows premium on redemption of preference shares to be adjusted against Securities Premium Account but the redemption itself cannot be financed out of the Securities Premium Account.

Again, a problem may arise when the fresh issue is made at a discount. Proceeds in connection with issue of shares at a discount would mean only the net amount received that is, face value less the discount. Suppose a share of Rs. 100 (face value) is issued at a discount of 5% money available from the proceeds of a fresh issue is Rs. 95 and not Rs. 100. Hence, the company can redeem only Rs. 95. Therefore, when the shares are issued at a discount, then the number of shares to be issued at a discount should be manipulated to ensure that at least the face value of the shares to be redeemed has been procured in money out of the proceeds of the fresh issue at a discount.

5.1.1 Reasons for issue of New Equity Shares

A company may prefer issue of new equity shares for the following reasons:

(a) When the company has come to realise that the capital is needed permanently and it makes more sense to issue Equity Shares in place of Redeemable Preference Shares which carry a fixed rate of dividend.

(b) When the balance of profit, which would otherwise be available for dividend, is insufficient.

(c) When the liquidity position of the company is not good enough.

5.1.2 Advantages of redemption of preference shares by issue of fresh equity shares

Following are the advantages of redemption of preference shares by the issue of fresh equity shares:

(1) No cash outflow of money – now or later.

(2) New equity shares may be valued at a premium.

(3) No capital gains tax for shareholders.

(4) Shareholders retain their equity interest.

5.1.3 Disadvantages of redemption of preference shares by issue of fresh equity shares

The disadvantages are:

(1) There is a possibility of dilution of further earnings;

(2) Share holdings in the company are changed.

5.1.4 Accounting Entries

1 When new shares are issued at par

Bank Account Dr.

To Share Capital Account

(Being the issue of …….shares of Rs……each for the purpose of redemption of preference shares, as per Board's Resolution No…… dated…….) .

2. When new shares are issued at a premium.

Bank Account Dr.

To Share Capital Account

To Securities Premium Account

(Being the issue of ……..shares of Rs……each at a premium of Rs……each for the purpose of redemption of preference shares as per Board's Resolution No….. dated……)

3 When new shares are issued at a discount

Bank Account Dr.

Discount on Issue of Shares Account Dr.

To Share Capital Account

(Being the issue of ……..shares of Rs…….each at a discount of Rs……..each for the purpose of redemption of preference shares, as per Board's Resolution No…….dated…….)

4 When preference shares are redeemed at par

Redeemable Preference Share Capital Account Dr.

To Preference Shareholders Account

5 When preference shares are redeemed at a premium

Redeemable Preference Share Capital Account Dr.

Premium on Redemption of Preference Shares Account Dr.

To Preference Shareholders Account

6 When payment is made to preference shareholders

Preference Shareholders Account Dr.

To Bank Account

7 For adjustment of premium on redemption

Profit and Loss Account Dr.

Securities Premium Account Dr.

To Premium on Redemption of Preference Shares Account

Illustration 1

Hinduja Company Ltd. had 5,000 8% Redeemable Preference Shares of Rs. 100 each, fully paid up. The company decided to redeem these preference shares at par by the issue of sufficient number of equity shares of Rs. 10 each fully paid up at par. You are required to pass necessary Journal Entries including cash transactions in the books of the company.

Solution

In the books of Hinduja Company Ltd.
Journal

Date	*Particulars*		*Dr. (Rs.)*	*Cr. (Rs.)*
	Bank A/c	Dr.	5,00,000	
	To Equity Share Capital A/c			5,00,000
	(Being the issue of 50,000 Equity Shares of Rs. 10 each at par for the purpose of redemption of preference shares, as per Board Resolution No ……..dated……..)			
	8% Redeemable Preference Share Capital A/c	Dr.	5,00,000	

	To Preference Shareholders A/c (Being the amount payable on redemption of preference shares transferred to Preference Shareholders Account)			5,00,000
	Preference Shareholders A/c	Dr.	5,00,000	
	To Bank A/c (Being the amount paid on redemption of preference shares)			5,00,000

Illustration 2

C. Ltd. had 10,000 10% Redeemable Preference Shares of Rs. 100 each, fully paid up. The company decided to redeem these preference shares at par, by issue of sufficient number of equity shares of Rs. 10 each at a premium of Rs. 2 per share as fully paid up. You are required to pass necessary Journal Entries including cash transactions in the books of the company.

Solution

In the books of C Limited

Journal

Date	*Particulars*		*Dr. (Rs.)*	*Cr. (Rs.)*
	Bank A/c	Dr	12,00,000	
	To Equity Share Capital A/c			10,00,000
	To Securities Premium A/c			2,00,000
	(Being the issue of 1,00,000 Equity Shares of Rs. 10 each at a premium of Rs. 2 per share as per Board's Resolution No….. dated……….)			
	10% Redeemable Preference Share Capital A/c	Dr	10,00,000	
	To Preference Shareholders A/c			10,00,000
	(Being the amount payable on redemption of preference shares transferred to Preference Shareholders A/c)			
	Preference Shareholders A/c	Dr	10,00,000	
	To Bank A/c			10,00,000
	(Being the amount paid on redemption of preference shares)			

Note: Amount required for redemption is Rs. 10,00,000. Therefore, face value of equity shares to be issued for this purpose must be equal to Rs. 10,00,000. Premium received on new issue cannot be used to finance the redemption.

Illustration 3

G India Ltd. had 9,000 10% redeemable Preference Shares of Rs. 10 each, fully paid up. The company decided to redeem these preference shares at par by the issue of sufficient number of equity shares of Rs. 10 each fully paid up at a discount of 10%.

You are required to pass necessary Journal Entries including cash transactions in the books of the company.

Solution

In the books of G India Limited

Journal

Date	*Particulars*		*Dr. (Rs.)*	*Cr. (Rs.)*
	Bank A/c	Dr.	90,000	
	Discount on Issue of Shares A/c	Dr.	10,000	
	To Equity Share Capital A/c			1,00,000
	(Being the issue of 10,000 Equity Shares of Rs. 10 each at a discount of 10%, as per Board's Resolution No.......Dated.....)			
	10% Redeemable Preference Shares Capital A/c	Dr.	90,000	
	To Preference Shareholders A/c			90,000
	(Being the amount payable on redemption of preference shares transferred to Preference Shareholders A/c)			
	Preference Shareholders A/c	Dr.	90,000	
	To Bank A/c			90,000
	(Being the amount paid on redemption of preference shares)			

Note: When shares are redeemed by issuing shares at a discount, the proceeds from new issue must be sufficient to cover the face value of shares redeemed. Here, face value of shares to be redeemed is Rs. 90,000. Proceeds from each new share is Rs. 9 (Rs. 10 – 10x10% discount). Therefore, the number of new shares to be issued = Rs. 90,000/Rs. 9 = 10,000 shares.

5.1.5 Calculation of Minimum Fresh Issue of Shares

Sometimes, examination problem does not specify the number of shares to be issued for the purpose of redemption of preference shares and requires that the minimum number of shares should be issued to ensure that provisions of Section 80 of the Companies Act, 1956, are not violated. This is done in four steps as given below:

(1) In such cases, the maximum amount of reserves and surplus available for redemption is ascertained taking into account the balances appearing in the balance sheet before redemption and the additional information provided in the problem. For example, if balance of general reserve in the balance sheet is Rs. 1,00,000 and additional information provides that the Board of Directors have decided that the balance of general reserve should not be less than Rs. 40,000 under any circumstances, then, the maximum amount of general reserve available for redemption is Rs. 60,000.

(2) After ascertaining the maximum amount of reserves and surplus available for redemption, adjustment for premium on redemption payable out of profits is made and then it is compared with the nominal value of shares to be redeemed. By comparison, one gets the minimum proceeds of fresh issue as Section 80 permits redemption either out of proceeds of fresh issue or out of divisible profits. Thus,

Minimum Proceeds of Fresh Issue of shares :

Nominal value of preference shares to be redeemed – Maximum amount of reserve and surplus available for redemption.

(3) After computation of minimum proceeds, the minimum number of shares to be issued are determined by dividing minimum proceeds by the proceeds of one share. This is done as follows:

$$\text{Minimum Number of Shares} = \frac{\text{Minimum proceeds to comply with Section 80}}{\text{Proceeds of one share}}$$

Proceeds of one share mean the par value of a share issued, if it is issued at par or premium. However, in case of issue of share at a discount, it refers to the discounted value.

(4) Minimum number of shares calculated as per (3) above, needs to be adjusted due to various reasons. Firstly, shares fractions cannot be issued. Thus, if minimum number of shares as per (3) above includes a fraction, it must be approximated to the next higher figure to ensure that provisions of Section 80 are not violated. Secondly, if the examination problem states that the proceeds/number of shares should be a multiple of say, 10 or 50 or 100, then again the next higher multiple should be considered.

Illustration 4

The Board of Directors of a Company decide to issue minimum number of equity shares of Rs. 10 each at 10% discount to redeem Rs. 5,00,000 preference shares. The maximum amount of divisible profits available for redemption is Rs. 3,00,000. Calculate the number of shares to be issued by the company to ensure that provisions of Section 80 are not violated. Also determine the number of shares if the company decides to issue shares in multiples of Rs. 50 only.

Solution

Nominal value of preference shares	Rs. 5,00,000	
Maximum possible redemption out of profits	Rs. 3,00,000	
Minimum proceeds of fresh issue	Rs. 5,00,000 - 3,00,000	Rs. 2,00,000

Proceed of one share	= Nominal value - Discount	= 10-1=Rs. 9
Minimum number of shares	= $\frac{2,00,000}{9}$	= 22,222.22 shares

As fractional shares are not permitted, the minimum number of shares to be issued is 22,223 shares.

If shares are to be issued in multiples of 5-, then the next higher figure which is a multiple of 50 is 22,250. Hence, minimum number of shares to be issued in such a case is 22,250 shares.

Illustration 5

The Balance Sheet of a Company on 30-6-2006 is as follows:

Liabilities	*Amount*	*Assets*	*Amount*
Equity Share Capital (Rs. 10)	5,00,000	Sundry Assets	10,00,000
Preference Share Capital (Rs. 100)	2,00,000		
Securities Premium	10,000		
Profit and Loss Account	90,000		
Liabilities	2,00,000		
	10,00,000		10,00,000

Compute the minimum number of equity shares of Rs. 10 each that the company must issue at par to redeem preference shares at a premium of 10%.

Solution

Nominal value of preference shares	Rs. 2,00,000		
Premium on redemption	10% of Rs. 2,00,000	=	Rs. 20,000
Securities premium	Rs. 10,000		
∴Premium on redemption payable out of profits	20,000-10,000	=	Rs. 10,000
Profits available for redemption	90,000-10,000	=	Rs. 80,000
Minimum proceeds	2,00,000-80,000	=	Rs. 1,20,000
Minimum number of shares	1,20,000/10	=	12,000 shares

5.1.6 Fresh Issue at a Premium and Minimum Fresh Issue

The calculation of minimum number of shares, when fresh issue is at a premium should be handled very carefully because premium of fresh issue of shares is available for writing off premium on redemption also. Minimum fresh issue cannot be calculated unless one knows the profits available for replacement of capital and profit available for replacement cannot be determined unless one knows the portion of profit available for redemption which is required for paying premium on redemption. To tackle this, assume that **profits available for redemption is not required for paying premium on redemption of preference shares.** In other words, it means that securities premium including premium on fresh issue is comparantively more than premium on redemption.

If the above assumption holds good, minimum number of shares can be calculated in a simple manner without use of equation. But, if above condition does not hold good, then an equation is used to determine the minimum number of shares.

5.1.7 Minimum Fresh Issue to Provide Funds for Redemption

Besides, ensuring compliance with Section 80, the fresh issue of shares is made to provide funds for making payment to preference shareholders. To calculate minimum number of fresh shares to be issued to provide funds, amount payable to preference shareholders is compared with funds available for redemption and the balance of funds to be raised by fresh issue of shares are calculated. The amount to be raised is divided by the issue price of a share (amount payable by shareholder including premium, if any, on fresh issue) to compute the minimum number of shares to be issued.

Illustration 6

The Balance Sheet of X Ltd. as on 31st March, 2006 was as follows:

Liabilities	*Amount*	*Assets*	*Amount*
Share Capital:		Fixed Assets	3,45,000
Preference Shares of Rs. 100 each		Investments	18,500
fully paid	65,000	Balance at Bank	31,000
Equity Shares of Rs. 50 each			
fully paid	2,25,000		
	2,90,000		
Profit and Loss Account	48,000		
Creditors	56,500		
	3,94,500		3,94,500

In order to facilitate the redemption of preference shares at a premium of 10%, the Company decided:

(a) to sell all the investments for Rs. 15,000.

(b) to finance part of redemption from company funds, subject to, leaving a bank balance of Rs. 12,000.

(c) to issue minimum equity share of Rs. 50 each at a premium of Rs. 10 per share to raise the balance of funds required.

You are required to pass:

The necessary Journal Entries to record the above transactions and prepare the balance sheet as on completion of the above transactions.

Solution

Journal

	Bank A/c	Dr.		37,500	
	To Share Application A/c				37,500
	(For application money received on 625 shares @ Rs. 60 per share)				
	Share Application A/c	Dr.		37,500	
	To Equity Share Capital A/c				31,250
	To Securities Premium A/c				6,250
	(For disposition of application money received)				
	Preference Share Capital A/c	Dr.		65,000	
	Premium on Redemption of Preference Shares A/c	Dr.		6,500	
	To Preference Shareholders A/c				71,500
	(For amount payable on redemption of preference shares)				
	Securities Premium A/c	Dr.		6,250	
	Profit and Loss A/c	Dr.		250	
	To Premium on Redemption of Preference Shares A/c				6,500
	(For writing off premium on redemption firstly out of securities premium and balance out of profits)				
	Bank A/c	Dr.		15,000	
	Profit and Loss A/c (loss on sale) A/c	Dr.		3,500	
	To Investment A/c				18,500
	(For sale of investments at a loss of Rs. 3,500)				
	Profit and Loss A/c	Dr.		33,750	
	To Capital Redemption Reserve A/c				33,750
	(For transfer to CRR out of divisible profits an amount equivalent to excess of nominal value over proceeds i.e., Rs. 65,000 - Rs. 31,250)				
	Preference Shareholders A/c	Dr.		71,500	
	To Bank A/c				71,500
	(For payment of preference shareholders)				
	Capital Redemption Reserve A/c	Dr.		25,000	
	To Bonus to Shareholders A/c				25,000
	(For making provision for issue of 500 bonus shares)				
	Bonus to Shareholders A/c	Dr.		25,000	
	To Equity Share Capital A/c				25,000
	(For issue of bonus shares)				

Balance Sheet (after redemption)

Liabilities	*Amount*	*Assets*	*Amount*
Equity Share Capital	2,56,250	Fixed Assets	3,45,000
Capital Redemption Reserve	33,750	Bank	
Profit and Loss Account		(31,000 + 37,500 + 15,000 - 71,500)	12,000
(48,000 - 250 - 3,500 - 33,750)	10,500		
Creditors	56,500		
	3,57,000		3,57,000

Working Note:

Calculation of Number of Shares:	***Rs.***
Amount payable on redemption	71,500
Less: Sale price of investment	15,000
	56,500
Less: Available bank balance (31,000 - 12,000)	19,000
Funds from fresh issue	37,500

∴ No. of shares = 37,500/60 = 625 shares

5.2 REDEMPTION OF PREFERENCE SHARES BY CAPITALISATION OF UNDISTRIBUTED PROFITS

Another method for redemption of preference shares, as per the Companies Act, is to use the distributable profits in place of issuing new shares. When shares are redeemed by utilising distributable profit, an amount equal to the face value of shares redeemed is transferred to Capital Redemption Reserve Account by debiting the distributable profit. In other words, some of the distributable profits are kept aside to ensure that it can never be distributed to shareholders as dividend.

In this connection, the provisions of the Companies Act state that 'When any such shares are redeemed otherwise than out of the proceeds of a fresh issue, there shall out of profits which would otherwise have been available for dividend, be transferred to a reserve fund to be called the Capital Redemption Reserve Account sum equal to the nominal amount of the shares redeemed'.

5.2.1 Advantages of redemption of preference shares by capitalisation of undistributed profits

The advantages of redemption of preference shares by capitalisation of undistributed profits are:

(1) No change in the percentage share holdings of the company;

(2) Future earnings are not diluted;

(3) Surplus funds can be used.

5.2.2 Disadvantages of redemption of preference shares by capitalisation of undistributed profits

The disadvantages of redemption of preference shares by capitalisation of undistributed profits are:

(1) There may be a reduction in liquidity;

(2) Capital gains tax liability for preference shareholders.

Accounting Entries

1 *When shares are redeemed at par*

Redeemable Preference Share Capital Account Dr.

To Preference Shareholders Account

(Being the amount payable on redemption of preference shares transferred to Preference Shareholders Account)

2. *When shares are redeemed at a premium*

Redeemable Preference Share Capital Account Dr.

Premium on Redemptions of Preference Shares Account Dr.

To Preference Shareholders Account

(Being the amount payable on redemption transferred to Preference Shareholders Account)

3. *When payment is made to preference shareholders*

Preference Shareholders Account Dr.

To Bank Account

(Being the payment to preference shareholders as per terms)

4 *For adjustment of premium of redemption*

Profit and Loss Account Dr.

Securities Premium Account Dr.

To Premium on Redemption of Preference Shares Account

(Being the premium on redemption adjusted against Profit and Loss Account and Securities Premium Account)

5 *For transferring nominal amount of shares redeemed to Capital Redemption Reserve Account*

General Reserve Account Dr.

Profit and Loss Account Dr.

To Capital Redemption Reserve Account

(Being the amount transferred to Capital Redemption Reserve Account as per the requirement of the Act).

Illustration 7

The following are the extracts from the Balance Sheet of ABC Ltd. as on 31st December, 2004.

Share capital: 40,000 Equity shares of Rs. 10 each fully paid - Rs. 4,00,000; 1,000 10% Redeemable preference shares of Rs. 100 each fully paid – Rs. 1,00,000.

Reserve & Surplus: Capital reserve – Rs. 50,000; Securities premium – Rs. 50,000; General reserve – Rs. 75,000; Profit and Loss Account – Rs. 35,000

On 1st January 2005, the Board of Directors decided to redeem the preference shares at par by utilisation of reserve.

You are required to pass necessary Journal Entries including cash transactions in the books of the company.

Solution

In the books of ABC Limited

Journal Entries

Date 2005	*Particulars*		*Dr. (Rs.)*	*Cr. (Rs.)*
Jan 1	10% Redeemable Preference Share Capital A/c	Dr.	1,00,000	
	To Preference Shareholders A/c			1,00,000
	(Being the amount payable on redemption transferred to Preference Shareholders Account)			
	Preference Shareholders A/c	Dr.	1,00,000	
	To Bank A/c			1,00,000
	(Being the amount paid on redemption of preference shares)			
	General Reserve A/c	Dr.	75,000	
	Profit & Loss A/c	Dr.	25,000	
	To Capital Redemption Reserve A/c			1,00,000
	(Being the amount transferred to Capital Redemption Reserve Account as per the requirement of the Act)			

Note: Securities premium cannot be utilised for transfer to Capital Redemption Reserve because dividend cannot be paid out of Securities Premium Account.

5.3 REDEMPTION OF PREFERENCE SHARES BY COMBINATION OF FRESH ISSUE AND CAPITALISATION OF UNDISTRIBUTED PROFITS

A company can redeem the preference shares partly from the proceeds from new issue and partly out of profits. In order to fill in the 'gap' between the face value of shares redeemed and the proceeds of new issue, a transfer to be made from distributable profits (Profit & Loss Account, General Reserve and other Free Reserves) to Capital Redemption Reserve Account.

Formula:

(i) Amount to be Transferred to Capital Redemption Reserve

	Rs.
Face value of shares redeemed	***
Less: Proceeds from new issue	***
	***

(ii) Proceeds to be collected from New Issue

	Rs.
Face value of shares redeemed	***
Less: Profits available for distribution as dividend	***
	***

Illustration 8

C Limited had 3,000, 12% Redeemable Preference Shares of Rs. 100 each, fully paid up. The company had to redeem these shares at a premium of 10%.

It was decided by the company to issue the following:

(i) 25,000 Equity Shares of Rs. 10 each at par,

(ii) 1,000 14% Debentures of Rs. 100 each.

The issue was fully subscribed and all amounts were received in full .The payment was duly made. The company had sufficient profits. Show Journal Entries in the books of the company.

Solution

In the books of C Limited

Journal Entries

Date	*Particulars*		*Dr. (Rs.)*	*Cr. (Rs.)*
	Bank A/c	Dr	2,50,000	
	To Equity Share Capital A/c			2,50,000
	(Being the issue of 25,000 equity shares of Rs. 10 each at par as per Board's resolution No……dated…..)			
	Bank A/c	Dr.	1,00,000	
	To 14% Debenture A/c			1,00,000
	(Being the issue of 1,000 Debentures of Rs. 100 each as per Board's Resolution No…..dated……)			
	12% Redeemable Preference Share Capital A/c	Dr.	3,00,000	

	Premium on Redemption of Preference Shares A/c	Dr.	30,000	
	To Preference Shareholders A/c			3,30,000
	(Being the amount payable on redemption transferred to Preference Shareholders Account)			
	Preference Shareholders A/c	Dr.	3,30,000	
	To Bank A/c			3,30,000
	(Being the amount paid on redemption of preference shares)			
	Profit & Loss A/c	Dr.	30,000	
	To Premium on Redemption of Preference Shares A/c			30,000
	(Being the adjustment of premium on redemption against Profits & Loss Account)			
	Profit & Loss A/c	Dr.	50,000	
	To Capital Redemption Reserve A/c (Note 1)			50,000
	(Being the amount transferred to Capital Redemption Reserve Account as per the requirement of the Act)			

Working Note:

Amount to be transferred to Capital Redemption Reserve Account

Face value of shares to be redeemed	Rs. 3,00,000
Less: Proceeds from new issue	Rs. 2,50,000
Total Balance	Rs. 50,000

Illustration 9

The capital structure of a company consists of 20,000 Equity Shares of Rs. 10 each fully paid up and 1,000 8% Redeemable Preference Shares of Rs. 100 each fully paid up.

Undistributed reserve and surplus stood as: General Reserve Rs. 80,000; Profit and Loss Account Rs. 10,000; Investment Allowance Reserve out of which Rs. 5,000, (not free for distribution as dividend) Rs. 10,000; Securities Premium Rs. 12,000, Cash at bank amounted to Rs. 98,000. Preference shares are to be redeemed at a Premium of 10% and for the purpose of redemption, the directors are empowered to make fresh issue of Equity Shares at par after utilising the undistributed reserve and surplus, subject to the conditions that a sum of Rs. 20,000 shall be retained in general reserve and which should not be utilised.

Pass Journal Entries to give effect to the above arrangements and also show how the relevant items will appear in the Balance Sheet of the company after the redemption carried out.

Solution

In the books of ....

Journal Entries

Date	*Particulars*		*Dr. (Rs.)*	*Cr. (Rs.)*
	Bank A/c	Dr.	25,000	
	To Equity Share Capital A/c			25,000
	(Being the issue of 2,500 Equity Shares of Rs. 10 each at a premium of Re. 1 per share as per Board's Resolution No…..dated…….)			
	8% Redeemable Preference Share Capital A/c	Dr.	1,00,000	
	Premium on Redemption of Preference Shares A/c	Dr.	10,000	
	To Preference Shareholders A/c			1,10,000
	(Being the amount paid on redemption transferred to Preference Shareholders Account)			
	Preference Shareholders A/c	Dr.	1,10,000	
	To Bank A/c			1,10,000
	(Being the amount paid on redemption of preference shares)			
	Securities Premium A/c	Dr.	10,000	
	To Premium on Redemption of Preference Shares A/c			10,000
	(Being the premium payable on redemption provided out of Securities Premium Account)			
	General Reserve A/c	Dr.	60,000	
	Profit & Loss A/c	Dr.	10,000	
	Investment Allowance Reserve A/c	Dr.	5,000	
	To Capital Redemption Reserve A/c			75,000
	(Being the amount transferred to Capital Redemption Reserve Account as per the requirement of the Act)			

Balance Sheet as on ....[Extracts]

Liabilities	*Amount*	*Assets*	*Amount*
Share capital		**Fixed Assets**	
22,500 Equity Shares of		**Investment**	
Rs. 10 each fully paid-up	2,25,000	**Current Assets**	
Reserve and Surplus		Cash	13,000
General Reserve	20,000		
Securities Premium:			
(Rs. 12,000-10,000)	2,000		
Capital Redemption Reserve	75,000		
Investment Allowance Reserve	5,000		

Working Note:

(1) No of Shares to be issued for redemption of Preference Shares:

Face value of shares redeemed		Rs. 1,00,000
Less: Profit available for distribution as dividend:		
General Reserve : Rs. (80,000-20,000)	Rs. 60,000	
Profit and Loss	Rs. 10,000	
Investment Allowance Reserve: (Rs. 10,000-5,000)	Rs. 5,000	Rs. 75,000
		Rs. 25,000

Therefore, No. of shares to be issued = 25,000/Rs. 10 = 2,500 shares.

Illustration 10

The books of B Ltd. showed the following balance on 31st December, 2005:

30,000 Equity Shares of Rs. 10 each fully paid; 18,000 12% Redeemable Preference Shares of Rs. 10 each fully paid; 4,000 10% Redeemable Preference Shares of Rs. 10 each, Rs. 8 paid up.

Undistributed Reserve and Surplus stood as: Profit and Loss Account Rs. 80,000; General Reserve Rs. 1,20,000; Securities Premium Account Rs. 15,000 and Capital Reserve Rs. 21,000.

Preference shares are redeemed on 1st January, 2006 at a premium of Rs. 2 per share. The whereabouts of the holders of 100 shares of Rs. 10 each fully paid are not known.

For redemption, 3,000 equity shares of Rs. 10 each are issued at 10% premium. At the same time, a bonus issue of equity share was made at par, two shares being issued for every five held on that date out of the Capital Redemption Reserve Account.

Show the necessary Journal Entries to record the transactions.

Solution

In the books of B Limited

Journal Entries

Date	*Particulars*		*Dr. (Rs.)*	*Cr. (Rs.)*
2006	12% Redeemable Preference Share Capital A/c	Dr.	1,80,000	
Jan 1	Premium on Redemption of Preference Shares A/c	Dr.	36,000	
	To Preference Shareholders A/c			2,16,000
	(Being the amount payable on redemption of 18,000 12% Redeemable Preference Shares transferred to Shareholders Account)			
	Preference Shareholders A/c	Dr.	2,14,800	
	To Bank A/c			2,14,800
	(Being the amount paid on redemption of 17,900 preference shares)			
	Bank A/c	Dr.	33,000	
	To Equity Shares Capital A/c			30,000
	To Securities Premium A/c			3,000
	(Being the issue of 3,000 Equity Shares of Rs. 10 each at a premium of 10% as per Board's Resolution No……. Dated……)			
	General Reserve A/c	Dr.	1,20,000	
	Profit & Loss A/c	Dr.	30,000	
	To Capital Redemption Reserve A/c			1,50,000
	(Being the amount transferred to Capital Redemption Reserve A/c as per the requirement of the Act.)			
	Capital Redemption Reserve A/c	Dr.	1,20,000	
	To Bonus to Shareholders A/c			1,20,000
	(Being the amount appropriated for issue of bonus share in the ratio of 5:2 as per shareholders Resolution No…... dated…)			

	Bonus to Shareholders A/c	Dr.	1,20,000	
	To Equity Share Capital A/c			1,20,000
	(Being the utilisation of bonus dividend for issue of 12,000 equity shares of Rs. 10 each fully paid)			
	Securities Premium A/c (Note 2)	Dr.	15,000	
	Profit & Loss A/c	Dr.	21,000	
	To Premium on Redemption of Preference Shares A/c			36,000
	(Being premium on redemption of preference shares adjusted against Securities Premium Account and the balance charged to Profit & Loss Account)			

Working Notes:

(1) Partly paid-up preference shares cannot be redeemed.

(2) Premium on redemption of preference shares is payable only from Securities Premium and Profit & Loss Account balance before redemption, i.e. current securities premium of Rs. 3,000 cannot be utilised for this purpose.

(3) Amount to be Transferred to Capital Redemption Reserve Account

Face value of share to be redeemed	Rs. 1,80,000
Less: Proceeds from fresh issue (excluding premium)	Rs. 30,000
	Rs. 1,50,000

5.4 SALE OF INVESTMENTS TO PROVIDE SUFFICIENT FUNDS FOR REDEMPTION

Companies may have sufficient investments, which can be sold, in the market to arrange funds for redemption of preference shares.

6. REDEMPTION OF PARTLY CALLED-UP PREFERENCE SHARES

One of the conditions of redemption is that only fully paid up preference shares can be redeemed by a company. If the examination problem states that it is decided to redeem preference shares which are partly called up, then it is assumed that final call on these shares is demanded and received before proceeding with redemption of these shares. If information about both fully paid and partly paid preference shares is provided, then, only fully paid shares are redeemed.

Illustration 11

The Balance Sheet of XYZ as at 31st December, 2005 *inter alia* includes the following:

	Rs.
50,000, 8% Preference Shares of Rs. 100 each, Rs. 70 paid up	35,00,000
1,00,000 Equity Shares of Rs. 100 each fully paid up	1,00,00,000
Securities Premium	5,00,000
Capital Redemption Reserve	20,00,000
General Reserve	50,00,000

Under the terms of their issue, the preference shares are redeemable on 31st March, 2006 at 5% premium. In order to finance the redemption, the company makes a rights issue of 50,000 equity shares of Rs. 100 each at Rs. 110 per share, Rs. 20 being payable on application, Rs. 35 (including premium) on allotment and the balance on 1st January, 2007. The issue was fully subscribed and allotment made on 1st March, 2006. The money due on allotment were received by 31st March, 2006. The preference shares were redeemed after fulfilling the necessary conditions of Section 80 of the Companies Act, 1956. The company decided to make minimum utilisation of general reserve.

You are asked to pass the necessary Journal Entries and show the relevant extracts from the balance sheet as on 31st March, 2006 with the corresponding figures as on 31st December, 2005.

Solution

Journal Entries

			Rs.	Rs.
	8% Preference Share Final Call A/c	Dr.	15,00,000	
	To 8% Preference Share Capital A/c			15,00,000
	(For final call made on preference shares @ Rs. 30 each to make them fully paid up)			
	Bank A/c	Dr.	15,00,000	
	To 8% Preference Share Final Call A/c			15,00,000
	(For receipt of final call money on preference shares)			
	Bank A/c	Dr.	10,00,000	
	To Equity Share Application A/c			10,00,000
	(For receipt of application money on 50,000 equity shares @ Rs. 20 per share)			
	Equity Share Application A/c	Dr.	10,00,000	
	To Equity Share Capital A/c			10,00,000
	(For capitalisation of application money received)			

	Equity Share Allotment A/c	Dr.	17,50,000	
	To Equity Share Capital A/c			12,50,000
	To Securities Premium A/c			5,00,000
	(For allotment money due on 50,000 equity shares @ Rs. 35 per share including a premium of Rs. 10 per share)			
	Bank A/c	Dr.	17,50,000	
	To Equity Share Allotment A/c			17,50,000
	(For receipt of allotment money on equity shares)			
	8% Preference Share Capital A/c	Dr.	50,00,000	
	Premium on Redemption of Preference Shares A/c	Dr.	2,50,000	
	To Preference Shareholders A/c			52,50,000
	(For amount payable to preference shareholders on redemption at 5% premium)			
	Securities Premium A/c	Dr.	2,50,000	
	To Premium on Redemption A/c			2,50,000
	(For writing off premium on redemption of preference shares)			
	General Reserve A/c	Dr.	27,50,000	
	To Capital Redemption Reserve A/c			27,50,000
	(For transfer of CRR the amount not covered by the proceeds of fresh issue of equity shares i.e., 50,00,000 - 10,00,000 - 12,50,000)			
	Preference Shareholders A/c	Dr.	52,50,000	
	To Bank A/c			52,50,000
	(For amount paid to preference shareholders)			

Balance Sheet (extracts)

	As at 31.3.2006	*As at 31.3.2005*
Share Capital:		
Issued, Subscribed and Paid up:		
1,00,000 Equity Shares of Rs. 100 each fully paid up	1,00,00,000	1,00,00,000
50,000 Equity Shares of Rs. 100 each Rs. 45 paid up	22,50,000	–
50,000 8% Preference Shares of Rs. 100 each, Rs. 70 called up	–	35,00,000

Reserves and Surplus :		
Capital Redemption Reserve	47,50,000	20,00,000
Securities Premium	7,50,000	5,00,000
General Reserve	22,50,000	50,00,000

Note: Amount received (excluding premium) on fresh issue of shares till the date of redemption should be considered for calculation of proceeds of fresh issue of shares. Thus, proceeds of fresh issue of shares are Rs. 22,50,000 (Rs. 10,00,000 application money plus Rs. 12,50,000 received on allotment towards share capital).

7. REDEMPTION OF FULLY CALLED BUT PARTLY PAID-UP PREFERENCE SHARES

The problem of unpaid calls on fully called up shares may be studied under following categories:

7.1 WHEN CALLS-IN-ARREARS IS RECEIVED BY THE COMPANY

If the amount of unpaid calls is received by the Company before redemption, the entry passed is as under:

Bank A/c Dr.

To Calls-in-Arrears A/c

After receipt of calls in arrears, the shares become fully paid up and, then, company can proceed with redemption in the normal course.

7.2 IN CASE OF FORFEITED SHARES

If, on getting a proper notice from the company, the shareholders fail to pay the unpaid calls, the Board of Directors may decide to forfeit the shares and cancel these shares instead of reissuing the forfeited shares because redemption of these share is due immediately or in near future. In this case, entry for forfeiture is passed as usual.

It is worth noting that to ensure replacement of capital out of proceeds of a fresh issue or out of divisible profits, total preference share capital (including the shares forfeited and cancelled) should be considered. However, while arranging funds for redemption, amount actually payable to shareholders is taken into consideration.

Illustration 12

A company invited application for issue of 10,000 14% Redeemable preference shares of Rs. 100 each at 10% discount. The amount was payable in three equal installments. Applications were received for 16,000 shares. Incomplete applications for 1,000 shares were rejected and the remaining applicants were allotted shares on *pro rata* basis.

Mr. X, to whom 100 shares were allotted, failed to pay the allotment and call money. Another shareholder Mr. Y, who had applied for 300 shares, failed to pay the call money.

Before redemption of preference shares, both Mr. X and Mr. Y were issued reminders to pay the unpaid amount. On getting the reminder, Mr. X paid the amount in arrear but Mr. Y failed to pay the arrears. On Mr. Y's failure to pay the arrears his shares were forfeited and cancelled. Remaining preference shares were redeemed at premium of 5%. On the date of redemption, following balances appeared in the books of the Company:

	Rs.
Securities Premium	1,40,000
General Reserve	3,50,000
Share Discount	1,00,000

For the purpose of redemption, it was decided to issue minimum number of equity shares of Rs. 10 each at Rs. 9 per share. Shares were issued in multiples of 100. Fresh issue of share was fully subscribed and preference shares were redeemed.

Pass Journal Entries to record the above transactions.

Solution

Journal Entries

			Dr. (Rs.)	Cr. (Rs.)
	Bank A/c	Dr.	4,80,000	
	To Share Application A/c			4,80,000
	(For application money received)			
	Share Application A/c	Dr.	4,80,000	
	To 14% R. Preference Share Capital A/c			3,00,000
	To Share Allotment A/c			1,50,000
	To Bank A/c			30,000
	(For disposition of application money received)			
	Share Allotment A/c	Dr.	3,00,000	
	Share Discount A/c	Dr.	1,00,000	
	To 14% R. Preference Share Capital A/c			4,00,000
	(For allotment money due)			
	Bank A/c	Dr.	1,48,500	
	To Share Allotment A/c			1,48,500
	(For amount received allotment instalment)			
	Share First and Final Call A/c	Dr.	3,00,000	
	To 14% R. Preference Share Capital A/c			3,00,000
	(For call money due)			
	Bank A/c	Dr.	2,91,000	
	Calls-in-Arrears A/c	Dr.	9,000	
	To Share First and Final Call A/c			3,00,000
	(For call money received and the amount not paid by shareholders)			

	Bank A/c	Dr.	4,500	
	To Share Allotment A/c			1,500
	To Calls-in-Arrears A/c			3,000
	(For arrears received on issue of a reminder)			
	14% R. Preference Share Capital A/c	Dr.	20,000	
	To Shares Forfeited A/c			12,000
	To Calls-on-Arrears A/c			6,000
	To Share Discount A/c			2,000
	(For forfeiture of shares due on non-payment of arrears)			
	Shares Forfeited A/c	Dr.	12,000	
	To Capital Reserve A/c			12,000
	(For transfer of amount forfeited to capital reserve on cancellation of shares for redemption)			
	Bank A/c	Dr.	6,50,700	
	To Share Application A/c			6,50,700
	(For application money received on 72,300 shares @ Rs. 9 per share)			
	Share Application A/c	Dr.	6,50,700	
	Share Discount A/c		72,300	
	To Equity Share Capital A/c			7,23,000
	(For disposition of application money received and recording of share discount)			
	Securities Premium A/c	Dr.	1,00,000	
	To Share Discount A/c			1,00,000
	(For writing off discount on issue of preference shares before their redemption)			
	14% R. Preference Share Capital A/c	Dr.	9,80,000	
	Premium on Redemption of Preference Shares A/c	Dr.	49,000	
	To Preference Share holders A/c			10,29,000
	(For writing off premium payable on redemption of preference shares)			
	General Reserve A/c	Dr.	3,49,300	
	To Capital Redemption Reserve A/c			3,49,300
	(For transfer to CRR out of divisible profits an amount equivalent to the excess of nominal value of shares redeemed (including by cancellation) over the proceeds of fresh issue of shares i.e., 10,00,000 - 6,50,700).			
	Preference Shareholders A/c	Dr.	10,29,000	
	To Bank A/c			10,29,000
	(For making payment to preference shareholders)			

Working Notes:

1. *Calculation of Minimum Number of shares:*

	Rs.
Nominal value of Preference Shares Capital	10,00,000
Less: Divisible profits	3,50,000
Minimum Proceeds	6,50,000

Proceed of one share = 10 - 10% of Rs. 10 = Rs. 9

Number of shares = 6,50,000/9 = 72,223 (Approx.)

Number of shares in next multiple of 100 = 72,300 shares.

2. Capital reserve realised in cash is available for paying premium on redemption of debentures. Therefore, out of Rs. 12,000 capital reserve on cancellation of shares forfeited Rs. 9,000 is utilised for writing off premium on redemption of preference shares.

SELF EXAMINATION QUESTIONS

1. Which of the following statements is **false**?
 (a) A company can redeem its preference shares
 (b) Preference shareholders are creditors of a company
 (c) The part of the authorized capital which can be called up only in the event of liquidation of a company is called reserve capital
 (d) Capital redemption reserve can be utilized for issuing fully paid bonus shares

Use the following information for questions 2 and 3

The Balance Sheet of A Ltd. as on March 31, 2009 is as under:

Liabilities	Rs.	Assets	Rs.
Share capital:		Land and building	4,00,000
Equity shares of Rs.100 each	5,00,000	Plant and machinery	3,00,000
12% Preference shares of Rs.10 each	3,00,000	Furniture and fixtures	2,50,000
Reserves and surplus:		Investments	2,25,000
General reserve	1,50,000	Sundry debtors	1,00,000
Profit and loss account	2,50,000	Inventories	1,50,000
18% Debentures	2,00,000	Cash	50,000
Sundry creditors	50,000		
Bank overdraft	25,000		
	14,75,000		14,75,000

The 12% preference shares are redeemable at a premium of 10%. The company wishes to maintain the cash balance at Rs.25,000. For the purpose of redemption of preference shares, it proposed to sell the investments for Rs.2,00,000. The company proposes to issue sufficient number of equity shares of Rs.100 each at a premium of 5% to raise required cash resources.

2. Total cash required to effect the above decisions is __________.
 (a) Rs. 3,30,000 (b) Rs. 3,55,000 (c) Rs. 25,000 (d) Rs 1,05,000

3. Number of equity shares to be issued is __________.

(a) 1,500 (b) 1,000 (c) 950 (d) 1,500

4. S Ltd. issued 2,000, 10% Preference shares of Rs.100 each at par, which are redeemable at a premium of 10%. For the purpose of redemption, the company issued 1,500 Equity Shares of Rs.100 each at a premium of 20 % per share. At the time of redemption of Preference Shares, the amount to be transferred by the company to the Capital Redemption Reserve Account = ?

(a) Rs.50,000 (b) Rs.40,000 (c) Rs.2,00,000 (d) Rs.2,20,000

5. During the year 2000-2001, T Ltd. issued 20,000, 12% Preference shares of Rs.10 each at a premium of 5%, which are redeemable after 4 years at par. During the year 2005-2006, as the company did not have sufficient cash resources to redeem the preference shares, it issued 10,000, 14% debentures of Rs.10 each at a premium of 10%. At the time of redemption of 12% preference shares, the amount to be transferred to capital redemption reserve = ?

(a) Rs.90,000 (b) Rs.1,00,000 (c) Rs.2,00,000 (d) Rs.1,10,000

6. According to section 78 of the Companies Act, the amount in the Securities Premium A/c **cannot** be used for the purpose of

(a) Issue of fully paid bonus shares

(b) Writing off losses of the company

(c) Writing off preliminary expenses

(d) Writing off commission or discount on issue of shares

7. Which of the following can be utilized for redemption of preference shares?

(a) The proceeds of fresh issue of equity shares (b) The proceeds of issue of debentures

(c) The proceeds of issue of fixed deposit (d) All of the above

8. Which of the following statements is **True**?

(a) Capital redemption reserve cannot be used for writing off miscellaneous expenses and losses

(b) Capital profit realized in cash can be used for payment of dividend

(c) Reserves created by revaluation of fixed assets are not permitted to be capitalized

(d) Dividend is payable on the calls paid in advance by shareholders.

9. Consider the following information pertaining to E Ltd.

On September 4, 2009, the company issued 12,000 7% Debentures having a face value of Rs.100 each at a discount of 2.5%. On September 12, the company issued 25,000, 8% Preference share of Rs.100 each. On September 29,the company redeemed 30,000, 6% Preference shares of Rs.100 each at a premium of 5% together with one month dividend thereon. Bank balance as on August 31, 2009 was Rs.29,25,000.

After effecting the above transactions, the Bank balance as on September 30, 2009 = ?

(a) Rs.33,15,000 (b) Rs.33,30,000 (c) Rs.33,45,000 (d) Rs.34,30,000

10. Which of the following accounts **can** be used for transfer to capital redemption reserve account?

(a) General reserve account (b) Forfeited shares account

(c) Profit prior to incorporation (d) Securities premium account

11. Preference shares amounting to Rs.2,00,000 are redeemed at a premium of 5%, by issue of shares amounting to Rs.1,00,000 at a premium of 10%. The amount to be transferred to capital redemption reserve = ?

(a) Rs.1,05,000 (b) Rs.1,00,000 (c) Rs.2,00,000 (d) Rs.1,11,000

12. Securities premium **cannot** be used to _______.

(a) Issue bonus shares
(b) Redeem preference shares
(c) Write-off preliminary expenses
(d) Write-off discount on issue of shares

13. A company **cannot** issue redeemable preference shares for a period exceeding _____________.

(a) 5 years (b) 10 years (c) 15 years (d) 20 years

14. Which of the following **cannot** be used for the purpose of creation of capital redemption reserve account?

(a) Profit and loss account (credit balance)
(b) General reserve account
(c) Unclaimed dividend account
(d) All of the above

ANSWERS

1.	(b)	2.	(b)	3.	(b)	4.	(a)	5.	(c)
6.	(b)	7.	(a)	8.	(a)	9.	(d)	10.	(a)
11.	(b)	12.	(b)	13.	(d)	14.	(c)		

CHAPTER – 9

COMPANY ACCOUNTS

Unit 4

Issue of Debentures

Learning Objectives

After studying this unit, you will be able to :

- Understand the meaning and basic purpose for raising debentures by the company
- Differentiate between shares and debentures of a company
- Understand various types of debentures
- Pass entries for issue of debentures payable in installments
- Make entries for issue of debentures considering the conditions of redemption
- Pass entries for issue of debentures as collateral security
- Pass entries for debentures issued for consideration other than for cash
- Write off discount on issue of debentures.
- Calculate interest on debentures

1. INTRODUCTION

In the earlier units of this chapter, we have studied the issue of share capital as a means of raising funds for financing the business activities. But with increasing and ever growing needs of the corporate expansion and growth, equity source of financing is not sufficient. Hence corporates turn to debt financing through various means. Issuing debt instruments by offering the same for public subscription is one of the sources of financing the business activities. Debt financing does not only helps in reducing the cost of the capital but also helps in designing appropriate capital structure of the company. Debenture is one of the most commonly used debt instrument issued by the company to raise funds for the business.

2. MEANING

The most common method of supplementing the capital available to a company is to issue debentures which may either be simple or naked carrying no charge on assets, or mortgage debentures carrying either a fixed or a floating charge on some or all of the assets of the company.

A debenture is a bond issued by a company under its seal, acknowledging a debt and containing provisions as regards repayment of the principal and interest. If a charge* has been created on any or on the entire asset of the company, the nature of the charge and the assets charged are described therein. Since the charge is not valid unless registered with the Registrar, and the certificate registering the charge is printed on the bond. It is also customary to create a trusteeship in favour of one or more persons in the case of mortgage debentures. The trustees of debenture holders have all powers of a mortgage of a property and can act in whatever way they think necessary to safeguard the interest of debenture holders.

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* Charge is an incumbrance to meet the obligation under the Trust Deed, whereby the company agrees to mortgage specific portion either by way of a first or second charge. Such charge implies right of lenders to secure their payment from such asset(s) or from the liquidator in the event of winding up or from the company when the charge becomes void.

3. FEATURES OF DEBENTURES

1. It is a document which evidences a loan made to a company.
2. It is a fixed interest-bearing security where interest falls due on specific dates.
3. Interest is payable at a predetermined fixed rate, regardless of the level of profit.
4. The original sum is repaid at a specified future date or it is converted into shares or other debentures.
5. It may or may not create a charge on the assets of a company as security.
6. It can generally be bought or sold through the stock exchange at a price above or below its face value.

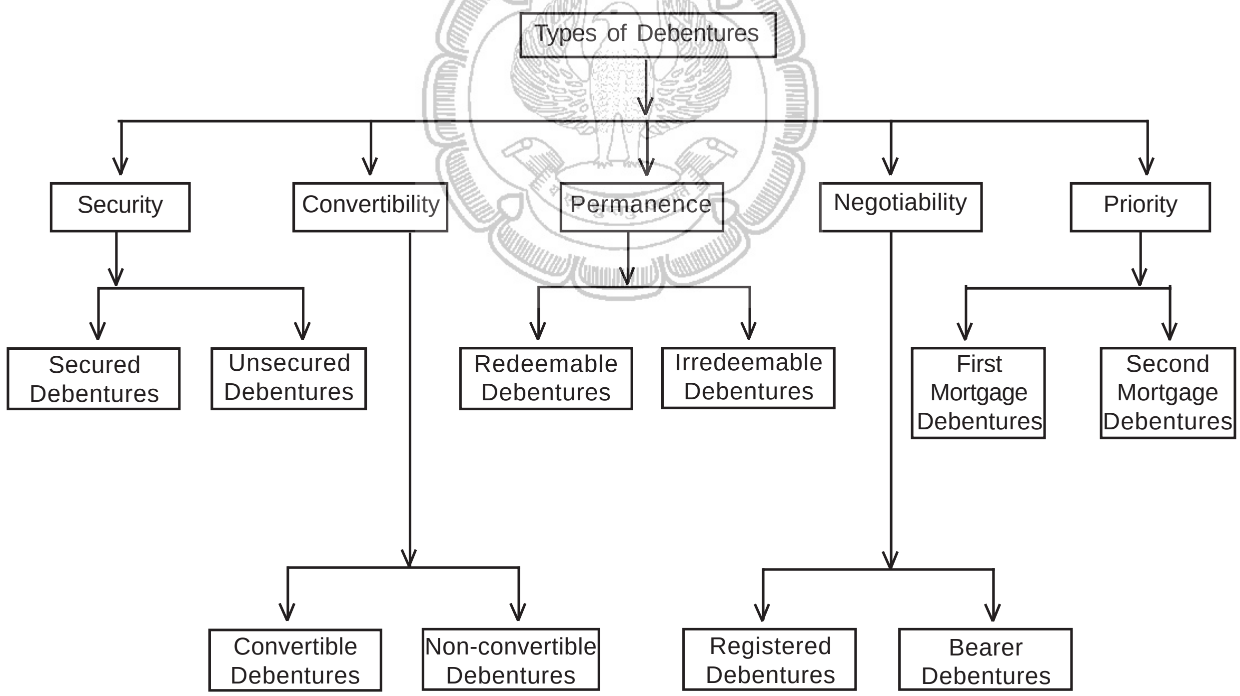
4. DISTINCTION BETWEEN DEBENTURES AND SHARES

Debentures	*Shares*
1. Debentureholders are the creditors of the company.	1. Shareholders are the owners of the company.
2. Debentureholders have no voting rights and consequently do not pose any threat to the existing control of the company.	2. Shareholders have voting rights and consequently control the total affairs of the company.
3. Debenture interest is paid at a pre-determined fixed rate. It is payable, whether there is any profit or not. Debentures rank ahead of all types of shares for payment of the interest due on them.	3. Dividend on equity shares is paid at a variable rate which is vastly affected by the profits of the company (however, dividend on preference shares is paid at a fixed rate).
4. Interest on debentures are the charges against profits and they are deductible as an expense in determining taxable profit of the company.	4. Dividends are appropriation of profits and these are not deductible in determining taxable profit of the company.
5. There are different kinds of debentures, such as Secured/ Unsecured; Redeemable/ Irredeemable; Registered/Bearer; Convertible /Non-convertible, etc.	5. There are only two kinds of shares – Equity Shares and Preference Shares.
6. In the Company's Balance Sheet, Debentures are shown under "Secured Loans".	6. In the Company's Balance Sheet, shares are shown under "Share Capital".
7. Debentures can be converted into shares as per the terms of issue of debentures.	7. Shares cannot be converted into debentures in any circumstances.

Debentures	Shares
8. Debentures cannot be forfeited for non-payment of call moneys.	8. Shares can be forfeited for non-payment of allotment and call moneys.
9. At maturity, debentureholders get back their money as per the terms and conditions of redemption.	9. Equity shareholders cannot get back their money before the liquidation of the company (however, preference shareholders can get back their money before liquidation).
10. At the time of liquidation, debentureholders are paid-off before the shareholders.	10. At the time of liquidation shareholders are paid at last, after paying debentureholders, creditors, etc.

5. TYPES OF DEBENTURES

The following are the types of debentures issued by a company. They can be classified on the basis of: (1) Security; (2) Convertibility; (3) Permanence; (4) Negotiability; and (5) Priority.



1. Security

(a) *Secured Debentures :* These debentures are secured by a charge upon some or all assets of the company. There are two types of charges: (i) Fixed charge; and (ii) Floating charge. A fixed charge is a mortgage on specific assets. These assets cannot be sold without the consent of the debentureholders. The sale proceeds of these assets are

utilized first for repaying debentureholders. A floating charge generally covers all the assets of the company including future one.

(b) *Unsecured or "Naked" Debentures :* These debentures are not secured by any charge upon any assets. A company merely promises to pay interest on due dates and to repay the amount due on maturity date. These types of debentures are very risky from the view point of investors.

2. **Convertibility**

(a) *Convertible Debentures :* These are debentures which will be converted into equity shares (either at par or premium or discount) after a certain period of time from the date of its issue. These debentures may be fully or partly convertible. In future, these debentureholders get a chance to become the shareholders of the company.

(b) *Non-Convertible Debentures* : These are debentures which cannot be converted into shares in future. As per the terms of issue, these debentures are repaid.

3. **Permanence**

(a) *Redeemable Debentures :* These debentures are repayable as per the terms of issue, for example, after 8 years from the date of issue.

(b) *Irredeemable Debentures :* These debentures are not repayable during the life time of the company. These are also called ***perpetual debentures***. These are repaid only at the time of liquidation.

4. **Negotiability**

(a) *Registered Debentures* : These debentures are payable to a registered holder whose name, address and particulars of holding is recorded in the Register of Debentureholders. They are not easily transferable. The provisions of the Companies Act, 1956 are to be complied with for effecting transfer of these debentures. Debenture interest is paid either to the order of registered holder as expressed in the warrant issued by the company or the bearer of the interest coupons.

(b) *Bearer Debentures :* These debentures are transferable by delivery. These are negotiable instruments payable to the bearer. No kind of record is kept by the company in respect of the holders of such debentures. Therefore, the interest on it is paid to the holder irrespective of any identity. No transfer deed is required for transfer of such debentures.

5. **Priority**

(a) *First Mortgage Debentures :* These debentures are payable first out of the property charged.

(b) *Second Mortgage Debentures :* These debentures are payable after satisfying the first mortgage debentures.

6. ISSUE OF DEBENTURES

6.1 ACCOUNTING ENTRIES FOR ISSUE OF REDEEMABLE DEBENTURES

Issue of redeemable debentures can be categorized into the following:

1. Debenture issued at a par and redeemable at par or at a discount;
2. Debenture issued at a discount and redeemable at par or at discount;
3. Debenture issued at premium and redeemable at par or at discount;
4. Debenture issued at par and redeemable at premium;
5. Debenture issued at a discount and redeemable at premium.

Journal entries in each of the above cases are discussed below:

1. **Debenture issued at par redeemable at par** : When debenture are issued at par, the issue price is equal to par value, in this regard the following entries are recorded:

(a) For receipt of application money :

Bank A/c Dr.

To Debenture Application A/c

(b) For transfer of application money to debentures account :

Debenture Application A/c Dr.

To …% Debenture A/c

Illustration 1

Amol Ltd. Issued 40,00,000, 9% debenture of Rs. 50 each, payable on application as per term mentioned in the prospectus and redeemable at par any time after 3 years from the date of issue. Record necessary entries for issue of debenture in the books of Amol Ltd.

Solution

Books of Amol Ltd.
Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Bank A/c	Dr.		20,00,00,000	
	To Debenture Application A/c				20,00,00,000
	(Debenture application money received)				
	Debenture Application A/c	Dr.		20,00,00,000	
	To 9% Debenture A/c				20,00,00,000
	(Application money transferred to 9% debentures account consequent upon allotment)				

Illustration 2

Country Crafts Ltd. Issued 20,00,000, 8% debenture of Rs.100 each at par payable as Rs.40 on application a nd Rs.60 allotment, redeemable at par after 5 years from the date of issue of debenture. Record necessary entries in the books of Country Crafts Ltd.

Solution

Books of Country Crafts Ltd.

Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
(a)	Bank A/c	Dr.		8,00,00,000	
	To Debenture Application A/c				8,00,00,000
	(Debenture application money received)				
(b)*	Debenture Application A/c	Dr.		8,00,00,000	
	Debenture Allotment A/c	Dr.		12,00,00,000	
	To 8% Debentures A/c				20,00,00,000
	(Debenture application and call made consequent upon allotment money transferred to debenture account)				
(c)	Bank A/c	Dr.		12,00,00,000	
	To Debenture Allotment A/c				12,00,00,000
	(Call made on allotment received)				
	*Alternatively, for entry (b) above, the following two entries can be made :				
(i)	Debenture Application A/c	Dr.		8,00,00,000	
	To 8% Debenture A/c				8,00,00,000
	(Transfer of application money to 8% debenture account on consequent upon allotment)				
(ii)	Debenture Allotment A/c	Dr.		12,00,00,000	
	To 8% Debenture A/c				12,00,00,000
	(Call made consequent upon allotment)				

2. **Debenture issued at Discount and Redeemable at par or at discount :** When debentures are issued at discount, issue price will be less than par value. The difference between the two is considered as loss on issue on debentures and is to be written-off over the life of debentures. The entries with regards to issue are given below :

(a) For receipt of application money

Bank A/c Dr.

To Debenture Application A/c

(b) At the time of making allotment

(i) Debenture Application A/c Dr.

Discount on issue of debenture A/c Dr.

To …% Debenture A/c

Illustration 3

Atul Ltd. issued 1,00,00,000, 8% debenture of Rs. 100 each at a discount of 10% redeemable at par at the end of 10th year. Money was payable as follows :

Rs. 30 on application

Rs. 60 on allotment

Record necessary journal entries regarding issue of debenture.

Solution

Books of Atul Ltd.
Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Bank A/c	Dr.		30,00,00,000	
	To Debenture Application A/c				30,00,00,000
	(Debenture application money received)				
	Debenture Application A/c	Dr.		30,00,00,000	
	To 8% Debenture A/c				30,00,00,000
	(Application money transferred to 8% debenture account consequent upon allotment)				
	Debenture allotment A/c	Dr.		60,00,00,000	
	Discount on issue of debenture A/c	Dr.		10,00,00,000	
	To 8% Debenture A/c				70,00,00,000
	(Amount due on allotment)				
	Bank A/c	Dr.		60,00,00,000	
	To Debenture Allotment A/c				60,00,00,000
	(Money received consequent upon allotment)				

3. **Debenture Issued at Premium and Redeemable at par or at discount**

When debenture are issued at premium, the issue price is more than the par value. The premium is transferred to securities premium account. In this regard, the following journal entries are recorded:

When premium amount is received at the time of application;

(a) For receipt of application money
Bank A/c Dr.
To Debenture Application A/c

(b) For transfer of application of money at the time of allotment
Debenture application A/c Dr.
To …% Debentures A/c
To Securities Premium A/c

Illustration 4

Koinal Chemicals Ltd. issued 15,00,000, 10% debenture of Rs. 50 each at premium of 10%, payable as Rs. 20 on application and balance on allotment. Debentures are redeemable at par after 6 years. All the money due on allotment was called up and received. Record necessary entries when premium money is included in application money

Solution

Books of Koinal Chemicals Ltd.
Journal

When premium money is received alongwith application money :

Date	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Bank A/c	Dr.		3,00,00,000	
	To Debenture Application A/c				3,00,00,000
	(Debenture application money received)				
	Debentures Application A/c	Dr.		3,00,00,000	
	To 10% Debenture A/c				2,25,00,000
	To Securities Premium A/c				75,00,000
	(Application money transferred to 10% debenture and securities premium account consequent upon allotment)				
	Debenture Allotment A/c	Dr.		5,25,00,000	
	To 10% Debenture A/c				5,25,00,000
	(Call made consequent upon allotment)				
	Bank A/c	Dr.		5,25,00,000	
	To Debenture Allotment A/c				5,25,00,000
	(Call made consequent upon allotment money received)				

Illustration 5

Koinal Chemicals Ltd. issued 15,00,000, 10% debenture of Rs. 50 each at premium of 10%, payable as Rs.20 on application and balance on allotment. Debentures are redeemable at par after 6 years. All the money due on allotment was called up and received. Record necessary entries when premium money is included in allotment money

Solution

Books of Koinal Chemicals Ltd.

Journal

When premium money is called on allotment :

Bank A/c	Dr.	3,00,00,000	
To Debenture Application A/c			3,00,00,000
(Debenture application money received)			
Debentures Application A/c	Dr.	3,00,00,000	
To 10% Debenture A/c			3,00,00,000
(Debenture application money transferred to 10% debenture account consequent upon allotment)			
Debenture allotment A/c	Dr.	5,25,00,000	
To 10% Debenture A/c			4,50,00,000
To Securities Premium A/c			75,00,000
(Call made on allotment of debenture including premium)			
Bank A/c	Dr.	5,25,00,000	
To Debenture Allotment A/c			5,25,00,000
(Money received consequent upon allotment)			

Where debentures are to be redeemed at premium, an extra entry is to be made at the time of issue and allotment of debentures. This extra entry is to be passed for providing premium payable on redemption.

4. Debenture issued at par and redeemable at a premium

In this case, the issue price is same as par value but the redemption value is more than the par value, therefore redemption premium is recorded as a loss on issue of debenture at the time of allotment of debenture. Following journal entries are recorded in this regard:

(a) For receipt of application money

Bank A/c Dr.

To Debenture application A/c

(b) At the time of making allotment

(i) Transfer of application money to debenture account

Debenture Application A/c Dr.
To …% Debenture A/c

(ii) Call made consequent upon allotment.
Debenture Allotment A/c Dr.
Loss on issue of debenture A/c Dr. [Equal to Debenture Redemption Premium]
To …% Debenture A/c
To Debenture redemption premium A/c

Students can note that instead of passing the separate entries, a compound entry can be passed:

Bank A/c	Dr.
Loss on issue of debenture A/c	Dr.
To …% Debenture A/c	
To Debenture redemption premium A/c	

Illustration 6

Modern Equipments Ltd. issued 2,00,000, 12% debenture of Rs. 1,000 payable as follows :

On application Rs. 300

On allotment Rs. 700

The debenture were fully subscribed and all the money was duly received. As per terms of issue, the debenture are redeemable at Rs. 1,100 per debenture. Record necessary entries regarding issue of debenture.

Solution

Books of Modern Equipments Ltd.

Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Bank A/c	Dr.		6,00,00,000	
	To Debenture application A/c				6,00,00,000
	(Debenture application money received)				
	Debentures Application A/c	Dr.		6,00,00,000	
	To 12% Debenture A/c				6,00,00,000
	(Application money transferred to 12% debenture account consequent to allotment)				
	Debenture Allotment A/c	Dr.		14,00,00,000	
	Loss on issue of Debenture A/c	Dr.		2,00,00,000	
	To 12% Debenture A/c				14,00,00,000

	To Debenture redemption premium A/c (Call made on allotment of debenture at par and redeemable at premium)				2,00,00,000
	Bank A/c To 12% Debenture allotment A/c (Call made consequent upon allotment money received)	Dr.		14,00,00,000	14,00,00,000

5. Debenture Issued at discount and redeemable at premium

In this situation the issue price is less than par value but redemption value is more than par value. The difference between the redemption price and the issue price is treated as discount/loss on issue of debenture. Suppose, a 10% debenture of Rs. 1,000 is issued at a discount of Rs. 100 and redeemable at a premium of Rs. 5 per debenture, the amount of loss will be equal to Rs.900 – Rs. 1,005 = Rs. 105. This is to be treated as loss on issue. It is to be noted that premium on redemption of debentures is also credited by Rs. 5.

(a) For the receipt of application money

Bank A/c Dr.

To Debenture Application A/c

(b) At the time of making allotment

(i) Transfer of application money to debenture account

Debenture Application A/c Dr.

To % Debenture A/c

(ii) Call made consequent upon allotment of debenture at discount and redeemable at premium

Debenture Allotment A/c Dr.

Discount/Loss on issue of debenture A/c Dr. [Amount equal to the discount on issue of debenture plus Premium on redemption]

To …% Debenture A/c

To Debenture Redemption Premium A/c

(c) For receipt of call made on allotment

Bank A/c Dr.

To Debenture Allotment A/c

Students can note that instead of passing the separate entries, a compound entry can be passed:

Bank A/c Dr.

Discount/Loss on issue of debenture A/c Dr.

To …% Debenture A/c

To Debenture redemption premium A/c

Illustration 7

Agrotech Ltd. issued 1,40,00,000, 9% debentures of Rs. 100 each at a discount of 6%, redeemable at a premium of 5% after 3 years payable as : Rs. 50 on application and Rs. 44 on allotment. Record necessary journal entries for issue of debentures.

Solution

Books of Agrotech Ltd.

Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Bank A/c		70,00,00,000	
	To Debenture Application A/c			70,00,00,000
	(Debentures application money received)			
	Debenture Application A/c Dr.		70,00,00,000	
	To 9% Debenture A/c			70,00,00,000
	(Application money transferred to 9% debenture account)			
	Debenture Allotment A/c Dr.		61,60,00,000	
	Discount on issue of debenture A/c Dr.		15,40,00,000	
	To 9% Debenture A/c			70,00,00,000
	To Debenture redemption premium A/c			7,00,00,000
	(Call made consequent upon allotment of debenture issued at discount and redeemable at premium)			
	Bank A/c Dr.		61,60,00,000	
	To Debenture Allotment A/c			61,60,00,000
	(Allotment amount received)			

Working Notes :

Discount/Loss on issue of debenture =

Amount of discount on issue + Premium payable on redemption

= 6% of Rs. 1,40,00,00,000 + 5% of Rs. 1,40,00,00,000

= Rs. 8,40,00,000 + Rs. 7,00,00,000

= Rs. 15,40,00,000

6. Debenture Issued at premium and redeemable at premium

In this situation the issue price is more than par value and also redemption value is more than par value. The premiuim received at the time of issue of debentures is credited to Debenture premium account and premium paid at the time of redemption is loss to be provided at the time of issue of debentures. Suppose, a 10% debenture of Rs. 1,000 is issued at a premium of Rs. 100 and redeemable at a premium of Rs. 5 per debenture. In the given case Rs. 100 is to be credited to Debenture premium account and Rs. 5 will be the loss to be provided at the time of issue of debentures. It is to be noted that premium on redemption of debentures is also credited by Rs. 5.

(a) For the receipt of application money

Bank A/c Dr.

To Debenture Application A/c

(b) At the time of making allotment

(i) Transfer of application money to debenture account

Debenture Application A/c Dr.

To % Debentures A/c

(ii) Call made consequent upon allotment of debenture at premium and redeemable at premium

Debenture Allotment A/c Dr.

Loss on issue of debenture A/c Dr. [Amount equal to the premiuim on redemption]

To ...% Debenture A/c

To Debenture Premium A/c

To Premium on Redemption of Debentures A/c

Students can note that instead of passing the separate entries, a compound entry can be passed:

	Bank A/c	Dr.	
	Loss on issue of Debentures A/c		Dr.
	To ...% Debentures A/c		
	To Debenture Premium A/c		
	To Premium on redemption of debenture A/c		

6.2 ACCOUNTING FOR ISSUE OF DEBENTURES PAYABLE IN INSTALMENTS

Just like shares, money payable on debentures may be paid either in full with application or by instalments. Accounting entries will differ to some extent in either case.

6.2.1 Debentures Payable in Full on Application

Where the amount due on debentures are payable in full on application, it is usual to open a separate Debentures Application Account for each class of debentures, such as 10% Debentures Application Account or 12% Debentures Application Account. These accounts record moneys received from the applicants of debentures. If an issue is over-subscribed, these accounts can be used to record the refund of moneys to the unsuccessful applicants. At the time of allotment of debentures, the amount in Debentures Application Account is transferred to the respective Debentures Account.

As in case of shares, debentures may also be issued at par, at a premium, or at a discount.

6.2.2 Debentures Issued at Par

The debentures which are issued at par are issued at the same price as their nominal value; that is, if a debt with a nominal value of Rs. 100 is issued at par, the company receives Rs. 100.

The accounting entries would be as follows:

(a)	*When cash is received* Bank Account To Debentures Application Account (Being money received on…. debentures @Rs.…each)	Dr.
(b)	*When excess money is refunded* Debentures Application Account To Bank Account (Being excess money…debentures refunded as per Board's Resolution No.…dated…..)	Dr.
(c)	*When the debentures are allotted* Debentures Application Account To Debentures Account (Being the allotment of…debentures of Rs.…each as per Board's Resolution No.…dated.…)	Dr.

Illustration 8

Simmons Ltd. issued 10,000, 12% Debentures of Rs. 100 each at par payable in full on application by 1st April, Application were received for 11,000 Debentures. Debentures were allotted on 7th April. Excess money refunded on the same date.

You are required to pass necessary Journal Entries (including cash transactions) in the books of the company.

Solution

In the books of Simmons Limited

Date	Particulars		Rs.	Rs.
April 1	Bank A/c To 12% Debentures Application A/c (Being money received on 11,000 debentures)	Dr.	11,00,000	11,00,000
April 7	12% Debentures Application A/c To Bank A/c (Being money on 1,000 debentures refunded as per Board's Resolution No.….dated…)	Dr.	1,00,000	1,00,000
April 7	12% Debentures Application A/c To 12% Debentures A/c (Being the allotment of 10,000 debentures of Rs.100 each at par, as per Board's Resolution No.…dated…)	Dr.	10,00,000	10,00,000

6.2.3 Debentures Issued at a Premium

Debentures are rarely issued at a premium. A company issues debentures at a premium when the market rate of interest is lower than the debentures interest rate. The debentures, which are issued at a premium, are issue at a higher price than their nominal value; that is, if a debenture with a nominal value of Rs. 100 is issued; 10% premium, the company receives Rs. 110 where the investor gets slightly less interest than stated in the debenture. For example, 12% Debentures of Rs. 100 issued at a premium of 10%. The investor will get Rs. 1 p.a. for his investment of 110. Therefore, the effective rate of interest on investment is (12/111x 100) = 10.91%.

There is no restriction in the Companies Act 1956 regarding the utilization of Debenture Premium. This is different from Share Premium. It can be used to write-off: (a) discount on issue of shares or debentures; (b) premium on redemption of shares or debentures; (c) capital losses; and (d) intangible assets, such as goodwill, etc. Any balance left in the Debenture Premium Account should be transferred to Capital Reserve Account.

The accounting entries would be as follows:

(a) When cash is received
Bank Account Dr. [Nominal value plus premium]
To Debentures Application Account
(Being money received on….debentures @ Rs…..
each including premium of Rs…..

(b) When excess money is refunded
Debentures Application Account Dr.
To Bank Account
(Being refund of money on….debentures
@ Rs….each, as per Board's Resolution No…..dated….)

(c) When the debentures are allotted
Debentures Application Account Dr.
To Debentures Account
To Debentures Premium Account
(Being the allotment of….debentures, premium
transferred to Debentures Premium Account,
as per Board's Resolution No….dated….)

(d) When debentures premium is transferred
Debentures Premium Account Dr.
To Capital Reserve Account
(Being the amount transferred to capital reserve)

Illustration 9

Kapil Ltd. issued 10,000. 12% Debentures of Rs. 100 each at a premium of 10% payable in full on application by 1st March, 2006. The issue was fully subscribed and debentures were allotted on 9th March, 2006.

Pass necessary Journal Entries (including cash transactions).

Solution

In the books of Kapil Limited

Date	Journal Particulars		Dr. Rs.	Cr. Rs.
2006				
March 1	Bank A/c	Dr.	11,00,000	
	To 12% Debentures Application A/c			11,00,000
	(Being the money received on 10,000 debentures @ Rs.110 each including premium of Rs.10 each)			
March 9	12% Debentures Application A/c	Dr.	11,00,000	
	To 12% Debentures A/c			10,00,000
	To Debentures Premium A/c			1,00,000
	(Being the allotment of 10,000 debentures of Rs.100 each, premium @ Rs.10 each transferred to Debenture Premium Account as per Board's Resolution No….dated….)			
	Debenture Premium A/c	Dr.	1,00,000	
	To Capital Reserve A/c			1,00,000
	(Being the debenture premium transferred to capital reserve)			

6.2.4 Debentures Issued at a Discount

The Companies Act does not impose any restriction on the price at which debentures can be issued. Unlike shares, there is no maximum limit for discount on issue of debenture. This is why it is very common for debentures to be issued at a discount. The debentures which are issued at a discount are issued at a lower price than nominal value, that is, if a debenture with a nominal value of Rs. 100 is issued at 10% discount, the company receives Rs. 90 only. The issue of debentures at a discount slightly increases the true rate of interest payable. For example, 12% Debentures of Rs.100 issued at a discount of 10%. The Company will have to pay Rs. 1 for a loan of Rs. 90. Therefore, the true rate of interest is (12/90 x 100) = 13.33%.

The company issues debentures at a discount when the market rate of interest is higher than the debenture interest rate. Like shares, Debentures Account is credited with the nominal value. The difference between the nominal value of debentures and cash received is transferred to "Discount on Issue of Debentures Account. In the Balance Sheet, "Discount on Issue of Debentures" is shown on the Assets side under "Miscellaneous Expenditure". In the subsequent years, Discount on Issue of Debentures is written-off proportionately by charging to the Profit and Loss Account.

The accounting entries would be as follows :

(a) When Cash is received

Bank Account	Dr. [Actual cash received]
To Debentures Application Account	
(Being money received on….debentures @Rs……each)	

(b) When excess money is refunded

Debentures Application Account	Dr.
To Bank Account	
(Being excess money on…debentures refunded as per Board's Resolution No…..dated….)	

(c) When the debentures are allotted

Debentures Application Account	Dr. [Actual cash received]
Discount on Issue of Debentures Account	Dr. [Discount on debentures]
To Debentures Account	[Nominal value of debentures]
(Being the allotment of…debentures of Rs….each @ Rs…..eachasper Board's Resolution No…..dated…)	

In fact, the discount on issue of debentures is considered as incremental interest expense. The true expense (net borrowing cost) for a particular accounting period is, therefore, the total interest payment plus the discount written off.

Illustration 10

X Ltd. issued 10,000 12% Debentures of Rs. 100 each at a discount of 10% payable in full on application by 31st March, 2006. Applications were received for 12,000 debentures. Debentures were allotted on 9th June, 2006. Excess monies were refunded on the same date. Pass necessary Journal Entries.

Solution

In the books of X Limited

Journal Entries

Date 2006	*Particulars*		*Dr.* *Rs.*	*Cr.* *Rs.*
May 31	Bank A/c	Dr.	10,80,000	
	To 12% Debentures Application A/c			10,80,000
	(Being money received for 12,000 debentures @ Rs. 90 each)			
June 9	12% Debentures Application A/c	Dr.	1,80,000	
	To Bank A/c			1,80,000
	(Being excess money on 2,000 debentures @ Rs. 90 refunded as per Board's Resolution No….dated….)			
June 9	12% Debentures Application A/c	Dr.	9,00,000	
	Discount on Issue of Debentures A/c	Dr.	1,00,000	
	To 12% Debentures A/c			10,00,000
	(Being the allotment of 10,000 debentures of Rs.100 each at a discount of Rs. 10 per debenture as per Board's Resolution No…..dated…)			

Dr.		Bank Account			Cr.
Date	Particulars	Rs.	Date	Particulars	Rs.
31.5.2006	To 12% Debentures		9.6.2006	By 12% Debentures	
	Application A/c	10,80,000		Application A/c	1,80,000
			9.6.2006	By Balance c/d	9,00,000
		10,80,000			10,80,000

Dr.		12% Debentures Account			Cr.
Date	Particulars	Rs.	Date	Particulars	Rs.
9.6.2006	To Balance c/d	10,00,000	9.6.2006	By 12% Debentures Application A/c	9,00,000
			9.6.2006	By Discount on Issue of Debentures A/c	1,00,000
		10,00,000			10,00,000

Dr.		12% Debentures Application Account			Cr.
Date	Particulars	Rs.	Date	Particulars	Rs.
9.6.2006	To Bank A/c	1,80,000	9.6.2006	By Bank A/c	10,80,000
9.6.2006	To 12% Debentures A/c	9,00,000			
		10,80,000			10,80,000

Dr.		Discount on Issue of Debentures Account			Cr.
Date	Particulars	Rs.	Date	Particulars	Rs.
9.6.2006	To 12% Debentures A/c	1,00,000	9.6.2006	By Balance c/d	1,00,000
		1,00,000			1,00,000

Balance Sheet of X Limited as on 09.06.2006 (includes)

Liabilities	*Rs.*	*Assets*	*Rs.*
Secured Loan		Current Assets	
12% Debentures	10,00,000	Cash at Bank	9,00,000
		Miscellaneous Expenditure	
		Discount on Issue of Debentures	1,00,000
	10,00,000		10,00,000

7. ISSUE OF DEBENTURES AS COLLATERAL SECURITY

Collateral security means secondary or supporting security for a loan, which can be realised by the lender in the event of the original loan not being repaid on the due date. Under this arrangement, the borrower agrees that a particular asset or a group of assets will be realized and the proceeds there from will be applied to repay the loan in the event that the amount due, cannot be paid.

Sometimes companies issue their own debentures as collateral security for a loan or a fluctuating overdraft. When the loan is repaid on the due date, these debentures are at once released with the main security. In case, the company cannot repay its loan and the interest thereon on the due date, the lender becomes the debentureholder who can exercise all the rights of a debentureholder.

The holder of such debentures is entitled to interest only on the amount of loan, but not on the debentures.

Accounting Entries

There are two methods of showing these types of debentures in the accounts of a company.

Method 1

Under this method, no entry is made in the books of account of the company at the time of making issue of such debentures. In the Balance Sheet, the fact of the debentures being issued and outstanding is shown by a note under the liability secured.

Illustration 11

X Ltd. obtains a loan from IDBI of Rs.10,00,000, giving as collateral security of Rs.15,00,000, 14%, First Mortgage Debentures. In the Balance Sheet of X Ltd., it is shown as follows:

Balance Sheet of X Limited as at...(includes)

Liabilities	*Rs.*	*Assets*	*Rs.*
Secured Loan			
IDBI Loan	10,00,000		
(Collaterally secured by issue of Rs. 15,00,000			
14% First Mortgage Debentures)			

Method 2

Under this method, the following entry is made to record the issue of such debentures:

Debentures Suspense Account Dr.

To Debentures Account

(Being the issue of…debentures collaterally…as per

Board's Resolution No…..dated)

The Debentures Suspense Account will appear on the assets side of the Balance Sheet and Debentures on the liabilities side of the Balance Sheet. When the loan is repaid, the entry is reversed in order to cancel it.

Illustration 12

Taking the same information of the above example, the entry on issue will be as follows :

In the Books of X Ltd.

Journal

Date	Particulars		Dr. Rs.	Cr. Rs.
	Debentures Suspense A/c	Dr.	15,00,000	
	To 14% First Mortgage Debentures A/c			15,00,000
	(Being the issue of Rs. 15,00,000 debentures collaterally as per Board's Resolution No…dated…)			

Balance Sheet of X Limited as at….(includes)

Liabilities	*Rs.*	*Assets*	*Rs.*
Secured Loan:		Debentures Suspense Account	15,00,000
IDBI Loan	10,00,000	(issue of Rs. 15,00,000 14% First Mortgage Debentures as collateral security as per contra)	
Unsecured Loan:			
14% First Mortgage Debentures	15,00,000		

Students should note that the Method 1 is much more logical from the accounting point of view. Therefore we advice to follow Method 1.

8. ISSUE OF DEBENTURES IN CONSIDERATION OTHER THAN FOR CASH

Just like shares, debentures can also be issued for consideration other than for cash, such as for purchase of land, machinery, etc. In this case, the following entries are passed :

(a) Sundry Assets Account Dr. [Assets taken over]
To Sundry Liabilities Account [Liabilities assumed]
To Vendors Account [Purchase consideration]
(Being the assets and liabilities are taken over)

(b) Vendors Account Dr.
To Debentures Account
(Being the issue of….debentures to satisfy purchase consideration)

Illustration 13

X Company Limited issued 14% Debentures of the nominal value of Rs. 10,00,000 as follows:

(a) To sundry persons for cash at 90% Rs. 5,00,000 nomonal.

(b) To a vendor for Rs. 2,00,000 for purchase of fixed assets – Rs. 2,50,000 nominal.

(c) To the banker as collateral security for a loan of Rs. 1,00,000 – Rs. 2,50,000 nominal.

Pass necessary Journal Entries.

Solution

In the books of X Company Ltd.

Journal Entries

Date	Particulars		Dr. Rs.	Cr. Rs.
(a)	Bank A/c	Dr.	4,50,000	
	To Debentures Application A/c			4,50,000
	(Being the application money received on 5,000 debentures @ Rs.90 each)			
	Debentures Application A/c	Dr.	4,50,000	
	Discount on issue of Debentures A/c	Dr.	50,000	
	To 14% Debentures A/c			5,00,000
	(Being the issue of 5,000, 14% Debentures @ 90% as per Board's Resolution No....dated....)			
(b)	Fixed Assets A/c	Dr.	2,00,000	
	To Vendor A/c			2,00,000
	(Being the purchase of fixed assets from vendor)			
	Vendor A/c	Dr.	2,00,000	
	Discount on Issue of Debentures A/c	Dr.	50,000	
	To 14% Debentures A/c			2,50,000
	(Being the issue of debentures of Rs.2,50,000 to vendor to satisfy his claim)			
(c)	Bank A/c	Dr.	1,00,000	
	To Bank Loan A/c (See Note)			1,00,000
	(Being a loan of Rs. 1,00,000 taken from bank by issuing debentures of Rs. 2,50,000 as collateral security)			

Note : No entry is made in the books of account of the company at the time of making issue of such debentures. In the Balance Sheet the fact that the debentures being issued and outstanding are shown under the respective liability.

9. TREATMENT OF DISCOUNT ON ISSUE OF DEBENTURES

The Discount on issue of debentures is amortised over a period between the issuance date and redemption date. It should be written-off in the following manner depending upon the terms of redemption:

(a) If the debentures are redeemable after a certain period of time, say at the end of 5 or 10 years, the total amount of discount should be written-off **equally** throughout the life of the debentures (applying the straight line method). The main advantage of this method is that it spreads the burden of discount equally over the years.

(b) If the debentures are redeemable at different dates, the total amount of discount should be written-off in the ratio of benefit derived from debenture loan in any particular year (applying the sum of the year's digit method). This method is suitable when debentures are redeemed by unequal instalments.

(c) If the debentures are irredeemable, the discount should be written-off gradually over a **long period**.

The accounting entries would be as follows :

Profit and Loss Account Dr.

To Discount on Issue of Debentures Account

(Being the amount of discount on issue of debentures written-off)

Illustration 14

HDC Ltd issues 10,000. 12% debentures of Rs. 100 each at Rs. 94 on 1st January, 2006. Under the terms of issue, the debentures are redeemable at the end of 8 years from the date of the issue. Calculate the amount of discount to be written-off in each of the 8 years.

Solution

Total amount of discount comes to Rs. 60,000 (Rs. 6 X 10,000). The amount of discount to be written-off in each year is calculated as under :

Year end	Debentures outstanding	Ratio in which discount to be written-off	Amount of discount to be written-off
1st	Rs. 10,00,000	1/8	1/8th of Rs. 60,000 = Rs. 7,500
2nd	Rs. 10,00,000	1/8	1/8th of Rs. 60,000 = Rs. 7,500
3rd	Rs. 10,00,000	1/8	1/8th of Rs. 60,000 = Rs. 7,500
4th	Rs. 10,00,000	1/8	1/8th of Rs. 60,000 = Rs. 7,500
5th	Rs. 10,00,000	1/8	1/8th of Rs. 60,000 = Rs. 7,500
6th	Rs. 10,00,000	1/8	1/8th of Rs. 60,000 = Rs. 7,500
7th	Rs. 10,00,000	1/8	1/8th of Rs. 60,000 = Rs. 7,500
8th	Rs. 10,00,000	1/8	1/8th of Rs. 60,000 = Rs. 7,500

Illustration 15

HDC Ltd. issues 10,000. 12% debentures of Rs. 100 each at Rs. 94 on 1st January, 2006. Under the terms of issue, 1/5th of the debentures are annually redeemable by drawings, the first redemption occurring on 31st December, 2006. Calculate the amount of discount to be written-off in 2006 to 2010.

Solution

Calculation of amount of discount to be written-off

At the Year end	Debentures outstanding	Ratio of benefit derived	Amount of discount to be written-off
2006	Rs. 10,00,000	5	5/15th of Rs. 60,000 = Rs. 20,000
2007	Rs. 8,00,000	4	4/15th of Rs. 60,000 = Rs. 16,000
2008	Rs. 6,00,000	3	3/15th of Rs. 60,000 = Rs. 12,000
2009	Rs. 4,00,000	2	2/15th of Rs. 60,000 = Rs. 8,000
2010	Rs. 2,00,000	1	1/15th of Rs. 60,000 = Rs. 4,000
	TOTAL	15	Rs. 60,000

Tutorial Note : The debentures are to be redeemed in 5 annual instalments, i.e., Rs. 2,00,000 every year. At the end of 1998, the company redeemed Rs. 2,00,000. Tthe company enjoyed benfit in 2006 Rs. 10,00,000 and in 1999 for Rs. 8,00,000 and so on.

10. INTEREST ON DEBENTURES

Interest payable on coupon debenture is treated as a charge against the profits of the company. Interest on debenture is paid periodically and is calculated at coupon rate on the nominal value of debenture. The company will pay interest net of tax to the debenture holders because the company is under obligation to deduct tax at source at the rates applicable under tax rules from time to time. The companies will deposit the tax so deducted with income tax authorities. Following accounting entries are to be recorded in this regard:

1. *For making interest due*
   Interest A/c Dr.
   To Debentureholders' A/c
2. *For making payment of interest and deduction of tax at source (TDS)*
   Debentureholders A/c Dr.
   To TDS Payable A/c
   To Bank A/c
3. *For making payment of tax deducted at source*
   TDS payable A/c Dr.
   To Bank A/c
4. *For transferring interest to profit and loss account*
   Profit and Loss A/c Dr.
   To Interest A/c

Illustration 16

A company issued 12% debentures of the face value of Rs. 2,00,000 at 10% discount on 1-1-2005. Debenture interest after deducting tax at source @ 10% was payable on 30th June and 31st of December every year. All the debentures were to be redeemed after the expiry of five year period at 5% premium.

Pass journal entries for the accounting year 2005.

Solution

Journal Entries

			Dr. (Rs)	*Cr. (Rs.)*
1-1-2005	Bank A/c	Dr.	1,80,000	
	Debenture Discount A/c	Dr.	20,000	
	Loss on Issue of Debentures A/c	Dr.	10,000	
	To 12% Debentures A/c			2,00,000
	To Premium on Redemption of Debentures A/c			10,000
	(For issue of debentures at discount redeemable at premium)			
30-6-2005	Debenture Interest A/c	Dr.	12,000	
	To Debentureholders A/c			10,800
	To Tax Deducted at Source A/c			1,200
	(For interest payable)			

	Debentureholders A/c	Dr.	10,800	
	Tax Deducted at Source A/c	Dr.	1,200	
	To Bank A/c			12,000
	(For payment of interest and TDS)			
31-12-2005	Debenture Interest A/c	Dr.	12,000	
	To Debentureholders A/c			10,800
	To Tax Deducted at Source A/c			1,200
	(For interest payable)			
	Debentureholders A/c	Dr.	10,800	
	Tax Deducted at Source A/c	Dr.	1,200	
	To Bank A/c			12,000
	(For payment of interest and tax)			
	Profit and Loss A/c	Dr.	24,000	
	To Debenture Interest A/c			24,000
	(For transfer of debenture interest to profit and loss account)			
	Profit and Loss A/c	Dr.	4,000	
	To Debenture Discount A/c			4,000
	(For proportionate debenture discount written off, i.e., 20,000 x 1/5)			
	Profit and Loss A/c	Dr.	2,000	
	To Loss on Issue of Debenture A/c			2,000
	(For proportionate loss on issue written off, i.e., 1/5 x 10,000)			

It may be noted that loss on issue of debenture is also written off in the ratio of debentures outstanding during different accounting years.

SELF EXAMINATION QUESTIONS

1. Which of the following statements is **true**?
   (a) A debenture holder is an owner of the company
   (b) A debenture holder can get his money back only on the liquidation of the company
   (c) A debenture issued at a discount can be redeemed at a premium
   (d) A debenture holder receives interest only in the event of profits

2. Premium on redemption of debentures account is _______.
   (a) A real account
   (b) A nominal account - income
   (c) A personal account
   (d) A nominal account - expenditure

3. Which of the following statements is **false**?
   (a) At maturity, debenture holders get back their money as per the terms and conditions of redemption
   (b) Debentures can be forfeited for non payment of call money
   (c) In company's balance sheet, debentures are shown under secured loans
   (d) Interest on debentures is charged against profits

4. Which of the following statements is **false**?
   (a. A company can issue convertible debentures
   (b) Debentures cannot be secured
   (c) A company can issue redeemable debentures
   (d) Debentures have no right to participate in profits over and above their fixed interest

5. Debenture premium **can** be used to _____.
   (a) Write off the discount on issue of shares or debentures
   (b) Write off the premium on redemption of shares or debentures
   (c) Write off capital loss (d) All of the above

6. F Ltd. purchased Machinery from G Company for a book value of Rs.4,00,000. The consideration was paid by issue of 10% debentures of Rs.100 each at a discount of 20%. The debenture account was credited with ______.
   (a) Rs.4,00,000 (b) Rs.5,00,000 (c) Rs.3,20,000 (d) Rs.4,80,000

7. Loss on issue of debentures is treated as ____________.
   (a) Intangible asset (b) Current asset
   (c) Current liability (d) Miscellaneous expenditure

8. T Ltd. has issued 14% Debentures of Rs.20,00,000 at a discount of 10% on April 01, 2007 and the company pays interest half-yearly on June 30, and December 31 every year. On March 31, 2009, the amount shown as "interest accrued but not due" in the Balance Sheet will be
   (a) Rs.70,000 (b) Rs.2,10,000
   (c) Rs.1,40,000 (d) Rs.2,80,000

9. On May 01, 2008 U Ltd. issued 7% 10,000 convertible debentures of Rs.100 each at a premium of 20%. Interest is payable on September 30 and March 31 every year. Assuming that the interest runs from the date of issue, the total amount of interest expenditure debited to profit and loss account for the year ended March 31, 2009 will be
   (a) Rs.70,000 (b) Rs.58,333 (c) Rs.84,000 (d) Rs.64,167

10. Which of the following is/are **true** with respect to debentures?
    (a) They can be issued for cash
    (b) They can be issued for consideration other than cash
    (c) They cannot be issued as collateral security
    (d) Both (a) and (b) above

11. W Ltd. issued 20,000, 8% debentures of Rs.10 each at par, which are redeemable after 5 years at a premium of 20%. The amount of loss on redemption of debentures to be written off every year will be
    (a) Rs.40,000 (b) Rs.10,000 (c) Rs.20,000 (d) Rs.8,000

12. When debentures are issued as collateral security, the final entry for recording the transaction in the books is __________.
    (a) Credit Debentures A/c and debit Cash A/c.
    (b) Debit Debenture suspense A/c and credit Cash A/c.

(c) Debit Debenture suspense A/c and credit Debentures A/c.

(d) Debit cash A/c and credit the loan A/c for which security is given.

13. Which of the following is **false**?

    (a) A company can issue redeemable debentures

    (b) A company can issue debentures with voting rights

    (c) A company can buy its own shares

    (d) A company can buy its own debentures

14. Which of the following is false with respect to debentures?

    (a) They can be issued for cash

    (b) They can be issued for consideration other than cash

    (c) They can be issued as collateral security

    (d) They can be issued in lieu of dividends

15. Debentures can be _________.

    I. Mortgage Debentures or Simple Debentures.

    II. Registered Debentures or Bearer Debentures.

    III. Redeemable Debentures or Irredeemable Debentures.

    IV. Convertible Debentures or Non-convertible Debentures.

    (a) Both (I) and (II) above   (b) Both (I) and (III) above

    (c) Both (II) and (III) above   (d) All of (I), (II), (III) and (IV) above.

16. Which of the following statements is false?

    (a) Debenture is a form of public borrowing

    (b) It is customary to prefix debentures with the agreed rate of interest

    (c) Debenture interest is a charge against profits

    (d) The issue price and redemption value of debentures cannot differ.

17. As per the Companies Act, "Interest accrued and due on debentures" should be shown

    (a) Under Debentures   (b) As Current Liabilities

    (c) As Provisions   (d) As a reduction of bank balance

18. T Ltd. purchased land and building from U Ltd. for a book value of Rs.2,00,000. The consideration was paid by issue of 12% Debentures of Rs.100 each at a premium of 25%. The debentures account is credited with _____________.

    (a) Rs.2,60,000   (b) Rs.2,50,000   (c) Rs.2,40,000   (d) Rs.1,60,000

19. P Ltd. issued 5,000, 12% debentures of Rs.100 each at a premium of 10%, which are redeemable after 10 years at a premium of 20%. The amount of loss on redemption of debentures to be written off every year = ?

    (a) Rs.80,000   (b) Rs.40,000   (c) Rs.10,000   (d) Rs. 8,000

20. Which of the following is **true** with regard to 10% Debentures issued at a discount of 20%?

    (a) The carrying amount of debentures gets reduced each year at a rate of 20%

    (b) Issue price and the carrying amount of debentures are equal

    (c) At the time of redemption, the debenture holder will be paid the issue price

(d) The face value and the carrying amount of debentures are equal.

21. Which of the following is **false**?
   (a) Equity is owners' stake and the debenture is a debt
   (b) Rate of interest on debentures is fixed
   (c) Debenture holders get preferential treatment over the equity holders at the time of liquidation
   (d) Interest on debentures is an appropriation of profits.

22. Discount on issue of debentures is a ____________.
   (a) Revenue loss to be charged in the year of issue
   (b) Capital loss to be written off from capital reserve
   (c) Capital loss to be written off over the tenure of the debentures
   (d) Capital loss to be shown as goodwill

23. When debentures are issued as collateral security against any loan then holder of such debentures is entitled to
   (a) Interest only on the amount of loan
   (b) Interest only on the face value of debentures
   (c) Interest both on the amount of the loan and on the debentures
   (d) None of the above.

24. When debentures are redeemable at different dates, the total amount of discount on issue of debentures should be written off
   (a) Every year by applying the sum of the year's digit method
   (b) Every year by applying the straight line method
   (c) To profit and loss account in full in the year of final or last redemption
   (d) To profit and loss account in full in the year of first redemption.

25. Which of the following is **not** a characteristic of Bearer Debentures?
   (a) They are treated as negotiable instruments
   (b) Their transfer requires a deed of transfer
   (c) They are transferable by mere delivery
   (d) The interest on it is paid to the holder irrespective of identity.

ANSWERS

1. (c)	2. (d)	3. (b)	4. (b)	5. (d)	6. (b)
7. (d)	8. (a)	9. (d)	10. (d)	11. (d)	12. (c)
13. (b)	14. (d)	15. (d)	16. (d)	17. (a)	18. (d)
19. (c)	20. (d)	21. (d)	22. (c)	23. (a)	24. (a)
25. (b)					