

Quadrant II – Notes

Paper Code : DSE7 COD125

Module Name : Sources of Finance and Journal Entries and Ledger Accounts regarding Redemption of Debentures

Module No : 09

SOURCES OF FINANCE FOR REDEMPTION OF DEBENTURES WITH JOURNAL ENTRIES

- I. WHERE THERE IS NO SINKING FUND/ DEBENTURE REDEMPTION RESERVE FUND
- II. WHERE THERE IS SINKING FUND/ DEBENTURE REDEMPTION RESERVE FUND
- III. CONVERTIBLE DEBENTURES

I – WHERE THERE IS NO SINKING FUND/ DEBENTURE REDEMPTION RESERVE FUND

Debentures can be redeemed by utilizing any of the following sources:

- a) **Redemption of Debentures from the proceeds of the fresh issue of shares/ debentures;**

A company can issue new shares / debentures and the proceeds from such new issue can be used for redemption of old debentures. If new shares are issued for this purpose, the loan capital of the company will be replaced by the own capital. If new debentures are issued for this purpose, the old debentures will be replaced by the new debentures.

- b) **Redemption of Debentures out of profit.**

As per Rule 18 of the Companies (Share Capital and Debenture) Rules 2014, the company shall create a Debenture Redemption Reserve for the purpose of redemption of debentures. An adequate amount is to be transferred to Debenture Redemption Reserve out of profit of the company. After redemption of debentures, the balance of Debenture Redemption Reserve is transferred to General Reserve.

Accounting Entries for redemption of debentures out of profit

Sr. No.	Particulars	Dr.	Cr.
(i)	<i>For transfer of amount to Debenture Redemption Reserve</i>		

	Surplus/Statement of Profit & Loss Dr. To Debenture Redemption Reserve Account		
(ii)	<i>For investment of Debenture Redemption Reserve</i> Debenture Redemption Reserve Account Dr. To Bank Account		
(iii)	<i>For encashment of Debenture Redemption Reserve Investment</i> Bank Account Dr. Tax Deducted at Source Account Dr. To Debenture Redemption Investment Account To Interest Earned Account		
(iv)	<i>For redemption of Debentures</i>		
a)	<i>When debentures are redeemed at par</i> (i) Debentures Account Dr. To Debenture holders Account (ii) Debentures holders Account Dr. To Bank Account	Nominal Value	
b)	<i>When debentures are redeemed at a premium</i> (i) Debentures Account Dr. Premium on Redemption of Debentures Account Dr. To Debenture holders Account (ii) Debentures holders Account Dr. To Bank Account	Nominal Value Premium	Total Amount
c)	<i>When debentures are redeemed at a discount</i> (i) Debentures Account Dr. To Debenture holders Account To Profit on Redemption of Debentures Account (ii) Debentures holders Account Dr. To Bank Account	Nominal Value	Actual amount Discount
(v)	<i>For transfer to General Reserve</i> Debenture Redemption Reserve Account Dr. To General Reserve Account		

II - WHERE THERE IS SINKING FUND/ DEBENTURE REDEMPTION RESERVE FUND

a) Sinking Fund Method

B. G. Wickery has defined sinking fund as 'A sinking fund may be defined as a fund, created by a charge against or an appropriation of profits and represented by specific investments, which is brought into existence for a special purpose, such as replacement of an asset at the expiration of its life, or the redemption of debentures'.

***Accounting Entries for creation of Sinking Fund/Debenture Redemption Reserve
Fund for the redemption of debentures***

Sr. No.	Particulars	Dr.	Cr.
	<u>At the end of the 1st year</u>		
(a)	<i>For annual contribution</i> Statement of Profit & Loss Dr. To Sinking Fund Account		
(b)	<i>For investing the amount set aside</i> Sinking Fund Investment Account Dr. To Bank Account		
	<u>At the end of the 2nd and subsequent years</u>		
(a)	<i>For receiving interest on sinking fund investment</i> Bank Account Dr. To Interest on Sinking Fund Investment Account		
(b)	<i>For transferring interest on sinking fund investment to sinking fund account</i> Interest on Sinking Fund Investment Account Dr. To Sinking Fund Account		
	<i>Alternatively,</i> Bank Account Dr. To Sinking Fund Account		
(c)	<i>For annual contribution</i> Statement of Profit & Loss Dr. To Sinking Fund Account		
(d)	<i>For investing the amount set aside plus interest received during the year</i> Sinking Fund Investment Account Dr. To Bank Account	(contribution plus interest)	
	<u>At the end of the year of redemption</u>		
(a)	<i>For receiving interest on sinking fund investment</i> Bank Account Dr. To Interest on Sinking Fund Investment Account		
(b)	<i>For transferring interest on sinking fund investment to sinking fund account</i> Interest on Sinking Fund Investment Account Dr. To Sinking Fund Account		
(c)	<i>For annual contribution</i> Statement of Profit and Loss Dr. To Sinking Fund Account		
(d)	<i>For realisation of sinking fund investments</i> Bank Account Dr. To Sinking Fund Investment Account		
(e)	<i>For profit on sale of investment</i> Sinking Fund Investment Account Dr. To Sinking Fund Account		
(f)	<i>For loss on sale of investment</i>		

	Sinking Fund Account Dr. To Sinking Fund Investment Account		
(g)	<i>For redemption of debentures at a premium</i> Debenture Account Dr. Premium on Redemption of Debentures Account Dr. To Debenture holders Account		
(h)	<i>For payment to debenture holders</i> Debenture holders Account Dr. To Bank Account		
(i)	<i>For transferring premium on redemption of debentures</i> Sinking Fund Account Dr. To Premium on Redemption of Debentures Account		
(j)	<i>For transferring part of the sinking fund no longer required</i> Sinking Fund Account Dr. To General Reserve Account		

b) Insurance Policy Method

This method is similar to the sinking fund method, but instead of investing the money in securities, the amount is used in paying premium on a policy taken out with an insurance company. The policy should mature immediately before the date of redemption of debentures. The money that is received from the insurance company is used for paying the debenture holders.

Accounting Entries

Sr. No.	Particulars	Dr.	Cr.
(a)	<i>For payment of yearly premium (at the commencement of the year)</i> Debenture Redemption Fund Policy Account Dr. To Bank Account		
(b)	<i>For appropriation (at the year-end)</i> Statement of Profit & Loss Dr. To Debenture Redemption Fund Account		
(c)	<i>For realisation of insurance policy</i> Bank Account Dr. To Debentures Redemption Fund Policy Account		
(d)	<i>For transfer of excess policy money received over premium paid</i> Debenture Redemption Fund Policy Account Dr. To Debenture Redemption Fund Account		
(e)	<i>After redemption of debentures, the balance of Debentures Redemption Fund Account is transferred to General Reserve Account.</i>		

III – CONVERTIBLE DEBENTURES

Convertible debentures are those which carry a provision of conversion in a number of shares at par or at a premium on or before a certain date. The dates and terms of the conversion are established at the time of the issue of debentures. A convertible debenture gives the holder the option to convert it into shares at a later date and also at a fixed price. In fact, it is a delayed form of equity financing.

Convertible debentures can be partly or fully convertible. When the entire amount of the debenture is convertible, it is called a **fully convertible debenture** (FCD). On the other hand, when only a part of the debenture is convertible, it is called a **partly convertible debenture** (PCD).

Accounting Entries

Sr. No.	Particulars	Dr.	Cr.
(a)	<i>On receipt of application money</i> Cash/Bank Account Dr. To Debentures Application Account		
(b)	<i>For allotment of debentures</i> Debenture Application Account Dr. To Convertible Debentures Account		
(c)	<i>For conversion of the convertible debentures into equity/preference shares at par</i> Convertible Debentures Account Dr. To Equity/Preference Share Capital Account		
(d)	<i>For conversion of the convertible debentures into equity/preference shares at a premium</i> Convertible Debentures Account Dr. To Equity/Preference Share Capital Account To Securities Premium Account		