Accounting For Debentures

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1. What is the Meaning of Debenture?

Ans: A Debenture is a certificate or voucher acknowledging a debt. A Debenture is a long-term Debt Instrument issued for the purpose of raising funds.
According to Section 2 (12) of the Companies Act "Debenture" includes debenture stock, bonds and any other securities of a company, whether or not constituting a charge on the assets of the company.

2. Explain the concept of Collateral Security.

Ans: Collateral security" means additional security to the main obligation in a contract. A company may issue its debentures in addition to the Primary Security when it takes loan from bank or any financial institution. It is called 'issue of debentures as collateral security'. The lender may take possession only if company is not able to repay the loan amount and the principal security is exhausted. In such a case company pays interest on loan, thus no interest will be paid on the debentures issued as collateral Security.

3. What is meant by issue of debentures for consideration other than cash?

Ans. When a company does not have sufficient Cash to acquire the fixed Assets for the business or Company is not able to meet its obligations, in such a case a company may offer and allot its debentures to the outsiders in lieu of cash. This is known as issue of debentures for consideration other than cash. For example Machinery is purchased and debentures are issued to Vendor instead of paying cash.

4. Give the meaning of Convertible and Non convertible debentures.

Ans: Convertible Debentures: Debentures which are convertible into Equity shares at the issuer's notice. After conversion of Debentures into Equity Shares the investors enjoy the same status as ordinary shareholders of the company. Such conversion should be approved by passing special resolution.
Non-Convertible Debentures: These are totally opposite to the convertible debentures. These debentures do not have the option of their conversion into the equity share.

5. What does an irredeemable debenture mean?

Ans. Irredeemable Debentures: Debentures which do not have any fixed Period of redemption. These debentures are redeemable at the time of winding up and not redeemable during the life time of the company.

6. Distinguish between a Share and a debenture (any two).

Ans:

BASIS	SHARE	DEBENTURE
Meaning	Share means share capital of the company. Share Capital is the Internal Liability of the firm.	Debenture means Loan or debt of the company. Debenture is the external liability of the firm
Status of Holder	Share Holders are treated as the owners of the company	Debenture Holders are the Creditors of the company
Dividend Vs Interest	Dividend is paid to the Shareholders. It is an appropriation of Profit	Interest is paid to the Debenture Holders at a fixed rate. It is charge against the profit

7. Why would an investor prefer to invest partly in Shares and partly in Debentures at a company?

Ans.

1. Main purpose of investing in shares is to enjoy the firm's profit in the form of dividend.
2. The main purpose of investing in debentures is to ensure the regular interest and safety of investment.

8. What is the nature of Interest on Debentures?

Ans. Interest on debentures is a charge against the profits. It means that whether there is profit or loss it will be paid to the debenture holders.

9. What is meant by Redemption of Debentures?

Ans. Repayment of the amount borrowed by a company is called redemption of debentures. Debentures can be redeemed at Par or Premium. Students must remember that debentures are redeemed on the due date by paying the lump sum amount to the debenture holders or by paying in installments.

10. Give two sources of finance for Redemption of Debentures.

Ans.

1. Out of profits
2. issue of fresh Share Capital and Debentures.

11. Define Secured and Unsecured Debentures.

Ans. Secured or Mortgaged Debentures: Debentures are secured by a charge on the fixed assets of the company. If the company fails on payment of the principal amount or interest amount, assets under charge are sold to repay the amount due to the debenture holders.

Unsecured Debentures: Debentures are called unsecured in the sense that if the company defaults on payment of the principal amount or interest, debenture holder has to be along with other unsecured creditors of the company. In simple words, these debentures are not secured by the charge of fixed assets.

12. Give two reasons why a company buy its own debentures from open market.

Ans.

1. To maintain the solvency ratio.
2. To utlize the surplus money or funds which are lying idle with the company.

13. What is meant by Debenture Redemption Reserve?

Ans. Debenture redemption reserve is a reserve representing retentions out of profit made for the purpose of redemption of debentures. Amount of DRR to be created: Section 117 (c) of the Indian Companies Act 1956 requires that, an adequate amount of profit should be transferred to DRR before redemption commences. However the adequate amount is not specified by the companies Act.

14. What is meant by Redemption out of profit?

Ans. Redemption out of profit means that adequate amount of profits are transferred to DRR A/c from Statement of P/L before the redemption of debenture commences. This reduce the amount available for dividends to shareholders.

15. What Journal entry is recorded when a company purchases its own debentures from the open market?

Ans. Following Journal entry is recorded in the books of accounts when a company purchases its own debentures from the open market:
Own Debentures A/c Dr.
To Bank A/c
(Being own debentures purchased)

16. Distinguish between Shareholders and debenture holders.

Ans. Distinction between Shareholders and Debenture holders

BASIS	SHAREHOLDERS	DEBENTURE HOLDERS
Ownership	Shareholders are considered as the owners of the company	Debenture holders are considered as Creditors of the company
Participation in Management	They are entitled to take part in the management	They are not entitled to take part in the management
Share of Profit	They enjoy the share of profit as dividend	They get interest and are not entitled to share the profits
Risk Taker	Shareholders are the Risk Taker	Debenture holders are safe in comparison of shareholders (for secured debentures)
Voting Rights	They have right to vote	They don't have right to vote
Option of Convertibility	Shareholders can not convert their shares in debentures	Debenture holders can convert their debentures in Equity Shares

17. What is meant by issue of debentures as 'Purchase Consideration'?

Ans. When a company purchases some assets but do not make the payment in cash to vendor, instead of paying cash to vendor, company issues fully paid debentures for the same amount, is called debentures issued for purchase consideration.