

1. Details of Module and its structure

Module Detail	
Subject Name	Accountancy
Course Name	Accountancy 04 (Class XII, Semester – 2)
Module Name/Title	Issue of Debentures – Collateral Securities, Interest on Debentures & Writing off Discount/Loss – Part 4
Module Id	leac_20204
Pre-requisites	Knowledge about Mortgage, Calculation of Interest, Writing off of Expenses & Losses
Objectives	After going through this lesson, learners will be able to understand the following: <ol style="list-style-type: none">1. Meaning of Issue of Debentures as Collateral Security2. Accounting Treatment of ‘Interest on Debentures’3. Accounting Treatment of ‘Writing of Discount/Loss on Issue of Debentures’
Keywords	Collateral Security, Debentures issued as Collateral Security, Interest on Debentures, Discount on Issue of Debentures, Loss on Issue of Debentures, Writing off Discount

2. Development Team

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4. Comprehensive Question Covering – Issue of Debentures with Terms of Redemption, Interest on Debentures & Writing off Discount/Loss on Issue of Debentures.

1. Issue of Debentures as Collateral Security

LOAN Taken by the Company from a BANK	
	
PRIMARY / MAIN SECURITY	
For Example - Land & Building - Plant & Machinery etc.	
	
	SECONDARY / ADDITIONAL SECURITY
	For Example - Fresh Debentures Issued by the Company as an additional Security

1.1 Meaning of ‘Issue of Debentures as a Collateral Security’

Collateral Security means additional or secondary or subsidiary security given to the Banker/Lender along with the primary or main security against a Loan.

When a Public Limited company obtains a loan or overdraft from a bank or any other financial institution, it may pledge or mortgage some tangible real assets as a security against the said loan.

But the lending institutions like, a bank may insist for an additional security which is called Collateral Security. The purpose of Collateral Security is that in case there is default in repayment of loan and the amount realized from the sale of principal/primary security falls short, then the balance could be realised with the help of collateral security.

A Joint Stock Company or a Public Ltd. Company can issue its own debentures to the lender/banker in addition to some other tangible assets already pledged. Such an issue of debentures is known as ‘Issue of Debentures as Collateral Security’.

- If the company fails to repay the loan along with interest, the lender is free to realise the amount by selling the primary security. If primary security fails to cover the entire amount, the lender has the right to claim the benefit of debentures received as collateral security. These debentures can be either presented for redemption or sold in the open market.

1.2 Accounting Treatment of Debentures issued as Collateral Security

Debentures issued as collateral security can be dealt with in the following two ways in the books of the company:

First Method

No journal entry is passed in the books of accounts since no immediate liability is created by such issue.

However, on the Liabilities side of the balance sheet, just below that Loan, it is mentioned in the form of a note that “**it has been secured by issue of debentures as a collateral security.**”

Example 1. VK Ltd. has issued 6½ %, 1,000 debentures of ₹ 1,000 each for a loan of ₹7,00,000 taken from a State Bank of India. This fact may be shown in the Balance Sheet as under:

BALANCE SHEET of VK Limited (Extract)

as at 31st March,

	PARTICULARS	NOTE NUMBER	Current Year Amt. in ₹	Previous Year Amt. in ₹
I.	EQUITY AND LIABILITIES Shareholders' Funds Reserves and Surplus		xxx	

Non-current Liabilities				
II.	Long-term borrowings	(i)	7,00,000	

* *Relevant information only.*

Notes to Accounts:

Note No.	PARTICULARS	Details (in ₹)	Amount (in ₹)
(i)	Long-term borrowings		
	Loan from SBI		7,00,000
	(☆ Collaterally secured by issue of 1,000, 6½ % Debentures of ₹1,000 each.)		
			7,00,000

Second Method

Issue of debentures as a collateral security may also be recorded by means of a journal entry. Let us go through the following example to experience & understand the concept:

Example 2. VK Ltd. Issued 500, 7% debentures of ₹2,000 each as collateral security for a loan of ₹9,00,000 from HDFC Bank. Record issue of debentures to the bank by passing a journal entry.

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DATE	PARTICULARS	LF	DR. Amt. in ₹	CR. Amt. in ₹
	Bank A/c Dr. To Loan from HDFC A/c (For loan taken from bank against a collateral security of 7% 500 Debentures of ₹2,000 each.)		9,00,000	9,00,000
*	7% Debenture Suspense A/c Dr. To 7% Debentures A/c (For issue of 500 7% Debentures of ₹2,000 each as collateral security.)		10,00,000	10,00,000
	*Though JE for taking Loan has also been given but in this topic only 2nd JE i.e. entry for Issue of Debentures as collateral security is relevant.			

- ‘**Debenture Suspense Account**’ will appear as a deduction, from the total value of debentures issued by the company.

BALANCE SHEET of VK Limited (Extract)

as at 31st March,

	PARTICULARS	NOTE NUMBER	Current Year Amt. in ₹	Previous Year Amt. in ₹
I.	EQUITY AND LIABILITIES Shareholders' Funds Reserves and Surplus		xxx	
II.	Non-current Liabilities Long-term borrowings	(i)	9,00,000	

* *Relevant information only.*

Notes to Accounts:

Note No.	PARTICULARS	Details (in ₹)	Amount (in ₹)
(i)	Long-term borrowings Loan from HDFC Bank (Secured by issue of 500, 7% debentures of ₹2,000 each as Collateral Security.)		9,00,000
	7% Debentures A/c	10,00,000	
	Less: 7% Debenture Suspense A/c	<u>(10,00,000)</u>	0
			9,00,000

- **Accounting Treatment on repayment of Bank Loan** - Cancellation of 9% debentures which were issued as collateral security.
- When loan is repaid by the company, previous entry of issue of debentures as collateral security is reversed to cancel these debentures as under:

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DATE	PARTICULARS	LF	DR. Amt. in ₹	CR. Amt. in ₹
	Loan from HDFC A/c Dr. To Bank A/c (For repayment of bank loan.)		9,00,000	9,00,000
*	9% Debenture A/c Dr. To 9% Debentures Suspense A/c (Debentures issued as collateral security cancelled.)		10,00,000	10,00,000
	* In this topic, only 2 nd JE is relevant.			

(Debenture interest transferred to profit and loss A/c)		

2.2 Interest on Debentures with TDS

2.2.a Annual Interest

2.2.b Half Yearly Interest

Following journal entries are recorded in the books of a company in connection with the interest on debentures (with TDS):

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DATE	PARTICULARS	LF	DR. Amt. in ₹	CR. Amt. in ₹
	1. When interest is due Debenture Interest A/c Dr. To Income Tax payable A/c (TDS) To Debentureholders A/c (Amount of interest due on debenture & tax deducted at source.)		100	20 80
	2. On payment of tax deducted at source to the Government Income Tax Payable A/c (TDS) Dr. To Bank A/c (Payment of tax deducted at source on interest on debentures)		20	20
	3. For payment of interest to debentureholders Debentureholders A/c Dr. To Bank A/c (Amount of interest paid to debentureholders).		80	100
	4. On transfer debenture Interest Account to statement of Profit and Loss Statement of Profit and Loss Dr. To Debenture Interest A/c (Debenture interest transferred to profit and loss A/c).		100	100
	# All the amounts/figures mentioned herein are imaginary.			

Illustration 1-A Ltd., issued 2,000, 10% debentures of Rs. 100 each on April 01, 2019 at a discount of 10% redeemable at a premium of 10%.

Give journal entries relating to the issue of debentures and debenture interest for the period ending March 31, 2020 assuming that interest was paid half yearly on September 30 and March 31 and tax deducted at source is 10%.

Book of A Ltd.

Solution:

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DATE	PARTICULARS	LF	DR. Amt. in ₹	CR. Amt. in ₹
2019 Apr. 1	Bank A/c Dr. To 10% Debenture Application & Allotment A/c (Application money received on 2,000, 10% debentures)		1,80,000	1,80,000
Apr. 1	10% Debentures Application & Allotment A/c Dr. Discount on Issue of Debenture A/c Dr. Loss on Issue of Debenture A/c Dr. To 10% Debentures A/c To Premium on Redemption of Debentures A/c (Allotment of debentures at a discount of 10% and redeemable at a premium of 10%.)		1,80,000 20,000 20,000	2,00,000 20,000
Sep. 30	Debenture Interest A/c Dr. To Income Tax Payable A/c To Debentureholders A/c (Interest due for 6 months and tax deducted at source)		10,000	1,000 9,000
Sep. 30	Income Tax payable A/c Dr. To Bank A/c (Tax deducted at source paid to the government)		1,000	1,000
Sep. 30	Debentureholders A/c Dr. To Bank A/c (Payment of interest)		9,000	9,000
Mar 31	Debenture interest A/c Dr. To Income Tax Payable A/c To Debentureholders A/c (Interest due for 6 months and tax deducted at source)		10,000	1,000 9,000
Mar 31	Income Tax Payable A/c Dr. To Bank A/c (Payment of interest)		1,000	1,000
Mar 31	Debenturesholders A/c Dr. To Bank A/c (Paid tax deducted at source to the government)		9,000	9,000
Mar 31	Statement of Profit and Loss Dr. To Debenture Interest A/c (Debenture interest transferred to profit and loss account)		20,000	20,000

3. Writing off Discount or Loss on Issue of Debentures

- Discount or Loss on issue of debentures is a capital loss and is written-off in the year when debentures are issued.
- Discount or loss can be written-off from securities premium reserve [section 52(2)].
- In case, capital profit do not exist or are inadequate, the amount should be written off against revenue profits of the year.
- The journal entry passed is:

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DATE	PARTICULARS	LF	DR. Amt. in ₹	CR. Amt. in ₹
	Securities Premium Reserve A/c Dr. [If exists, to the extent of balance of SPR] Or / & Statement of Profit and Loss Dr. To Discount/Loss on Issue of Debentures A/c (Discount/Loss on issue of debentures written-off.)			

Illustration 2. X Ltd. issued 2,000, 10% debentures of ₹100 each at a discount of 8% on April 01, 2019 which are redeemable. It has balance in Securities Premium Reserve of ₹30,000. Calculate the amount to be written-off from securities Premium Reserve and pass necessary journal entry.

Solution:

JOURNAL

DATE	PARTICULARS	LF	DR. Amt. in ₹	CR. Amt. in ₹
	Securities Premium Reserve A/c Dr. To Discount/Loss on Issue of Debentures A/c (Discount/Loss on issue of debentures written-off.)		16,000	16,000

Note: Since sufficient balance is there in Securities Premium Reserve A/c, full amount of Discount/Loss on issue of debentures will be written off from it.

Illustration 3. Y Ltd. issued 3,000, 10% debentures of ₹100 each at a discount of 4% on April 01, 2019 which are redeemable in three equal annual instalments starting from 31st March, 2021. Security Premium Reserve doesn't exist. Calculate the amount of discount on issue to be written-off and pass necessary journal entry.

Solution:

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DATE	PARTICULARS	LF	DR. Amt. in ₹	CR. Amt. in ₹
	Statement of P & L Dr.		12,000	
	To Discount/Loss on Issue of Debentures A/c (Discount/Loss on issue of debentures written-off.)			12,000

Note: In the absence of balance in Securities Premium Reserve A/c, full amount of Discount/Loss on issue of debentures will be written off debiting 'Statement of Profit & Loss.

Illustration 4. Z Ltd. issued 4,000, 10% debentures of ₹100 each at a discount of 4% on April 01, 2019 redeemable after four years at a premium of 6%. Calculate the amount to be written-off and pass necessary journal entry.

Solution:

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DATE	PARTICULARS	LF	DR. Amt. in ₹	CR. Amt. in ₹
	Statement of P & L Dr.		40,000	
	To Discount on Issue of Debentures A/c			16,000
	To Loss on Issue of Debentures A/c			24,000
	(Discount/Loss on issue of debentures written-off.)			

Illustration 5. On July 01, 2019 a company issued 15,000, 9% debentures of ₹100 each at 10% discount. It has a balance of ₹1,00,000 in a Securities Premium Reserve Account. The discount on issue of debentures of ₹1,50,000 will be written-off in the year ending March 31, 2020 as follows:

Solution:

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DATE	PARTICULARS	LF	DR. Amt. in ₹	CR. Amt. in ₹
	Securities Premium Reserve A/c Dr.		1,00,000	
	[If exists & to the extent of balance] Or / &			
	Statement of Profit and Loss Dr.		50,000	
	To Discount/Loss on Issue of Debentures A/c			1,50,000
	(Discount/Loss on issue of debentures written-off.)			

Note: Balance in Securities Premium Reserve A/c is insufficient. First of all, Discount/Loss on issue of debentures will be written off from using Securities Premium Reserve to the extent it is possible and balance will be written off debiting 'Statement of Profit & Loss.