

1. Details of Module and its structure

Module Detail	
Subject Name	Accountancy
Course Name	Accountancy 04 (Class XII, Semester – 2)
Module Name/Title	Redemption of Debentures – Purchase in Open Market & Redemption by Conversion – Part 7
Module Id	leac_20207
Pre-requisites	Knowledge about Terms of Redemption & Provision of DRR & DRI
Objectives	<p>After going through this lesson, learners will be able to understand the following:</p> <ol style="list-style-type: none">1. Concept and accounting treatment of Redemption of own debentures by purchase in Open Market2. Concept and accounting treatment of Redemption of Debentures by Conversion into Shares or a new class of debentures.3. Preparation of Ledger Accounts in case of Issue and Redemption of Debentures.
Keywords	Purchase in Open Market, Own Debentures, Conversion, Conversion of Debentures into Shares, Redemption by Conversion, Conversion of Debentures into new Debentures

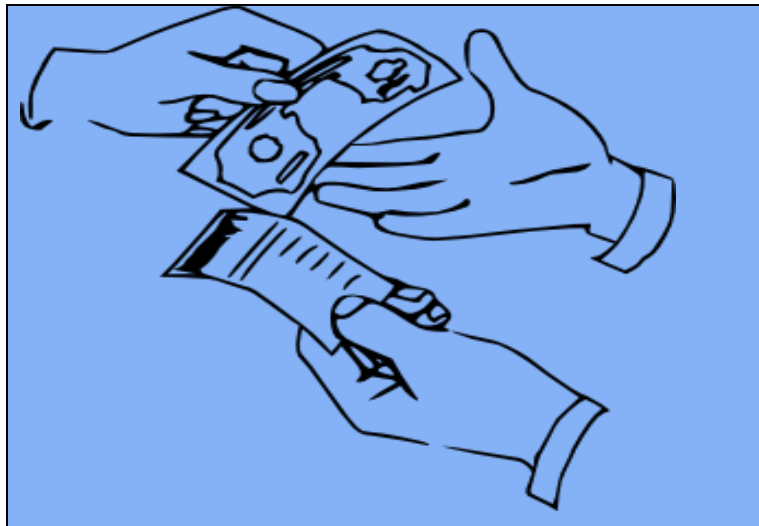
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1. **Redemption of Debentures by Purchase in Open Market - Concept**



A company can purchase its own debentures in the open market if its ‘Article of Association’ provides for it. When it purchases its own debenture and then cancels them, it is termed as ‘Redemption by Purchase in the Open Market’.

Now a question can arise in your mind that why will a company buy back its own debentures?

Answer to this question lies in the points mentioned herein:

- ⇒ A company can buy its own debentures if these are available in the market at a price lower than its nominal value i.e. at a discount.
- ⇒ It can buy back its own debentures even at a value higher than nominal value if the market rate of interest is lower than the agreed rate of interest i.e. Coupon Rate of debentures.

⇒ Moreover, under this option company can buy its own debentures and redeem them at its convenience whenever it has surplus funds.

Note:

* In this method:

‘**PROFIT on Cancellation**’ is credited or transferred to **CAPITAL RESERVE A/C** &

‘**LOSS on Cancellation**’ (if any) is debited or transferred to ‘**Statement of Profit & Loss**’

* Just like ‘Lump Sum method’ and ‘Draw of Lots method’, even in this method companies are required to fulfil the criteria of **Debenture Redemption Reserve (DRR)** and **Debenture Redemption Investment (DRI)** if they fall in that category.

PROCEDURE FOR RECORDING REDEMPTION BY PURCHASE IN OPEN MARKET

Under this method, following journal entries are passed to record the purchase and cancellation of debentures:

Case A) When debentures are purchased from the market at a discount and then cancelled:

STEP 1 - Purchase of own debentures for immediate cancellation

JOURNAL (Alternative 1)

DATE	PARTICULARS	LF	DR. Amt. in ₹	CR. Amt. in ₹
	% Debentures A/c Dr. To Bank A/c To Profit on Redemption of Debentures A/c (..... Own debentures of ₹....each purchased at and cancelled.)			

OR

JOURNAL (Alternative 2)

DATE	PARTICULARS	LF	DR. Amt. in ₹	CR. Amt. in ₹
	Own Debentures A/c Dr. To Bank A/c (..... Own debentures of ₹....each purchased at)			

	% Debentures A/c Dr. To Own Debentures A/c To Profit on Redemption of Debentures A/c (.....% Debentures redeemed by cancelling own debentures.) <hr/>			

STEP 2 - Transfer of Profit on Redemption to Capital Reserve

JOURNAL

DATE	PARTICULARS	LF	DR. Amt. in ₹	CR. Amt. in ₹
	Profit on Redemption of Debenture A/c Dr. To Capital Reserve A/c (Profit on cancellation of own debentures transferred to Capital Reserve.)			

Case B) When debentures are purchased from the market at a higher price & then cancelled:

In case, the debentures are purchased from the market at a price which is above the nominal value (face value) of debenture, the excess will be debited to 'Loss on Redemption of Debentures'.

Despite loss on purchase, companies can prefer it if it cuts or reduces their Interest Cost.

STEP 1 - Purchase of own debentures for immediate cancellation

JOURNAL (Alternative 1)

DATE	PARTICULARS	LF	DR. Amt. in ₹	CR. Amt. in ₹
	% Debentures A/c Dr. Loss on Redemption of Debentures A/c Dr. To Bank A/c (..... Own debentures of ₹....each purchased at and cancelled.) <hr/>			

OR
JOURNAL (Alternative 2)

DATE	PARTICULARS	LF	DR. Amt. in ₹	CR. Amt. in ₹
	Own Debentures A/c Dr. To Bank A/c			
	(..... Own debentures of ₹....purchased at)			
	% Debentures A/c Dr. Loss on Redemption of Debentures A/c Dr. To Own Debentures A/c			
	(.....% Debentures redeemed by cancelling own debentures.)			

STEP 2 - Transfer of Loss on Redemption to Statement of Profit & Loss

JOURNAL

DATE	PARTICULARS	LF	DR. Amt. in ₹	CR. Amt. in ₹
	Statement of Profit and Loss Dr. To Loss on Redemption of Debentures A/c			
	(Loss on cancellation of own debentures transferred to Statement of Profit & Loss.)			

2. Purchase of Own Debentures

Purchase for Own Debentures for Immediate Cancellation

Illustration 1 - Xylophone Housing Finance Ltd. which is registered with National Housing Bank purchased its own debentures of ₹100 each of the face value of ₹20,000, from the open market for cancellation, at ₹92 each.

Record necessary journal entries.

On 31.03.2020, company purchased for cancellation debentures of the face value of ₹80,000 at ₹950 per debenture and of the face value of ₹1,20,000 at ₹900 per debenture.

Pass journal entries for the first two years. (Ignore Interest on Debentures.)

* An unlisted company is required to fulfil the conditions of DRR & DRI.

Solution:

JOURNAL

DATE	PARTICULARS	LF	DR. Amt. in ₹	CR. Amt. in ₹
2018 Apr 1	Bank A/c Dr. To 8% Debentures Application & Allotment A/c (Debentures application money received)		9,60,000	9,60,000
Apr 1	8% Debentures Application & Allotment A/c Dr. Discount on Issue of Debentures A/c Dr. To 8% Debentures A/c (Debentures application money transferred to Debentures A/c)		9,60,000 40,000	10,00,000
2019 Mar 31	Statement of profit and loss Dr. To Discount on Issue of Debenture A/c (Discount on issue of debentures written-off.)		40,000	40,000
2019 Mar 31	Surplus i.e. Balance in Statement of P & L Dr. To Debenture Redemption Reserve A/c (Profit equal to 10% of ₹10,00,000 the nominal value, transferred to Debentures Redemption Reserve A/c) <i>* Assuming that company fulfilled the condition of DRR on 31st March of the year immediately preceding the year when redemption begins.</i>		1,00,000	1,00,000
2019 Apr 1	Debenture Redemption Investment A/c Dr. To Bank A/c (An amount equal to 15% of ₹2,00,000 nominal value of debentures due for redemption, invested in specified Securities.)		30,000	30,000
2020 Mar 31	Bank A/c Dr. To Debenture Redemption Investment A/c		30,000	30,000

		(DRI Securities realized for redemption of 200 debentures.)			
2020	8% Debentures A/c	Dr.	80,000		
Mar 31	To Bank A/c				
	To Profit on Redemption of Debenture A/c				76,000
	(Redemption of 80 debentures of face value ₹80,000 by purchasing @ ₹950 per debenture.)				4,000
Mar 31	8% Debentures A/c	Dr.	1,20,000		
	To Bank A/c				
	To Profit on Redemption of Debentures A/c				1,08,000
	(Redemption of 120 debentures of nominal value ₹1,20,000 @ ₹900 by purchasing in open market.)				12,000
Mar 31	Profit on Redemption of Debentures A/c	Dr.	16,000		
	To Capital Reserve A/c				
	(Transfer of profit on cancellation of debentures to Capital Reserve.)				16,000
Mar 31	Debenture Redemption Reserve A/c	Dr.	20,000		
	To General Reserve A/c				
	(10% of the nominal value of debentures redeemed i.e. Proportionate amount transferred from DRR A/c to General Reserve A/c.)				20,000

3. Redemption Either by 'Purchase in Open Market' or 'By Draw of Lots'

Sometimes a company can decide to redeem debentures of a certain amount of face value every year either by 'Purchase in Open Market' or by 'Draw of Lots'.

- Even in this case companies are required to fulfil the conditions related to 'Debenture Redemption Reserve' and 'Debenture Redemption Investment'. (If they fall in that category)

Example,

Vidya Educational Services Ltd., a listed company, decided to redeem 250, 9% debentures of ₹100 each amounting to ₹25,000. For this purpose, the company purchased debentures amounting to ₹20,000 in the open market at ₹98.50 each. Expenses of ₹100 were incurred in this process. The balance of debentures amounting to ₹5,000 were redeemed by draw of lots. Journalise.

Books of Vidya Educational Services Ltd.

JOURNAL

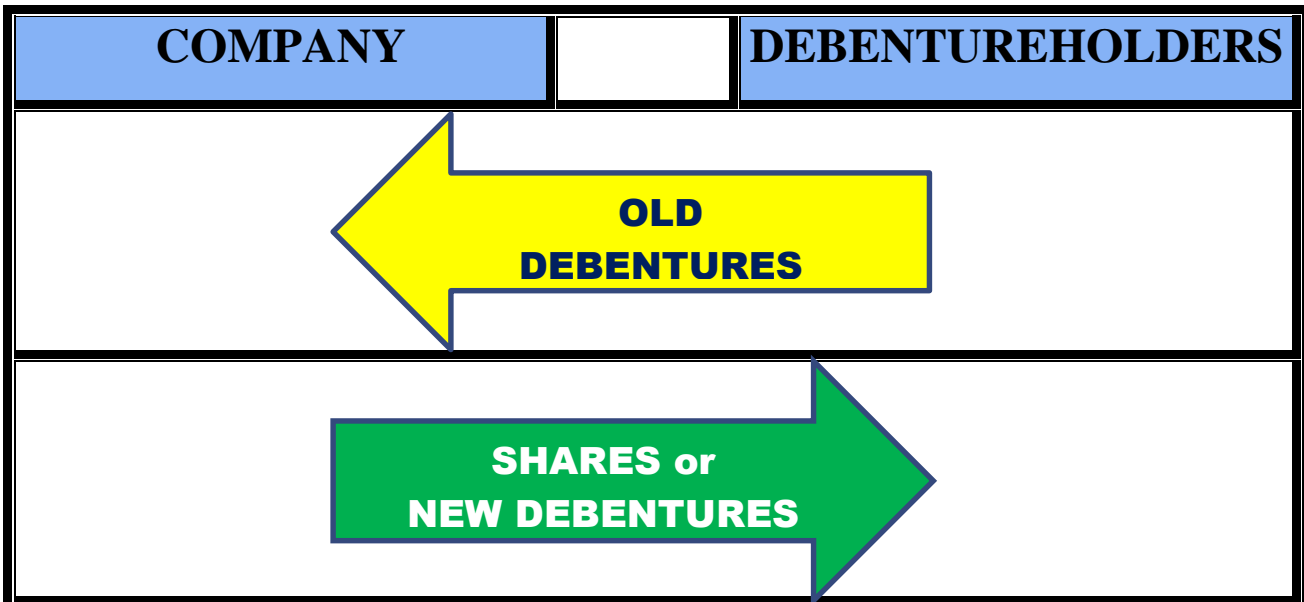
DATE	PARTICULARS	LF	DR. Amt. in ₹	CR. Amt. in ₹
April 1 (Year of Redemption)	Debenture Redemption Investment A/c Dr. To Bank A/c (15% of ₹25,000 the nominal value of debentures invested in Specified Securities.)		3,750	3,750
Date of Redemption	Bank A/c Dr. To Debenture Redemption Investment A/c (DRI encashed at the time of redemption of debentures)		3,750	3,750
Date of Redemption of Own Debentures by Cancellation	Redemption by Purchase in Open Market 9% Debentures A/c Dr. To Bank A/c (Cost to the Company) To Profit on Redemption of Debentures A/c (Purchase of 200 debentures @ ₹98.50 plus expenses amounting to ₹100.)		20,000	19,800 200
Date of Redemption	[Cost to the Company = 200 x 98.50 + 100] * Expenses incurred are added in purchase price.			
Date of Redemption	Profit on Redemption of Debentures A/c Dr. To Capital Reserve (Profit on Redemption transferred to Capital Reserve.)		200	200
Date of Redemption	Redemption by Draw of Lots: 9% Debentures A/c Dr. To Debentureholders A/c		5,000	5,000

	(50 debentures of nominal value ₹5,000 redeemed by draw of lots.)			
	<div style="display: flex; justify-content: space-between;"> 9% Debentures A/c Dr. </div> <div style="text-align: center; margin-top: 5px;">To Bank A/c</div>		5,000	5,000
	(50 debentures of nominal value ₹5,000 redeemed by draw of lots.)			

Note:

A listed company is not required to create DRR but it has to invest 15% of nominal value of debentures (due for redemption) in Specified Securities.


4. Redemption of Debentures by Conversion – Concept



** It is a kind of Barter Exchange of Old Debentures with Shares or New Debentures.*

If terms of issue provides, a company can also redeem its debentures by converting them into shares or a new class of debentures.

⇒ If debentureholders find that the offer is beneficial to them, they can exercise their right of converting their debentures into shares or new class of debentures.

	<p>In this case new Shares or Debentures can be issued: <u>At Par</u> or <u>At Premium</u></p> <p>* New debentures can be issued at discount also.</p>
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⇒ Here it is important to note that only **Actual Proceeds** i.e. the actual amount received towards the Face Value of original/old debentures has to be redeemed should be considered for ascertaining the number of Shares or new debentures to be issued.

To have a clear idea let us go through the following situations:

Situation 1 - If 1,000 9% Debentures of ₹100 each were issued at par

Actual Proceeds towards Face Value of Debentures are $1,000 \times 100 = ₹ 1,00,000$

Situation 2 - If 1,000 9% Debentures of ₹100 each were issued at 10% discount

Actual Proceeds towards Face Value of Debentures are $1,000 \times 90 = ₹ 90,000$

Situation 3 - If 1,000 9% Debentures of ₹100 each were issued at 20% premium

Actual Proceeds towards Face Value of Debentures are $1,000 \times 100 = ₹ 1,00,000$

Important to Note:

- i. Conditions of DRR & DRI are not required to be fulfilled for Convertible Debentures and for convertible part of Partially Convertible Debentures.
- ii. Actual Proceeds are considered only if Debentures are Converted into Shares before maturity date.
- iii. If Debentures are Converted into shares on the maturity date then we will take amount as per the condition of Redemption.

PROCEDURE FOR RECORDING REDEMPTION BY CONVERSION INTO SHARES

Under this method, following journal entries are passed to record the cancellation of old debentures and issue of Shares:

STEP 1 – Cancellation or Redemption of Old Debentures

JOURNAL

DATE	PARTICULARS	LF	DR. Amt. in ₹	CR. Amt. in ₹
	Redemption of old Debentures - Originally issued at Par			
	% Debentures A/c Dr. To Debentureholders A/c (.....% Debentures of ₹... each due for redemption.)			
	OR			
	Redemption of old Debentures - Originally issued at Premium			

On March 31, 2020, debentureholders holding 2,000, 9% debentures opted for converting their debentures into Equity shares. Give the necessary Journal entries for conversion.

Books ofLtd.

JOURNAL

DATE	PARTICULARS	LF	DR. Amt. in ₹	CR. Amt. in ₹
2020 Mar 31	6% Debentures A/c Dr. To Debentureholders A/c		2,00,000	184,000
	To Statement of Profit & Loss (Written off discount)			16,000
	(Amount due to debentureholders on redemption of 2,000 debentures of ₹100 each issued at ₹92 each.)			
	<i>* In case of Conversion into shares before maturity date</i>			
Mar 31	<i>Discount or Loss on Issue is cancelled.</i>		1,84,000	
	Debentureholders A/c Dr. To Equity Share Capital A/c (New equity shares issued to debentureholders)			1,84,000
	No. of shares = Net Proceeds of Debentures / Issue Price of Share			
	No. of shares = 1,84,000 / 20 or 9,200			

Note: In case of redemption by conversion, DRR & DRI are not required

4.2 Redemption by Conversion into a New Class of Debentures - Illustration

Illustration 4 - Alloy Products Limited redeemed 1,000, 6% debentures of ₹100 each by converting them into 15% Debentures of ₹10 each at a premium of ₹2.50 per share.

Give the necessary journal entries.

Solution:

Books of Alloy Products Limited

JOURNAL

DATE	PARTICULARS	LF	DR. Amt. in ₹	CR. Amt. in ₹
	6% Debentures A/c (Old) Dr. To Debentureholders A/c		1,00,000	1,00,000
	(Amount on 1,000 6% debentures of ₹ 100 each due to debentureholders)			
	Debentureholders A/c Dr. To 15% Debentures A/c (New) [8,000 x 10] To Securities Premium Reserve A/c [8,000 x 2.50]		1,00,000	80,000 20,000
	(Issue of 8,000 15% Debentures of ₹ 10 each at a premium of ₹2.50)			
	Working Notes: No. of New Debentures = $\frac{\text{Amount Payable on Old Debentures}}{\text{Issue Price of New Debentures}}$ No. of New Debentures = $1,00,000 / (10 + 2.50)$ No. of New Debentures = $1,00,000 / 12.50 = 8,000$			

Illustration 5 - Novel Corona Vaccine Limited, an unlisted company redeemed 1,200, 10% debentures of ₹500 each by converting them into 18% Debentures of ₹200 each at a discount of 25%.

Give the necessary journal entries.

Solution:

Books of Novel Corona Vaccine Ltd.

JOURNAL

DATE	PARTICULARS	LF	DR. Amt. in ₹	CR. Amt. in ₹
	6% Debentures A/c (Old) Dr. To Debentureholders A/c		6,00,000	6,00,000
	(Amount on 1,200 10% debentures of ₹ 500 each due to debentureholders.)			

Dr.**7% Debentureholders Account****Cr.**

Date	Particulars	Amt. (₹)	Date	Particulars	Amt. (₹)
2020 Mar 31	To Bank A/c	50,00,000	2020 Mar 31	By 7% Debenture A/c	50,00,000
		50,00,000			50,00,000

Dr.**Debentures Redemption Reserve Account****Cr.**

Date	Particulars	Amt. (₹)	Date	Particulars	Amt. (₹)
2019 Mar 31	To Balance C/d	5,00,000	2019 Mar 31	By Surplus i.e. Balance in Statement of P & L	5,00,000
		5,00,000			5,00,000
2020 Mar 31	To General Reserve A/c	5,00,000	2019 April 1	By Balance B/d	5,00,000
		5,00,000			5,00,000

Dr.**Debenture Redemption Investment Account****Cr.**

Date	Particulars	Amt. (₹)	Date	Particulars	Amt. (₹)
2019 April 1	To Bank A/c (Purchase)	7,50,000	2020 Mar 31	By Bank A/c (Sale)	7,50,000
		7,50,000			7,50,000