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**DEPARTMENT OF COMMERCE**

**JANTA KOSHI COLLEGE BIRAU, DARBHANGA**

**For – LNMU B. Com part -2 ,PAPER -IV CORPORATE  
ACCOUNTING (Hons.)**

**Lecture -4 unit-1**

**Accounting for shares and Debentures**



**Easy to Understand the concept**

## Redemption of Debentures

**Q.1 What are different method of Redemption of Debentures? Explain with Accounting entries.**

**Ans.:** The following are the important methods of redemption of debentures :-

**(1) By payment in one lump sum**

**(i) Out of capital or issue of new debentures or shares**

**(ii) Out of accumulated profits**

**(2) By annual drawings**

**(3) By purchase in open market, and**

**(4) By conversion in shares and Debentures**

**(1) By Payment in One Lump-Sum**

**(i) Redemption Out of Capital:** When the amount of debentures to be redeemed is small, this method of redemption out of capital is followed. In this method company issue new shares or debentures for making arrangement of funds for redemption. Journal entries for issuing shares and debentures will be passed as discussed earlier.

**Journal entries for redemption are as follows :-**

### **Redemption at par:**

Debentures A/c Dr.

To Bank A/c

(Debentures redeemed at par)

### **Redemption at premium:**

1) Debentures A/c Dr.

Premium on Redemption Of Debenture A/c Dr.

To Bank

2) P&L or Securities premium A/c. Dr

To Premium on Redemption of Debentures A/c

(Premium on redemption of Debentures written off)

### **Redemption at discount:**

1) Debentures A/c Dr.

To Bank A/c

To Profit on Redemption of Debentures A/c

(Debentures redeemed at discount)

**2) Profit on Redemption of Debentures A/c Dr.**

**To Capital Reserve A/c**

**(Profit on redemption transferred)**

**(ii) Redemption Out of Profits :** When adequate amount of Profits is transferred from P&L A/c to the debenture Redemption reserve account, at the time of redemption of Debentures. Such redemption is known as redemption out of Profits. In addition to the entries explain in case of Redemption out of capital,

**The following entry is passed Every year for the transfer to redemption reserve.**

**Profit & Loss Appropriation A/c Dr.**

**To Debenture Redemption Reserve A/c**

**(Annual Installment transferred)**

**Note: A Company has to create DRR in case of Issue of debenture With maturity of more than 18 month, equivalent to 50% of the Amount of debenture issue before debenture redemption Commences).**

**This reserve is transferred to General Reserve after the redemption**

## **Of debentures is completed:-**

### **Journal Entry :**

**Debenture Redemption Reserve (DRR) A/c Dr.**

**To General Reserve A/c**

**(Balance of debenture redemption fund transferred to general reserve  
After redemption)**

**(2) Redemption by Annual Drawings:** If debentures are to be Redeemed by Annual drawings the debentures for redemption are Selected by lottery or drawings. Debenture account is debited with The amount of face value of debentures and debenture holder Account is credited. On actual payment debenture holders account Is debited and Bank account is credited.

**(3) Redemption of Debentures by Purchasing in Open Market:** If a Company has right to purchase its own debentures under the terms And conditions of issue, then the company may purchase its own Debentures for :-

- (i) Direct Cancellation**
- (ii) for investment in debentures**

**(i) Purchase of Own Debentures for Cancellation: Following**

Entry will be passed :-

Debentures A/c Dr.

To Bank A/c

. To Profit on Redemption of Debentures A/c

(Own debentures cancelled by purchases in the open market)

This profit is capital profit and transferred to capital reserve.

**(ii) Purchase of Company's Own Debentures for Investment:**

When adequate additional funds are accumulated in the Company; which are not deployed profitably the company May purchase its own debentures so that interest payable on Such debentures may be saved. This decision will be taken By company if its debentures are available in open market at Discount:-

**(A) Journal Entry for Purchase of Own Debentures:**

Own Debentures A/c Dr. (with the purchase price)

To Bank A/c

**(B) Resale of Own Debenture kept for Investment at a Profit :**

**(a) Bank A/c Dr.**

**To Own Debentures A/c**

**To Profit on Resale of Own Debentures A/c**

**(b) In case of loss,**

**“Loss on Resale of own Debenture A/c“ will be debited.**

**(C) Cancellation of Own Debentures kept for Investment (at a Profit) :**

**(a) Debentures A/c Dr.**

**To Own Debentures A/c**

**To Profit on Cancellation of Own Debentures A/c**

**(b) In case of loss, loss on cancellation of own Debentures A/c will be debited.**

**(4) Redemption of Debentures by Conversion:** Redemption by Conversion means redeeming the debentures by converting them

**Into new class of debentures or shares:**

**The following entries are passed :-**

**(i) Debentures A/c Dr.**

**To debenture holders A/c**

**(Transfer of the balance of debentures to debenture holder on Conversion)**

**(ii) At Par:**

**Debenture Holder A/c Dr.**

**To Share Capital A/c**

**Or To New Debenture A/c**

**Or To Bank A/c**

**(Debentures converted and paid off at par)**

**(iii) At Premium**

**Debenture Holder A/c Dr.**

**To Securities Premium A/c**

**Or To Share Capital A/c**

**Or To New Debentures A/c**



**(iv) At Discount:**

Debenture Holders A/c Dr.

Discount on Issue of Share A/c Dr.

Discount on Issue of Debenture A/c Dr.

To Share Capital A/c

Or To New Debentures A/c

(Debentures converted into shares and debentures at Discount)

**Q.2 Explain Redemption of Debentures by Creative Sinking Fund. Also Show the Accounting Entries.**

Ans.: Debentures has to be redeemed after the expiry of specified period. If Proper provision is not made, then there will be no strain on working Capital and the company may face liquidity crises.

At Par collecting funds for redemption of debenture a sinking fund is created By making a charge against divisible profits. Every year an equal amount Is debited to P&L Appropriation Account and simultaneously credited to Sinking fund account. The amount so appropriated is invested outside the Business in marketable securities.

**Sinking fund may be of the following two types : -**

- (1) **Cumulative Sinking Fund** : When the amount appropriated is Allowed to accumulate at a compound interest, so as to generate the Amount required to redeem debentures on the date of redemption, It is called cumulative sinking fund.

**Journal Entries :**

At the End of First Year :

- (i) **Amount to be Appropriated Annually Out of Profits :**

Profit & Loss Appropriation A/c Dr.

To Debentures Sinking Fund A/c

(Annual sum transferred to debenture sinking fund A/c)

- (ii) **Amount to be Invested :**

Debenture Sinking Fund Investment A/c Dr.

To Bank A/c

**After First Year :**

**(i) Interest on Investments :**

**Bank A/c Dr**

**To debenture sinking fund A/c**

**(Interest received on Sinking fund Investment A/c)**

**(ii) Annual Installment to be Appropriated :**

**Profit & Loss Appropriation A/c Dr.**

**To Debenture Sinking Fund A/c**

**(iii) Annual Installment & Interest Invested :**

**Debentures Sinking Fund Investment A/c Dr.**

**To Bank A/c**

**Last Year (When Debentures are to be Redeemed) :**

**(i) Interest of Accumulated Investment Received :**

**Bank A/c Dr.**

**To Debenture Sinking Fund A/c**

**(ii) Transfer of Annual Installment :**

**Profit & Loss Appropriation A/c Dr.**

**To Debenture Sinking Fund A/c**

**(iii) Sale of Sinking fund Investment :**

**Bank A/c Dr.**

**To Debenture Sinking fund investment A/c**

**(iv) Profit on Sale of Investment :**

**Debenture Sinking Fund Investment A/c Dr.**

**To Debenture Sinking Fund A/c**

**In case of loss reverse entry will be passed :-**

**Debenture sinking fund A/c. Dr.**

**To Debenture sinking fund investment A/C**

**(v) Payment of Debentures :**

**Debentures A/c Dr.**

**To Bank A/c**

**(vi) Balance of Sinking Fund Transferred :**

**Debenture Sinking fund A/c Dr.**

**To General Reserve A/c**

**(2) Non-Cumulative Sinking Fund :** Under this method of Sinking Fund, the amount is appropriated when there are adequate profits.

**The amount so appropriation will be uniform each year.**

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