Redemption of Debentures

Standard difficulty · 20 questions · 40 marks · Time: 43 minutes

Name: _____ Date: _____ Score: ____ / 40

Show your working for Sections B and C. Answers are on the last page — try every question first!

Section A — Choose the correct answer — 8 × 1 = 8 marks

1. A profit made on cancelling own debentures bought below their face value is transferred to:
(a) the Statement of Profit and Loss as revenue
(b) Securities Premium
(c) General Reserve
(d) Capital Reserve

2. What is meant by “draw of lots”?
(a) choosing at random which debentures are repaid in an instalment
(b) repaying debentures without keeping back any profit for the purpose
(c) specified securities or deposits bought by 30 April for the debentures maturing that year
(d) a company’s debentures that it has bought back from the market

3. On redemption of debentures, what happens to loss on buying own debentures above their face value?
(a) credited to Securities Premium
(b) credited to Debentureholders A/c
(c) transferred to Capital Reserve
(d) written off to the Statement of Profit and Loss

4. Brightway Ltd, an ‘other unlisted’ company, has 18,000 11% Debentures of ₹100 each, all due for redemption on 31 March next year. What is the minimum Debenture Redemption Reserve it must have?
(a) ₹1,80,000 **(b)** ₹90,000 **(c)** ₹2,70,000 **(d)** ₹4,50,000

5. Meadow Ltd has 11,500 8% Debentures of ₹50 each, redeemable at a premium of 5% in 5 equal annual instalments by draw of lots, the first at the end of the first year. Interest is paid yearly on the debentures outstanding. What is the interest for the second year?
(a) ₹9,200 **(b)** ₹36,800 **(c)** ₹46,000 **(d)** ₹27,600

6. Maple Ltd must redeem 60 debentures of ₹1,000 each on 31 March of the first year and 590 on 31 March of the second year. It made the required Debenture Redemption Investment by 30 April before the first redemption and has kept it. What must it do by the next 30 April, before the second redemption?
(a) invest a further ₹79,500 **(b)** realise the whole ₹9,000
(c) realise ₹79,500 of the investment **(d)** invest a further ₹88,500

7. Riverstone Ltd redeemed its 11,300 11% Debentures of ₹100 each at par by converting them into equity shares of ₹100 each at a premium of ₹25 each. How many shares were issued?
(a) 9,040 shares **(b)** 9,140 shares **(c)** 11,300 shares **(d)** 18,080 shares

8. Hilltop Ltd bought 1,100 of its own 12% Debentures of ₹100 each in the open market at ₹102 each, paying expenses of ₹500, and cancelled them at once. What is the result of the cancellation, and how is it treated?

(a) loss of ₹2,700, transferred to Capital Reserve

(b) loss of ₹2,700, transferred to General Reserve

(c) profit of ₹2,700, transferred to Capital Reserve

(d) loss of ₹2,700, written off to the Statement of Profit and Loss

Section B — Short answer — 8 × 2 = 16 marks

9. What is meant by redemption of debentures?

10. Explain each term used in redemption of debentures: (a) redemption out of capital (b) Debenture Redemption Reserve

11. Brightway Ltd, an ‘other unlisted’ company, has 12,800 9% Debentures of ₹100 each due for redemption on 31 March next year. Find the minimum (a) Debenture Redemption Reserve (b) Debenture Redemption Investment to be made by 30 April.

12. Maple Ltd bought 17,700 of its own 11% Debentures of ₹100 each in the open market at ₹99 each, and cancelled them at once. Pass the journal entries.

13. Hilltop Ltd redeemed its 13,300 12% Debentures of ₹100 each at a premium of 10% by converting them into equity shares of ₹20 each at a premium of ₹5 each. Pass the journal entries.

14. Greenleaf Ltd bought 7,300 of its own 10% Debentures of ₹100 each in the open market at ₹90 each, paying expenses of ₹2,000, and cancelled them at once. How much is transferred to Capital Reserve?

15. Brightway Ltd has 7,000 10% Debentures of ₹100 each, redeemable at a premium of 10% in 5 equal annual instalments by draw of lots, the first at the end of the first year. Find (a) the number of debentures redeemed each year (b) the amount paid to debentureholders on each redemption, leaving out interest.

16. Brightway Ltd redeemed its 12,000 12% Debentures of ₹100 each at a premium of 5% by converting them into new 10% Debentures of ₹100 each at par. Find the number of debentures issued.

Section C — Word problems — 4 × 4 = 16 marks

17. Distinguish between redemption of debentures out of capital and out of profits.

18. Skylark Ltd, an ‘other unlisted’ company, has 900 10% Debentures of ₹1,000 each, redeemable at a premium of 5%, due for redemption in a lump sum on 31 March. Pass the journal entries for the Debenture Redemption Reserve required, the Debenture Redemption Investment made by 30 April and its encashment, the amount due on redemption, the payment and the transfer of the reserve after redemption.

19. Greenleaf Ltd, an ‘other unlisted’ company, decided to redeem 5,700 11% Debentures of ₹100 each at par. It created the required Debenture Redemption Reserve, made the required Debenture Redemption Investment and encashed it at redemption. It bought 3,300 of the debentures in the open market at ₹90 each, with expenses of ₹1,500, and cancelled them; the rest were redeemed at par by draw of lots. Pass the journal entries.

20. Seabreeze Ltd has 3,400 8% Debentures of ₹100 each, redeemable at par in 2 equal annual instalments by draw of lots, the first at the end of the first year. Interest is paid yearly on the debentures outstanding during the year. Find (a) the number of debentures redeemed each year (b) the interest for the first year (c) the interest for the last year (d) the total paid to debentureholders at the end of the first year, including interest.

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Answer key

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Q	Answer	Working
1	**(d) Capital Reserve**	—
2	**(a) choosing at random which debentures are repaid in an instalment**	—
3	**(d) written off to the Statement of Profit and Loss**	—
4	**(a) ₹1,80,000**	10% × ₹18,00,000
5	**(b) ₹36,800**	(11,500 − 2,300) × ₹50 × 8/100
6	**(a) invest a further ₹79,500**	required: 15% × ₹5,90,000 = ₹88,500; held: ₹9,000
7	**(a) 9,040 shares**	amount due ₹11,30,000; ÷ ₹125 = 9,040
8	**(d) loss of ₹2,700, written off to the Statement of Profit and Loss**	face value ₹1,10,000; cost 1,100 × ₹102 + ₹500 = ₹1,12,700; loss ₹2,700
9	**Repaying the debenture holders as the terms of issue require, which discharges the company's debt on the debentures.**	—
10	**(a) repaying debentures without keeping back any profit for the purpose (b) a reserve built out of profits so that funds are kept back for repaying debentures**	—
11	**(a) ₹1,28,000; (b) ₹1,92,000**	(a) 10% × ₹12,80,000 (b) 15% × ₹12,80,000
12	**(i) 11% Debentures A/c Dr. ₹17,70,000** **To Bank A/c ₹17,52,300** **To Profit on Redemption of Debentures A/c ₹17,700** **(own debentures bought and cancelled)** **(ii) Profit on Redemption of Debentures A/c Dr. ₹17,700** **To Capital Reserve A/c ₹17,700** **(profit on cancellation transferred to capital reserve)**	face value ₹17,70,000; cost 17,700 × ₹99 = ₹17,52,300; profit ₹17,700 is a capital profit
13	**(i) 12% Debentures A/c Dr. ₹13,30,000** **Premium on Redemption of Debentures A/c Dr. ₹1,33,000** **To Debentureholders A/c ₹14,63,000** **(amount due on redemption)** **(ii) Debentureholders A/c Dr. ₹14,63,000** **To Equity Share Capital A/c ₹11,70,400** **To Securities Premium A/c ₹2,92,600**	amount due ₹13,30,000 + ₹1,33,000 = ₹14,63,000; ÷ ₹25 = 58,520

Q	Answer	Working
	(58,520 equity shares of ₹20 each issued at a premium of ₹5 each)	
14	**₹71,000**	face value ₹7,30,000; cost 7,300 × ₹90 + ₹2,000 = ₹6,59,000; profit ₹7,30,000 − ₹6,59,000
15	**(a) 1,400 debentures; (b) ₹1,54,000**	(a) 7,000 ÷ 5 (b) 1,400 × ₹100 × 110/100
16	**12,600 debentures**	amount due ₹12,00,000 + ₹60,000 = ₹12,60,000; ÷ ₹100 = 12,600
17	**Out of capital: the company repays without keeping back any profit, so the profit available for dividend is untouched; listed companies, banks, NBFCs and housing finance companies may do this. Out of profits: profit is first moved to Debenture Redemption Reserve, which keeps funds in the business for the repayment and is moved to General Reserve once the debentures are repaid.**	—
18	**(i) Surplus, i.e. Balance in Statement of Profit and Loss A/c Dr. ₹90,000** **To Debenture Redemption Reserve A/c ₹90,000** **(DRR of 10% of the outstanding debentures)** **(ii) Debenture Redemption Investment A/c Dr. ₹1,35,000** **To Bank A/c ₹1,35,000** **(15% of the debentures maturing this year invested by 30 April)** **(iii) Bank A/c Dr. ₹1,35,000** **To Debenture Redemption Investment A/c ₹1,35,000** **(investment encashed for the redemption)** **(iv) 10% Debentures A/c Dr. ₹9,00,000** **Premium on Redemption of Debentures A/c Dr. ₹45,000** **To Debentureholders A/c ₹9,45,000** **(amount due on redemption)** **(v) Debentureholders A/c Dr. ₹9,45,000** **To Bank A/c ₹9,45,000** **(payment to debentureholders)** **(vi) Debenture Redemption Reserve A/c Dr. ₹90,000** **To General Reserve A/c ₹90,000** **(DRR transferred after redemption)**	DRR 10% × ₹9,00,000 = ₹90,000; DRI 15% × ₹9,00,000 = ₹1,35,000; amount due ₹9,45,000
19	**(i) Surplus, i.e. Balance in Statement of Profit and Loss A/c Dr. ₹57,000** **To Debenture Redemption Reserve A/c ₹57,000** **(DRR of 10% of the debentures)** **(ii) Debenture Redemption Investment**	DRR ₹57,000, DRI ₹85,500; cost 3,300 × ₹90 + ₹1,500 = ₹2,98,500, profit ₹31,500; by lots 2,400 × ₹100

Q	Answer	Working
	A/c Dr. ₹85,500 **To Bank A/c ₹85,500** **(15% invested)** **(iii) Bank A/c Dr. ₹85,500** **To Debenture Redemption Investment A/c ₹85,500** **(investment encashed)** **(iv) 11% Debentures A/c Dr. ₹3,30,000** **To Bank A/c ₹2,98,500** **To Profit on Redemption of Debentures A/c ₹31,500** **(own debentures bought and cancelled)** **(v) Profit on Redemption of Debentures A/c Dr. ₹31,500** **To Capital Reserve A/c ₹31,500** **(capital profit transferred)** **(vi) 11% Debentures A/c Dr. ₹2,40,000** **To Bank A/c ₹2,40,000** **(debentures redeemed by draw of lots)** **(vii) Debenture Redemption Reserve A/c Dr. ₹57,000** **To General Reserve A/c ₹57,000** **(DRR transferred after redemption)**	
20	**(a) 1,700 debentures; (b) ₹27,200; (c) ₹13,600; (d) ₹1,97,200**	(a) 3,400 ÷ 2 (b) 3,400 × ₹100 × 8/100 (c) 1,700 × ₹100 × 8/100 (d) ₹1,70,000 + ₹27,200