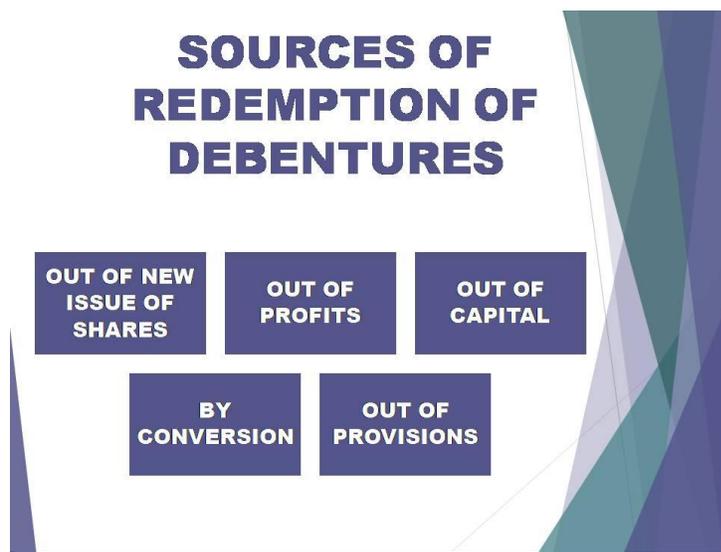


# Redemption of Debentures

Redemption of debentures refers to the repayment of these debentures by the company to the debenture holders. So the company will discharge its liability and remove it from the balance sheet. This is a major transaction for the company since the amount of money involved tends to be quite significant.

## Sources of Funds for Redemption of Debentures:



### *1. Redemption of Debentures out of Capital:*

Under this method the company may dispose off some fixed asset and may use the sale proceeds for redemption of debentures. However, it is a very unusual source of finance and is rarely followed. Again the company may utilize its working capital to redeem the debentures. This adversely affects the working capital of the company. In either case, the assets of the company are reduced. However, in view

of the legal provisions with regard to creation of DRR, redemption of debentures purely out of capital is not possible.

## ***2. Redemption of Debentures out of Profits:***

Redemption of debenture out of profits implies that an amount equal to the face value of the debentures redeemed is transferred to DRR. Thus, a part of the profits of company are withheld from distribution to shareholders.

There are a few ways in which this redemption of debenture can take place. These methods all have different accounting treatment as well. So let us take a look at the various methods of redemption of debentures.

### **Lump Sum Method**

This method as the name suggests is a one-time payment method. Here the company will repay the whole amount in one lump sum payment to the debenture holders. The amount and the date of the payment will be according to the terms of issue.

Since the company knows the date of the repayment in advance they can plan their finances accordingly. So they make provisions to pay the debenture holders. So as per the provisions of the Companies Act and the SEBI guidelines the company has to make provisions for such a debenture. And hence the company sets up a special account known as the Debenture Redemption Reserve.

### **The Debenture Redemption Reserve**

This debenture redemption reserve is a capital reserve account. It is funded by the divisible profits of each year, i.e. a portion of the profits are set aside for this purpose. This account can only be utilized for the purpose of redemption of debentures and for no other purpose.



4	DRF Investement A/c .....Dr To Bank A/c ..... (Being amount invested in securities)		xxxx	Xxxx
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**The entries passed in the last year, i.e. the year of redemption**

S.no	Particular		Amount	Amount
1	Bank A/c.....Dr To DRF Investement A/c.. (Being investment sold)		xxxx	xxxx
2	Profit & Loss Appropriation A/c .....Dr To Debenture Redemption Fund A/c.... (Being amount of profit transfered)		xxxx	Xxxx
3	Debenture Redemption Fund A/c .....Dr To General Reserve A/c.. To Capital Reserve A/c.. (Profit on sale of investment)		xxxx	Xxxx xxxx