

## Objectives

At the end of this chapter, students should be able to:

- Explain the following loan capital terminologies;
  - Debentures
  - Mortgage
  - Interest
- Distinguish between shares and debentures;
- Prepare debenture account.

## 22.1 Introduction

Debentures like other related obligations such as long term loan and mortgages are means of raising capital by companies, as well as, by the various governmental units-, that is, federal, state and local government.

## 22.2 Debenture

Debenture may be defined as unsecured bond or note issued by a business or government.

Debentures like any other bond or note, is promissory note. It is a loan capital raised by a company. It is quite different from ownership shares.

Debenture is a formal (written) promise to pay a specified principal at a certain date in the future including interest. There are two parties to debentures; the investor, who holds the document which indicates claim in the future and the borrower (issuer) who owes the obligation to pay. Debenture interest payments are usually made semi-annually by the borrowing company. Interest is a debt due to the party who is holding the document known as debenture holder and is paid whenever it is outstanding. It must be paid or provided for before dividends are paid to shareholders.

## Types of Debentures

Debentures are of two types. These are

(i) Fixed debentures and floating debentures.

(ii) Fixed debentures are those debentures that are secured on fixed assets of the company.

Floating debentures are those that are secured on circulating assets like inventories:

where another party promises those to make payment on debentures if the issuing company fails to do so, the debentures are known as guaranteed debentures. A parent company for example, may guarantee payment of the debenture obligations issued by its subsidiaries.

Debentures can be transferred just like share capital through the normal way of share transfer. Therefore, documents are usually negotiated but like any other note, it is the wording on them that determines whether or not they are negotiable.

## 22.3 Mortgage

A mortgage is a collateral given upon property to secure a debt. The mortgage is not the debt itself but only the security given for the debt, should in case the borrower fails to pay or honour his obligations. A house, land, all kinds of property and even property rights may be mortgaged for the purpose of obtaining loan. Upon payment of debt, which a property was pledged as surety, the owner of such property regains full right to his property.

## 22.4 Interest and Principal

The mortgagor (a person who uses property as security to obtain loan) must make all payments of interest and principal whenever they become due. Most mortgages are paid by installment either monthly, semi-annually or annually. Other mortgages may demand payment of the entire principal at once. Should the mortgagor by default, fail to pay either the periodic payments of interest and the principal, or payment of interest only, the mortgagee has the right to foreclose or dispose of the property which was given as security.

## 22.5 Accounting for the Issue of Debentures

Debentures could be issued just like shares in a form of per value, at discount or at premium. Debenture are generally in the unit of N100 each, payable by installments. The entries in the company books are like issue of shares. A debenture holder is not a member of a company, but a creditor. A shareholder has right of ownership in a business, but debenture holder has none, except to the amount of loan and interest thereon.

### Example 22.1

Ekpo Electric (Nig) Plc had some financial needs and decided to look for a loan capital. The company on 1st April: 2010 offered 1,000 units, 5 percent debentures of N100 per unit payable as follows: N20 on application, N50 on allotment and the remaining N30 on June 2nd, 2010 as first and final call. The public subscribers applied and paid full application and allotment amount and the final call when due. The following

### Journal

Date	Particulars	Dr	Cr
19x2 April 1	Cash Debenture application Account Being receipt of cash on application for 1,000 units 5% debenture at N100 per unit	N 70,000	N 70,000
April 1	Debenture Application and Allotment 5% 70,000 debenture Account Being N20 on application N50 on Allotment of 1,000 units 5% debenture at N100 per unit	17,000	12,000
June 2	Cash Debenture first and final call Account Being receipt of cash for first and final call of N30 for 1,000 units 5% debenture at N30 per unit.	30 000	30,000 8 000
June 2	Debentures first and final call Account 5% debenture Account being final installment of N30 on 1,000 debenture Account		30 000

books will be necessary to record these transactions:

Now the journal has directed us to the appropriate books of accounts to be debited and the one to be credited. The books will look as follows:

### CASH ACCOUNT

Date	Particulars	Amount	Date	Particulars	Amount N
April 1	Debenture Appi. And Allotment	70,000			
June 2		30,000			

#### Debentures Application and Allotment Account

Date	Particulars	Amount N	Date	Particulars	Amount N
2010 April 1	5% debenture	70,000	2010 70,000	Cash	70,000

#### Call on Debentures Account

Date	Particulars	Amount N	Date	Particulars	Amount N
2010 April 1	5% debenture	30,000	2010 30,000	Cash	30,000

#### 5% Debentures Account

Date	Particulars	Amount N	Date	Particulars	Amount N
2010	5% debenture	30,000	2010 April 1	Debentures App and allotment	30,000
			June 2	debentures call	70,000
					30,000

Debentures issued at a premium debenture cannot be treated as a loan capital but as a profit and must be retained in the business. It should be shown separately on special heading as debenture premium under equity section of the balance sheet.

### Example 22.2

Owing to Ekpo electrical company PLC strong financial investments and prospects, it decided to offer the same 1,000 units 5% debenture at a premium of 2.00 per unit. That is, the per value plus N2.00 will be N102 payable in the following order: N20 on application, N52 on allotment and 30 on final call. These were fully complied with on due dates. The accounting

#### Journal

Date	Particulars	Dr. N	Cr. N
	Cash 5% Debenture Application and Allotment Account Being receipt of cash on application and allotment for 1,000 units 5% debenture at N102 per unit.	72,000	72,000
	Debenture Application and Allotment Acc. 5% Debentures Account Debenture Premium Account Being N20 on application N52 on allotment per debenture as per directors' resolution this date.	72,000	70,000 2,000
	Debentures Final Call Account 5% Debenture Account Being final installment of N30 on 1,000 units 5% debenture as per directors' resolution this date.	30,000	30,000
	Cash Debenture Final Call Account Being receipt of cash for final call on 1,000 units 5% debenture at N30 per unit.	30,000	30,000

## Cash Book

Date	Particulars	Amount		Date	Particulars	Amount
	Debenture Application And Allotment	N 72,000				
	Debenture Call	30,000				

## Debentures Application and Allotment Account

Date	Particulars	Amount		Date	Particulars	Amount
	5% Debenture	N 70,000			Cash	N 72,000
	Debenture Premium	2,000				

procedure to record these transactions will be as shown below:

## 22.6 Summary

In this chapter, students have learnt that:

1. There is a difference between shares and debentures;

2. The share capital are divided into three classes: preference shares, ordinary shares and loan capital. The preferred shareholder is entitled to fixed dividend, the ordinary shareholder is entitled to surplus profit and loan capital holder is entitled to fixed interest;
3. The authorised capital or registered capital is the number of shares that can be issued legally as specified in the memorandum of association;
4. The issued share capital is the number of shares of authorised share capital that have been offered to Public for subscription. Issued share capital can be oversubscribed or under-subscribed;
5. Shares can be issued per value, above per value and below per value;
6. Shares sold at less than stated value is said to be issued at a discount, while those sold above per value is said to be issued at a premium;
7. Payment for shares according to Companies Act, 1990 is usually done by installment, that is on application, on allotment and calls;
8. When all the shares, value are paid in full, the shares can be described as fully paid shares. If there is any default to pay in full, the unpaid balance due is known as .calls in arrears.;
9. Before any class of share is issued at a discount the company must satisfy the conditions as required by Company Allied Matter Act (CAMA) 1990;
10. In the balance sheet, the sum of discount is shown on the asset side as fictitious asset until it is written off to the profits or loss appropriation account;
11. Premium is the excess amount received on per value share. Premium on shares is classified as contribution or paid in capital and must be retained in the account and balance sheet until full retirement of the share;
12. Debentures, like other related obligation such as long-term notes, are means of raising capital by limited liability.