

ISSUE OF DEBENTURES

A debenture is a written acknowledgement of a debt owed by a company executed under the common seal of the company. It is a loan obtained by a company from investors through the capital market. Only a company has access to this kind of loan. Unincorporated businesses such as partnerships, and sole proprietorships do not.

Where a company offers debentures to the public for subscription or purchase, it shall execute a debenture trust deed in respect of the debentures. The deed shall contain provisions regarding, among others, payment of interest and repayment of principal. Debenture interest is normally paid at half-yearly intervals and the debenture trust deed shall specify the dates and manner of payment of the interest.

ISSUE PRICE

Debentures may be issued at par, at a premium or at a discount. They are normally issued in units of ₦100.

- a. **Issue at Par:** in this case, the debentures are issued at the nominal value. That is ₦100 debentures are issued for ₦100.
- b. **Issue at a Premium:** in this case debentures are issued at a price above the nominal value. The premium is the excess of the issues price over the nominal value. CAMA 2004 (as amended) does not specify any restrictions as to the manner in which the balance in the debenture premium account can be used, hence it is classified as revenue reserve. This is different from the treatment of Share premium account balance, the use of which is restricted by CAMA 2004 and is classified as Capital Reserve.
- c. **Issue at a Discount:** here, debentures are issued at a price lower than the nominal value. The discount is the excess of the nominal value over the issue price. The balance on the discount on debenture account shall be carried to the statement of financial position as a **fictitious asset** to be written off to reserves as follows:
 - In equal annual instalments against existing reserves if the debentures are redeemable at a specified date without a sinking fund being built up;
 - In full against the sinking fund at the date of redemption if a sinking fund has been accumulated; or
 - On reducing balance basis or in equal annual instalments against existing reserves if the debentures are redeemable by annual drawings.

Types of Debentures

- i. **Secured Debentures:** These are debentures with a charge or mortgage on the assets of the company. They are of two categories:
 - a. **Fixed Charge:** This is a mortgage on specific assets, which deprives the company of the right to deal with such assets in any manner prejudicial to the rights of the debenture holders.
 - b. **Floating Charge:** This is a mortgage on all, or a class of the present and future assets of the company. The assets charged are however not specified. A floating charge does not preclude the company from dealing with the assets in any way it deems necessary in the

ordinary course of business. The charge floats over the assets (as they continually change in form in the ordinary course of business) until some event occurs (e.g. default in paying principal or interest), which crystallises/fixes the charge.

- ii. **Unsecured Debentures:** They are also known as naked debentures. They are debentures, which carry no charge on the assets of the company. In other words, such debentures do not confer security on the holders.
- iii. **Redeemable Debentures:** these are debentures which are redeemable (repayable) at a specified future date.
- iv. **Irredeemable Debentures:** Also known as perpetual debentures. These are debentures which the company is not under any obligation to redeem/repay at a specified date, unless the company is being liquidated or the company defaults in paying interests within a specified time limit.
- v. **Convertible Debentures:** These are debentures which instead of redemption, may be converted to shares of the company at the option of the company or the debenture holder.

REDEMPTION OF REDEEMABLE DEBENTURES

Redemption of redeemable debentures means the repayment or repurchase of the debentures by the company.

Redeemable debentures may be redeemed at a premium (the company pays an amount higher than the nominal value of the debentures), at par (the company pays the nominal value), or at a discount (the company pays an amount lower than the nominal value of the debentures). It must be emphasised that redemption at a discount can only occur when the company purchases its debentures in the open market. It should be assumed that the redemption of debentures is at par unless otherwise indicated.

A company has the power to reissue redeemed debentures or issue other debentures in place of the redeemed ones.

Methods of Redemption

1. **Redemption by annual Drawings:** under this method, the debentures are repaid by annual instalments. When this instalments are paid they are debited to the debentures account while the cash book is credited.
If the debentures had been issued at a discount, the discount is written off in either of two ways over the life of the debentures:
 - a. On a straight line basis; or
 - b. Proportionate to the outstanding debentures at the start of each year.
2. **Redemption by payment of a lump sum at a fixed date provided by accumulation of a sinking fund:** under this method, a lump sum is paid at a fixed date or at the company's option, at a date within the specified period. A sinking fund is accumulated by annual transfers of equal amounts out of profit to the sinking fund account. Simultaneously, an amount equal to the amount appropriated is invested annually in a sinking fund investment, which with compound interest at the specified rate, will add up to the sum required to pay off the debentures at the date fixed for redemption. At the Statement of Financial Position date, the Sinking fund investment is shown as an asset representing a Sinking Fund of the same amount, which will be

shown as a Capital Reserve. At the due date of redemption, the Sinking Fund Investment is realised to provide the cash for the redemption.

The amount to be set aside annually is obtained from actuarial tables or computed using the Sinking fund formula shown below:

$$S = a[(1 + r)^n - 1]/r$$

Where S= Lump sum required to redeem debentures; a = equal amount to be appropriated annually; n = number of years; r = interest rate

- 3. Redemption by Purchase of the Debentures in the Open Market:** under this method, the company, at its option, purchases the debentures in the open market particularly if the market value falls below the nominal value. Sometimes, the company may still go ahead to purchase the debentures even when the market value is higher than the nominal value. This is the case provided that the market value is lower than the price payable on redemption at a fixed date (and the purchase occurs before the fixed date).