COMMERCE

B.COM HONS. PART-2 (PAPER-3) SPECIALIZED ACCOUNTING

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Debentures

Debentures are a debt instrument used by companies and government to issue the loan. The loan is issued to corporates based on their reputation at a fixed rate of interest. Debentures are also known as a bond which serves as an IOU between issuers and purchaser. Companies use debentures when they need to borrow the money at a fixed rate of interest for its expansion. Secured and Unsecured, Registered and Bearer, Convertible and Non-Convertible, First and Second are four types of debentures. Let us learn more about Debentures in detail.

In layman's term, a Debenture is the acknowledgment of the debt the organization has taken from the public at large. They are very crucial for raising long-term debt capital. A company can raise funds through the issue of debentures, which has a fixed rate of interest on it. The debenture issued by a company is an acknowledgment that the company has borrowed an amount of money from the public, which it promises to repay at a future date. Debenture holders are, therefore, creditors of the company.

Advantages and Disadvantages of Debentures

Advantages of Debentures

- Investors who want fixed income at lesser risk prefer them.
- As a debenture does not carry voting rights, financing through them does not dilute control of equity shareholders on management.
- Financing through them is less costly as compared to the cost of preference or equity capital as the interest payment on debentures is tax deductible.
- The company does not involve its profits in a debenture.
- The issue of debentures is appropriate in the situation when the sales and earnings are relatively stable.

Disadvantages of Debentures

- Each company has certain borrowing capacity. With the issue of debentures, the capacity of a company to further borrow funds reduces.
- With redeemable debenture, the company has to make provisions for repayment on the specified date, even during periods of financial strain on the company.

- Debenture put a permanent burden on the earnings of a company. Therefore, there is a greater risk when the earnings of the company fluctuate.

Types of Debenture

1. Secured and Unsecured:

Secured debenture creates a charge on the assets of the company, thereby mortgaging the assets of the company. Unsecured debenture does not carry any charge or security on the assets of the company.

2. Registered and Bearer:

A registered debenture is recorded in the register of debenture holders of the company. A regular instrument of transfer is required for their transfer. In contrast, the debenture which is transferable by mere delivery is called bearer debenture.

3. Convertible and Non-Convertible:

Convertible debenture can be converted into equity shares after the expiry of a specified period. On the other hand, a non-convertible debenture is those which cannot be converted into equity shares.

4. First and Second:

A debenture which is repaid before the other debenture is known as the first debenture. The second debenture is that which is paid after the first debenture has been paid back.

DEPRECIATION METHODS

Depreciation methods allow companies and individuals to show how much value their assets lose over a certain amount of time. You may choose from various different depreciation methods to show the depreciation in value for fixed (non-current) and current assets. The type of method you use depends on your company's needs, your financial situation and the way in which you use your assets.

Straight Line Method

The straight line method is very simple, so Internal Revenue Service recommends it. To determine how much depreciation a specific asset will have with this method, divide the cost of the asset evenly over its years of life. To use this method, you need to know how much you paid for the asset, the asset's useful life, or how long it will be in use to establish the salvage value for the asset. Salvage value is the value of the asset at the end of its life. You determine it through analyzing how much your asset is likely to cost at the end of its life. Once you have this information, divide the difference between the cost of the asset and its salvage value by the asset's span of useful life. Apply the result of this calculation to each year of depreciation for the asset's life.

Declining Balance Method

The declining balance method is an accelerated depreciation method. Accelerated depreciation means that it calculates more depreciation for the asset's first few years of life than simpler methods such as the straight line method. Use this method if you want to show more depreciation in the first years. To calculate depreciation with this method, first determine the rate of depreciation. Divide 1 by the asset's useful life and multiply the result by 1.5, or 2 if you prefer the double declining balance method, which gives you an even higher depreciation. This result is your depreciation rate. Every year, multiply the book value of the asset--the cost of the asset minus the accumulated depreciation, which is zero for the first year--by the depreciation rate. The result is what you deduct from your asset's total cost. "Publication 946," an IRS document, recommends the use of this method for long-term properties.

Sum-of-the-years'-digits Method

The sum-of-the-years'-digits method is another accelerated method of calculating depreciation. However, the depreciation of the first years is even larger than in the declining balance method. To calculate depreciation with this method, find the depreciation fraction, which is the asset's total years of life still left divided by the sum of all the years. For example, if the asset's life is four years, divide the years still left by the following sum: 1+2+3+4. The general formula for the sum of the year is 1+2+3+4+...+n, where "n" is the asset's total life. Multiply the value of the fraction of each year by the difference between the cost of the asset and its salvage value. The result you get each year is the depreciation for that year.

Depreciation Fund Method:

This method provides funds for the replacement of the asset at the end of its servicing life. The amount of depreciation is credited to an account called Sinking Fund or Depreciation Fund account which is shown on the liabilities side of the balance sheet. This amount is invested in outside securities.

Every year the amount set aside for depreciation along with the interest is again invested. The amount so invested is debited to an account known as Sinking Fund Investment Account and these investments are shown as an asset in the balance sheet. The amount of depreciation remains the same for the year.

The rate of interest available from investments and the time required for the replacement of the assets enables the determination of amount of depreciation. A reference to Sinking Fund Table gives the extra amount of depreciation to be charged year after year. The investments are sold when the asset is due for replacement and the amount so received is used for purchasing the new asset.

The value of assets is shown at its original cost in all years. In the last year, the asset is written off by transferring it to Depreciation Fund Account.

This method is suitable where intention is not to provide depreciation but also to provide for its replacement as happens in case of Plant and Machinery and many other wasting assets.

Insurance Policy Method:

This method is almost similar to Depreciation Fund Method. In depreciation fund method if investments are sold at a loss then the aim of replacement will be adversely affected. Insurance policy method overcomes this drawback. In this method an insurance policy is purchased for the value of the asset. This policy is taken up for the life of the asset and it matures at a time when the asset is to be replaced.

The amount provided for depreciation is paid towards insurance premium. The amount of premium remains the same in all the years. No entries for interest and reinvestments are required as in depreciation fund method. On maturity of the policy, insurance company will pay the amount and the amount will be used for replacing the asset.

Revaluation Method:

In this method the amount of depreciation is calculated by revaluing the asset at the end of each year. The difference between the value of the asset at the beginning and the end of the period is taken as depreciation. There can be an appreciation in value too. The amount of appreciation is debited to the asset and credited to profit and loss account.

This method can be used for specific assets like loose tools, horses, copy rights, trade marks, etc. It is difficult to assess the life of these assets, so calculation of depreciation becomes a problem. The nature of these assets is also different from other ordinary assets. This method has only a limited applicability.

Depletion Method:

This method is specially used for those assets which deplete with use. The cost of the assets is divided by total workable deposits. If a mine has 2 lakh tons of coal and the value of mine is Rs. 5 lakhs, each ton of coal will cost Rs. 2½. The quantity of coal taken out of the mine in a period will be multiplied by the rate per ton, i.e., Rs. 2½ and the resultant figure will be the amount of depreciation.

This method is suitable for mines, quarries, sandpits, etc.

Machine Hour Rate Method:

The life of the asset is estimated in hours. The value of the asset minus scrap value is divided by the estimated number of hours. In this way a machine hour rate is calculated. Machine hour rate determines the amount of depreciation per hour.

The number of hours a machine runs in year is multiplied by the machine hour rate and the amount of depreciation to be taken in that year is calculated. This method is considered more scientific and precise than either the fixed installment method or the reducing balance method.

Depreciation is an accounting term that helps individuals, and especially companies, to lower their tax burdens. Depreciation is defined as the decrease in the value of an asset over its useful life, and the different depreciation methods calculate how much depreciation per year a specific asset should incur. There are various methods, and among the most common are the straight-line method, the declining-balance method and the sum-of-the-years'-digit method.

Advantages of the Straight-Line Method

The straight-line depreciation method calculates depreciation based on the asset's price of purchase, its salvage value and its useful life. An asset's salvage value is how much this asset is worth after its useful life has ended. This value can be a positive number, zero or a negative number. The first advantage of this method is that it is the simplest and easiest method to calculate, mostly because the information you need to calculate depreciation with this method is very basic and because the formula you use is very simple:

(cost of asset - salvage value) / asset's useful life.

Also, with the straight-line depreciation method, you count an even amount of depreciation per year. If you spread the use of your asset out evenly over its useful life, this method is the best option. Because of this even distribution, this method also allows you to easily project your expenses and deductions over the next several years.

Advantages of the Declining-Balance Method

The declining-balance method calculates depreciation with information regarding the asset's price of purchase and the depreciation rate. The depreciation rate is the division of the number 1.5 or 2 (in case you prefer double-declining-balance method) by the asset's useful life. The main advantage of this method is that it allows a greater depreciation for the first years of the asset's life. Some assets experience more use during their first years of life, and for this reason, the declining balance method shows this higher decrease of value during the first years with more accuracy. With the double-declining balance method, the depreciation rate is even faster in the first few years. Another closely related benefit is that it results in a greater reduction of your taxes early on. If your specific situation is such that you can validate the use of this depreciation method, this is a better option than the previous one.

Advantages of Sum-of-the-Years'-Digit Method

This is another type of accelerated method, calculating higher depreciation in the first few years. However, with this method, your depreciation is even higher for the first few years of use than it is with the simple or double-declining-balance method. This method's advantages are very similar to the previous one: it provides a more accurate decrease in the value of the asset if it is being used more heavily in the first years, and it decreases tax burdens faster than the straight-line method does. If, for financial reasons, you prefer an even larger estimate of depreciation during the first years, this is the best method for your business.

What Is Liquidation?

Liquidation in finance and economics is the process of bringing a business to an end and distributing its assets to claimants. It is an event that usually occurs when a company is insolvent, meaning it cannot pay its obligations when they are due. As company operations end, the remaining assets are used to pay creditors and shareholders, based on the priority of their claims. General partners are subject to liquidation.

Special Considerations

Liquidation can also refer to the act of exiting a securities position. In the simplest terms, this means selling the position for cash; another approach is to take an equal but opposite position in the same security—for example, by shorting the same number of shares that make up a long position in a stock. A broker may forcibly liquidate a trader's positions if the trader's portfolio has fallen below the margin requirement, or she has demonstrated a reckless approach to risk-taking.

What Is a Liquidator?

A liquidator is a person or entity that liquidates something—generally assets. When assets are liquidated, they are sold on the open market for cash or other equivalents. The liquidator is legally empowered to act on behalf of the company in various capacities.

A liquidator refers to an officer who is specially appointed to wind up the affairs of a company when the company is closing—typically when the company is going bankrupt. Assets of a company are sold by the liquidator and the resulting funds are used to pay off the company's debts.

In some jurisdictions, a liquidator may also be referred to as a trustee, such as a bankruptcy trustee.

Understanding Liquidators

A liquidator is a person with the legal authority to act on behalf of a company to sell the company's assets before the company closes in order to generate cash for a variety of reasons including debt repayment.

Liquidators are generally assigned by the court, by unsecured creditors, or by the company's shareholders. They are often employed when a company goes bankrupt. Once the liquidator is assigned, he or she then takes over control of the person or organization's assets. These are then pooled together and sold off one-by-one. Cash received from the proceeds of the sale are then used to pay off outstanding debt held by unsecured creditors.

One of the chief functions of many liquidators is to bring and defend lawsuits. Other actions include collecting outstanding receivables, paying off debts and finishing other corporate termination procedures.

Powers and Duties of the Liquidator

A liquidator's power is defined by the law where he or she is assigned. The liquidator may be granted complete authority over all matters of the business until the assets are sold and the debts are all paid off. Some others are granted liberties, while still under the supervision of the court.

The liquidator has a fiduciary and legal responsibility to all parties involved—the company, court, and the creditors involved. Generally considered to be the go-to person when it comes to making any decisions about the company and its assets, the liquidator must keep them under his or her control to ensure they are properly valued and dispersed after they are sold. This person issues any correspondence and holds meetings with creditors and the company in question to ensure the liquidation process goes through smoothly.

Examples of Liquidators

Many retailers undergo liquidation under a liquidator in order to dispose of their assets because of a looming bankruptcy. The liquidator assesses the business and its assets and may make decisions on when and how to sell them. New inventory shipments will be stopped and the liquidator may plan for sales of the current stock. Everything under the retailer's banner including fixtures, real estate, and other assets will be sold. The liquidator will then organize the proceeds and pay off the creditors.

Liquidation Sales

Liquidators aren't always part of the liquidation process. It isn't uncommon to see a retailer advertising a liquidation sale, selling off as much of, if not all, of their stock—often at a deep discount to consumers. In some cases, this may be due to insolvency, but don't always do this because they're closing down. In fact, some stores do this to get rid of and replace older stock with new inventory.

FORMAT

Trading and Profit and Loss Account for the period ending March 31, XXXX

Particulars	Amount	Particulars	Amount

DIRECT EXPENSES:		DIRECT INCOMES:	
To opening Stock		By Sales A/c	
To Purchase A/c		Less: Sales Return A/c (If any)	
Less: Purchase Returns A/c (If any)		By Closing Stock A/c	
To Wages A/c		By Gross Loss c/d	
To Power, fuel & water A/c			
To Carriage inward & Cartage A/c			
To Import duty A/c			
To Excise duty A/c			
To Octroi A/c			
To Gross Profit c/d			
		By Gross Profit b/d	
To Gross Loss b/d		INDIRECT INCOMES:	
INDIRECT EXPENSES:		By Rent Received A/c	
Office Expenses:		By Interest Received A/c	
To Salaries A/c		By Dividend Received A/c	
To Rent A/c		By Commission Received A/c	
To Printing and stationery A/c			
To Postage and telegram A/c		By Bad debts recovered A/c	
To Office insurance A/c		By Discount Received A/c	
To Lighting and heating A/c		By Profit on sale of property	

To Audit fees A/c To Legal Charges A/c Maintains Expenses: To Repairs A/c To Depreciation A/c Selling and distribution expenses: To Rent of warehouse A/c To Insurance of warehouse A/c To Packing charges A/c To Advertisement A/c To Carriage outwards A/c To Bad debts A/c To Commission paid A/c To Travelling expenses A/c Financial Expenses: To Interest on loan A/c, To Discount allowed A/c, To Loss on sale of property A/c, To Loss on sale of investment A/c To Interest on Capital A/c		A/c By Profit on sale of investment A/c By Interest on Drawing A/c By Net Loss C/d to Balance Sheet	

To Net Profit c/d to Balance Sheet			

Balance sheet as on March 31, XXXX

LIABILITIES	Amount	ASSETS	Amount
Capital Capital Add: Profit b/d by P/L A/c (if profit) Less: Loss b/d by P/L A/c		Fixed Assets Less Depreciation Land & Building A/c Plant & Machinery A/c	

(if loss) Drawings (if any) Long term Loans Loan taken from bank, financial institution or any person for long term i.e. more than one year. Current Liabilities Sundry Creditors A/c Bills Payable A/c Bank overdraft A/c Outstanding Expenses A/c Income Received Advance A/c		Furniture & Fixture A/c Typewriter & Computers A/c Vehicles A/c Goodwill A/c Patents A/c Trade Marks A/c Copy Rights A/c Long term Investments Investment in shares, debentures, government securities etc. for long term i.e. more than one year Current Assets Cash A/c Bank A/c Short term investment A/c Sundry Debtors less Bad Debts A/c Bills Receivable A/c Stock A/c Prepaid Expenses A/c Outstanding Incomes A/c	