CMA Inter

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Financial Accounting

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Coverage

S. No.	Chapters
1	Fundamentals (J23-Q2b, J23-Q8, D23-8b)
2	Trial Balance (D23-Q2b)
3	Subsidiary Books
4	Rectification of Errors (J23 -Q3a, J24-Q2b)
4	Bad Debts and Provision for Doubtful Debts (J23-Q6, J24-Q8b)
4	Final Accounts (J23-Q2c)
5	Depreciation (J23-Q5d, J24-Q2a)
6	Single Entry (J23-Q4, D23-Q4, J24-Q4)
7	NPO
8	Hire Purchase (J23-Q8b, J24-Q3b)
9	Insurance Claim (J23-Q6c, D23-Q6b, J24-Q6b)
10	Departmental Accounts
11	Branch Accounts (J23-Q5c, D23-Q6a, J24-Q6a)

Fundamentals

Theory Base of Accounting		
Basic Accounting Assumption		**Examples**
1. Business Entity Concept	Business is treated as distinct and separate from individuals who own or manage it. Application of this concept enables recording of transactions of the business entity with its owners or managers or other stakeholders.	E.g. Capital Introduced by Proprietor, Drawings Made, Personal Expenses paid from Business Cash, Profit transferred to capital.
2. Going Concern Concept	Business is assumed to exist for an indefinite period and is not established with the objective of closing it down. The going concern concept forms a sound basis for preparation of a Balance Sheet.	Due to this principal, Assets and Liabilities are carried forward without checking the recoverability.
3: Money Measurement Concept	Business transactions that can be measured in terms of money will be recoded. When transactions are recorded in terms of money, we only consider the absolute value of the money. The real value of the money may fluctuate from time to time due to inflation, exchange rate changes, etc.	E.g. Rent paid ` 10000 is recorded. Labour Strike or Retirement of Manager is not recorded.

4, Accounting Period Concept	Indefinite life of the Business is divided into small intervals called Accounting Period. This period is usually one year.	E.g. 1st January to 31st December or a fiscal year like in India 1st April to 31st March.
5. Accrual Concept	Recognition of both cash and credit transactions.Revenues are not the same as cash receipts and expenses are not same as cash paid during the period. It is also called Mercantile System of Accounting.	E.g. Goods sold on credit i.e Right to receive from customer, Credit Purchases, Salary outstanding etc.
6. Revenue Realisation Concept	Revenue should be recognized only when there is reasonable certainty of realizing the money. This concept ensures that income unearned or unrealized will not be considered as revenue and the firms will not inflate profits.	E.g. Order received from customer will not be recorded. Also, Doubtful customers to be provided for.
7. Matching Concept	Cost or Expenses of a particular period is matched with the Revenue or Income of that period. The net effect of Incomes and Expenses will reflect either profit or loss. In order to correctly arrive at the net result, both aspects must be recognized during the same accounting period.	E.g. Closing Stock is shown in trading account to match the cost of goods sold with Sales of that particular period.
8. Full Disclosure Concept	All significant information must be disclosed. This principle emphasizes on the materiality, objectivity and consistency of accounting data which should disclose the true and fair view of the state of affairs of a firm. Full disclosure must be made for all material information which are useful to the users of accounting information.	E.g. Disclosure of Contingent Liabilities as a footnote, Notes to Accounts etc.

9. Dual Aspect Concept	*The assets represent economic resources of the business, whereas the claims of various parties on business are called obligations. The obligations could be towards owners (called as owner's equity) and towards parties other than the owners (called as liabilities).* *Assets = Liabilities + Capital* *Every business transaction has dual impact on the financial position. Recording of both these aspects of every transaction is called Double-entry system of accounting.*	*E.g. Cash ` 25,00,000 = Liabilities ` nil + Mr. Suresh's Capital ` 25,00,000*  *OR*  *Cash ` 40,00,000 = Liabilities ` 15,00,000 + Mr. Suresh's Capital ` 25,00,000*
10. Historical Cost Concept	*Business transactions are recorded at the actual cost at which they are actually undertaken. Asset is recorded at its actual cost and the same is used as the basis for charging depreciation on the use of asset.* *The actual value of the asset may rise or fall subsequent to the purchase, but that is considered irrelevant for accounting purpose as per the historical cost concept.*	*E.g. Equipment bought for ` 1.50 crores will be shown at the same value in all future periods. Depreciation will be calculated with reference to the actual cost.*
11. Materiality Concept	*Only those* **information** *which may have material effect on profitability or financial position of the business should have* **special consideration for reporting**. *The effect is said to be material, if the knowledge of it would influence the decision of an informed stakeholder.*	*E.g. Unused Postal stamps or stationery of ` 500 not shown as inventory.* ***Note: Even conveyance of ` 20 must be recorded.***

12. Consistency Concept	*As per this principle, same principle should be followed year after year. Once an organization decides to adopt a particular method of revenue or expense recognition in line with the other concepts, the same should be consistently applied year after year, unless there is a valid reason for change in the method.*	*E.g. Depreciation policy (SLM or WDV), Inventory Valuation policy etc.*
13. Conservatism / Prudence Concept	*As per this principle, Business entities must recognise all anticipated losses immediately and delay all anticipated gains.* *This can be stated as* *(i) Delay in recognizing income unless one is reasonably sure* *(ii) Immediately recognize expenses when reasonably sure.*	*E.g. Provision for Bad Debts, Cost or NRV whichever is lower.*

Difference between capital expenditure and revenue expenditure:

S.No.	Revenue Expenditure	Capital Expenditure
1	*The economic benefits of Revenue Expenditures are enjoyed within an accounting period.*	*The economic benefits of Capital Expenditures are enjoyed for more than one accounting period.*
2	*Revenue Expenditures are of recurring in nature.*	*Capital Expenditures are of non-recurring in nature.*
3	*Revenue Expenditures are not generally capital expenditures.*	*All Capital Expenditures eventually become Revenue Expenditures Eg. depreciation.*
4	*All Revenue Expenditures are matched with Revenue Receipts.*	*Capital Expenditures are not matched with Capital Receipts.*

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Difference between capital receipts and revenue receipts:

S.No.	Revenue Receipt	Capital Receipt
1	*It has short-term effect. The benefit is enjoyed within one accounting period.*	*It has long-term effect. The benefit is enjoyed for many years in future.*
2	*It occurs repeatedly. It is recurring and regular.*	*It does not occur again and again. It is non recurring and irregular.*
3	*It is shown in profit and loss account on the credit side, as an income for the year.*	*It is shown in the Balance Sheet on the liability side.*
4	*This does not increase or decrease the value of asset or liability.*	*The capital receipt decreases the value of asset or increases the value of liability e.g.* ***sale of a fixed asset***, ***loan from bank*** *etc.*

Bases of Accounting

Distinction between Accrual Basis of Accounting and Cash Basis of Accounting

S. No.	Basis of Distinction	Accrual Basis of Accounting	Cash Basis of Accounting
1.	Prepaid/Outstanding Expenses/ accrued/unaccrued Income in Balance Sheet.	Under this, there may be prepaid/ outstanding expenses and accrued/ unaccrued incomes in the Balance Sheet.	Under this, there is no prepaid / outstanding expenses or accrued/ unaccrued incomes.
2.	Higher/lower Income in case of prepaid expenses and accrued income	Income Statement will show a relatively higher income	Income Statement will show lower income.
3.	Higher/lower income in case of outstanding expenses and unaccrued income	Income Statement will show a relatively lower income.	Income Statement will show higher income.
4.	Recognition under the Companies Act, 2013.	This basis is recognized under the Companies Act, 2013.	This basis is not recognized under the Companies Act, 2013.

Hybrid or Mixed Basis *– Is the combination of both the basis i.e. Cash as well as Accrual basis. Incomes are recorded on Cash basis but expenses are recorded on Accrual basis.*

Accounting Equation

The whole Financial Accounting dependes on Accounting Equation which is also known as Balance Sheet Equation. The basic Accounting Equation is:

Assets = Liabilities + Owner's equity

Rectification of Errors

Accounting Process

Transction

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Journal / Subsidiary Books

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Ledger

↓

Trail Balance

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Final Accounts

Error can be at any stage of the Accounting Process

And

That Error can be identified at any stage of the Accounting Process

Understanding the Errors and their stage of identification

There are 3 Stages of identifying the Error

- Before Preparing TB
- After TB but before Final A/c
- After Final A/c

TYPES OF ERRORS

(1) Errors of Omission

- Omitting an entry completely from the Subsidiary Books.
  Trial Balance will still match.
- Omitting to post the Ledger Account from the Subsidiary Books.
  Trial Balance will not match.

(2) Errors of Commission

- Writing the wrong amount in the Subsidiary Books.
  Trial Balance will still match.
- Posting an amount in the wrong account but on the correct side.
  Trial Balance will still match.
- Wrong casting of Subsidiary Books.
- Posting the wrong amount in the Ledger.
- Posting an amount on the wrong side.
- Wrong balancing of an account.

  Trial Balance will not match.

(3) Errors of Principle

Treating a revenue expenditure as capital expenditure or vice versa or treating the sale of a fixed asset as ordinary sale.

Trial Balance will still match.

(4) Compensating Errors

These are errors that cancel each other, e.g., underposting of the Purchase Journal may be compensated or cancelled out with the undercasting of the Sales Journal by a similar amount.

Trial Balance will match.

Error of Posting may or may not affect the agreement of Trial Balance

Situation	Account to which the posting was made	Side (Debit or credit)	Amount with which Posting was made	Whether affects the agreement of Trial Balance
1	✓ (correct)	✓	X (wrong)	
2	✓	X	✓	
3	✓	X	X	
4	X	✓	✓	
5	X	✓	X	
6	X	X	✓	
7	X	X	X	

Final Accounts

Q 1 What is Final Accounts?

Sol: Final destination of the accounting process.

It Includes Trading A/c, Profit & Loss A/c, Profit & Loss Appropriation A/c and Balance Sheet.

Q 2 Why to do Final Accounts?

Sol: To ascertain the Profit or Loss in an Accounting period and to know the Financial Position of the Business as on a date.

Q 3 How to do Final Accounts?

Sol: **<u>Accounting Process</u>**

Transaction

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Journal / Subsidiary Books

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Ledger

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Trail Balance

↓

Final Accounts

Final Accounts is prepared on the basis of Trial Balance and Adjustment Entries (Entries which have not already been reflected in Trial Balance i.e. which have not passed through the double entry system)

Steps to prepare Final Accounts:

Step 1 *Prepare the format of Trading and Profit & Loss Account*

Step 2 *Read the adjustments and mark the Items in Trial Balance which will be effected.*

Step 3 *Pick up the items from Trial Balance serially and drop at the correct place in Final Accounts (At any one place in Final Accounts. Marked items to be placed in the internal column)*

Correct place in Final Accounts means:

Items to pick from Trial Balance	Place at
Opening Stock, Purchases and Direct Expenses	Trading Account Dr Side
Sales	Trading Account Credit Side
All Other Expenses	P/L A/c Dr Side
All Other Income	P/L A/c Cr Side
All Assets	Balance Sheet Asset Side
Capital and All Liabilities	Balance Sheet Liability Side
Some items to be deducted from other specific items:	
Purchase Return / Return Outward	Deduct from Purchases
Sales Return / Return Inward	Deduct from Sales
Drawings	Deduct from Capital

Step 4 *Analyse adjustments and give the* ***Debit and Credit effect*** *of each Adjustment entry in the Final Accounts (Refer Separate Summary sheet for Effect of Various Adjustments). (For Adjustments, Debit and Credit, both the effect is to be given).*

Step 5 *Transfer Gross Profit / Gross Loss from Trading A/c to Profit & Loss A/c, Net Profit / Net Loss from Profit & Loss A/c to Capital and Close the Final Accounts.*

Refer list of Adjustment entries in a separate sheet.

Adjustments for Rectification of Errors (Examples)

1. Rs. 2,400 paid as rent for office was debited to Landlord's A/c and was included in debtors.

2. A withdrawal slip indicated a cash withdrawal of Rs. 15,000 which was charged as drawing. However, it was noticed that Rs. 11,000 was used for business purpose only and was entered as expenses in cash book.

3. Goods worth Rs. 19,000 were purchased on 24th March 2013 and sold on 29th March 2013 for Rs.23,750. Sales were recorded correctly, but purchase invoice was missed out.

4. Purchase returns of Rs. 1,500 were routed through sales return. Party's A/c was correctly posted.

5. Expenses include Rs. 3,750 related to the period after 31st March 2013.

6. Purchase book was over-cast by Rs. 1,000. Posting to suppliers' A/c is correct.

7. Salaries include Rs. 10,000 towards renovation of Proprietor's residence.

8. Sales included Rs. 30,000 as goods sold cash on behalf of Mr. Thakurlal who allowed 15% commission on such sales for which effect is to be given.

If Suspense is given in the sum of Final Accounts, it means some rectification entries needs to be passed to remove the suspense.

Eg. Suspense given in Trial Balance - Rs. 39400 Credit balance

A new machinery was purchase for Rs. 50,000 but the amount was wrongly posted to Furniture Account as Rs. 5,000.

Cash received from Debtors Rs. 5,600 was omitted to be posted in the ledger.

Note: When Suspense is given, look for Single Sided Errors i.e those errors due to which Trial Balance must not have matched.

Points to Remember:

1. Adjusted Purchases – It means, Closing Stock is already deducted from Purchases. Closing Stock is reflected in the Trial Balance. Since Closing Stock is part of Trial Balance, it need to be just picked from Trial Balance and dropped at the correct place in Final Accounts. It being Asset, will be only shown in the Asset Side of the Balance Sheet and not in the Credit side of Trading A/c.

2. Provision for Doubtful Debts also called Reserve for Doubtful debts. Provision for Discount on Debtors also called Reserve for Discount on Debtors.

3. Even if Advertisement Expense is useful for generating revenue for multiple years, full amount is to be treated as expense in P/L A/c in the 1st year itself and not to be treated as Deferred Revenue Expenditure. (AS - 26).

   Eg. Advertising will be useful for generating revenue for 5 years. Total Expense Rs. 500000.

   Treat full amount of Rs. 5,00,000/- as revenue expenditure.

4. Intangible Assets are to be amortised over the life of the asset. (AS – 26)

   Eg. Patents Rs. 40000 for 10 years.

5. Closing stock valued at cost or NRV whichever is lower.

6. Direct Expenses means those expenses which are incurred till the goods become saleable or suitable for sale. Eg. Freight Inward, Octroi, Wages, Royalty on production, Gas and Fuel, Power, All factory related expenses etc.

7. Adjustments are sometimes given in bracket within Trial Balance itself mainly interest rates of loan taken and Investments. Also dates of Purchase of Investment or Loan taken. Adjustments need to be done accordingly.

8. If Wages & Salaries is given, its treated as Wages and hence Direct Expense. If Salaries & Wages is given its treated as Salaries and hence Indirect Expense to be shown in P/L A/c.

9. Income Tax of Proprietor, LIC, are personal expenses treated as drawings.

Single Entry

Q 1 What is Single Entry System of Accounting?

Sol: Single Entry System is a system in which rules of Double Entry System are not followed completely. The accounts maintained under this system are incomplete and unsystematic. Therefore, it is also known as '***Accounts from Incomplete Records***'. Single Entry System is an unscientific method of record keeping, which does not follow the accepted accounting rules.

Q 2 What are the features of Single Entry System?

Sol: Main Features of Single-Entry System are:

a. Maintenance of books by a sole trader or partnership firm
b. Maintenance of cash book
c. Only personal accounts are kept
d. Collection of information from original documents – Dependency on Source Documents
e. Lack of uniformity
f. Difficulty in preparation of final accounts

Q 3 What are the benefits of Single Entry System?

Sol: Main advantages of Single Entry System are:

a) Quick and easy

b) Useful for small business run by individuals

c) Economical

d) Flexible Method

e) Requires only basic accounting knowledge

Q 4 What are the Weaknesses or Limitations of Single Entry System?

Sol: 1. Principles of Double Entry not followed

2. Trial Balance can not be prepared

3. Accurate Profit or Loss can not be ascertained.

4. Accurate Financial Position can not be ascertained.

5. Difficult to detect frauds or errors

6. External agencies like Banks cannot use financial information

7. Business and personal transactions of the proprietor get mixed.

Q 5 What are the differences between single entry system and double entry system?

Sol:

Double Entry	Single Entry
Both the aspects (debit and credit) of all the transactions are recorded	- No record of some transactions. - Some transactions are recorded only in one of their aspects. - Some transactions are recorded in both of their aspects.
Various subsidiary books such as sales book, purchases book etc are maintained.	No such subsidiary books maintained except cash book.
Ledger contains personal, real and nominal accounts	Ledger contains some personal accounts only.
Preparation of trial balance is possible	Preparation of trial balance is not possible
Trading A/c, Profit & Loss A/c and the Balance Sheet are prepared in a scientific manner.	Not possible – only a rough estimate of profit or loss is made and a Statement of Affairs is prepared which resembles a balance sheet in appearance but which does not present an accurate picture of the financial position of the business.

Q 6 What are the steps for preparing Final Accounts under Single Entry System?

Sol: **2 Statements are prepared:**

a. Statement of Profit and Loss

b. Statement of Affairs (Just like Balance Sheet)

Step 1: Prepare statement of affairs at the start to calculate Opening Capital

Step 2: Prepare statement of affairs at the end to calculate Closing Capital

Step 3: Prepare statement of profit and loss to ascertain the trading profit.

Statement of Profit and Loss for the year ended.....

Particulars	Amount (Rs.)	Amount (Rs.)
Closing Capital	XX	
Less: Opening Capital	XX	XX
Add: Drawings		XX
		XX
Less: Further Capital Introduced		XX
Profit / Loss		**XX**
Less: Adjustments:		
Bad Debts	XX	
Depreciation etc.	XX	XX
Net Profit / Loss for the period		**XX**
Add: Appropriation Items:		
Interest on Drawings	XX	
Less: Appropriations:		
Commission on Net Profit	XX	
Interest on Partner's Capital	XX	
Partner's Salaries	XX	XX
Divisible Profit		**XX**

OR

Particulars	Amount (Rs.)	Amount (Rs.)
Closing Capital (**After All Adjustments**)	XX	
Less: Opening Capital	XX	XX
Add: Drawings		XX
		XX
Less: Further Capital Introduced		XX
Divisible Profit		**XX**

Note: Drawings can be in cash and in kind like Stock, furniture etc. Consider total Drawings including in kind. Also, Interest on drawings should be calculated on the total amount of drawings.

Eg. He withdrew goods of Rs.2,100 and cash of Rs.7,200 for his personal use. Interest on drawing is to be charged at 10%

Q How to convert Single Entry into Double Entry System and prepare the Final Accounts?

Sol:

Step 1: Prepare the format of Trading A/c, Profit & Loss A/c and Balance Sheet.

Step 2: Keep putting the figures at the correct place as you find them.

Step 3: Prepare necessary ledger accounts and Statements to find missing information. Give Dr and Cr effect of the missing information.

(Most common ledgers required to be prepared are Cash Book or Cash/Bank A/c, Debtors, A/c, Creditors A/c, Bills Receivable A/c, Bills Payable A/c, Opening Balance Sheet, Fixed Assets A/c, Capital A/c).

Name of the Ledger	Balancing figure (Generally)
Cash A/c / Bank A/c	Opening / Closing Balance, Cash Sales, Cash Purchases, Receipts from Debtors, Payment to Creditors
Bills Receivable A/c	Opening / Closing Balance, New BR or BR Dishonoured
Debtors A/c	Opening / Closing Balance, Credit Sales or Receipts from Debtors
Bills Payable A/c	Opening / Closing Balance, New BP or BP Dishonoured
Creditors A/c	Opening / Closing Balance, Credit Purchases or Payments to Creditors
Fixed Asset A/c	Opening / Closing Balance, Depreciation.
Capital A/c	Opening Capital
Opening Balance Sheet	Opening Capital

Points to remember:

1. Total Purchases = Cash Purchases + Credit Purchases
2. Total Sales = Cash Sales + Credit Sales
3. Cost of Goods Sold = Opening Stock + Purchases + Direct Expenses – Closing Stock
4. Cost of Goods Sold = Sales – Gross Profit

Non-Profit Organisations

Q 1 What is the meaning of Non-Profit Organisation?

Sol: Organisations that are not established for making profit but to provide some service given to members who make subscriptions to avail them.

These organisations get their funds in the form of contributions by way of entrance fees, life membership fees, annual subscriptions, donations, grants, legacies etc.

Examples of Non Profit Organisations are Gymkhana / sports clubs; Educational institutions; Public hospitals; Libraries; Cultural clubs like Rotary or Lions club; Religious institutions; Charitable trusts.

Q 2 Why there's a need to study Final Accounts of NPO separately?

Sol: There are 2 main reasons for this:

a. Nature of NPO is unique and certain items of revenue and expenses need special understanding (Like Donations, Entrance Fees, Subscriptions, Grants Received, Tournament Expenses, Prizes etc.)

b. Final Accounts prepared by Non-Profit Organisations is slightly different from the Profit making organisations. NPOs prepare the following as part of their Financial Statements:

   i. Receipts and Payments Account

   ii. Income & Expenditure Account

   iii. Balance Sheet

Some Special items of Incomes and Expenses in an NPO:

Incomes		Expenses	
Revenue Income	**Capital Receipts**	**Revenue Expenses**	**Capital Expenses**
Donation	Specific Donation	Upkeep of Grounds	Fixed Assets
Admission Fees	Legacy	Tournament Expenses	
Entrance Fees	Admission Fees	Prizes	
Subscriptions	Entrance Fees	Honorarium	
Grants Received	Endowments	Examination Expenses	
Fair Receipts	Specific Grant received	Fair Expenses	
Variety Show receipt	Any Specific Fund	Variety Show Expenses	
Bar Receipts	Life Membership Fees	Bar Purchases	
Sale of news papers		News papers	
Sale of periodicals		Periodicals	
Certificate Fees		Certificate Fees	
Hire Charges		Hire Charges	
		Locker Rent	
Sale of Tickets		Sports Expenses	
		Programme Expenses	
		Allowances	
		Consultancy	
		Audit fees	
		Any material consumed	
		Stationery consumed	

Receipts and Payments Account for the year ended..			
Receipts	Amount	Payments	Amount
To Balance b/d(Opening Balance):		By Balance b/d (Opening Balance)(in case of Bank Overdraft)	XXX
Cash in Hand	XXX	By Salaries	XXX
Cash at Banks	XXX	By Rent	XXX
To Subscriptions:		By Postage Expenses	XXX
For Previous Year XXX		By Newspapers and Magazines, etc.	XXX
For Current Year XXX		By Repairs	XXX
For Next Year XXX	XXX	By Audit Fee	XXX
To General Donations	XXX	By Maintenance Expenses	XXX
To Entrance/Admission Fees	XXX	By Insurance	XXX
To General Grants	XXX	By Secretary's Honorarium	XXX
To Sale of Newspaper, Grass, etc.	XXX	By Honorarium	XXX
To Sale of Old Used Sports Material	XXX	By Municipal Tax	XXX
To Interest on Investments	XXX	By Prize Distributed	XXX
To Income from Concerts/Lectures	XXX	By Office Expenses	XXX
To Dividends	XXX	By Expenses on Show	XXX
To Rent Received	XXX	By Miscellaneous Payments	XXX
To Interest Received	XXX	By Purchase of Fixed Assets (e.g., Furniture)	XXX
To Miscellaneous Receipts	XXX	By Sports Equipment	XXX
To Life Membership Fees	XXX	By Investments	XXX
To Subscriptions for Specific Purpose	XXX	By Books	XXX
To Donation for Specific Purpose	XXX	By Loan (Repayment)	XXX
To Legacies	XXX	By Building	XXX
To Endowment Fund	XXX	By Balance c/d (Closing Balance):	
To Sale of Fixed Assets	XXX	Cash in Hand	XXX
To Receipts on Account of Special Fund,i.e.,Match Fund, Prize Fund, etc.	XXX	Cash at Bank*	XXX
To Balance c/d (Bank Overdraft)*	XXX		

	XXXX		XXXX

Income and Expenditure Account for the period ended...			
Dr			Cr
Expenditure	**Amount**	**Income**	**Amount**
To Salaries XX		By Subscriptions	
Add: Outstanding at the end XX		Add: Outstanding at the end XX	
XX		Advance in the beginning XX	
Less: Outstanding at beginning XX	XX	XX	
To Rent		Less: Outstanding at beginning XX	
To Insurance Premium XX		XX	
Less: Prepaid XX	XX	Less: Advance at the end XX	XX
To Audit Fees	XX	By Entrance Fees	XX
To Printing and Stationery	XX	By Donations	XX
To Honorarium	XX	By Sale of Old Newspapers	XX
To Telephone Expenses	XX	By Hall Rent	XX
To Repairs	XX	By Sundry Receipts	XX
To Depreciation	XX	By Deficit	XX
To Sports Material Used	XX	(excess of expenditure over income)*	
To Surplus	XX		
(excess of income over expenditure)*			
	XXX		XXX

Difference between Receipts and Payments A/c and Income & Expenditure A/c:

Basis of Difference	Receipts and Payments Accounts	income and Expenditure Account
1. Nature	It is a summary of the Cash Book.	It is similar to Profit and Loss Account of a Business Enterprise.
2. Basis of Accounting	It is prepared on Cash Basis of Accounting.	It is prepared on Accrual Basis of Accounting.
3. Nature of Account	It is a real account.	It is a nominal account.
4. Balance	It starts with the opening balance of cash and bank. Balance at the end represents cash and bank balance at the end.	It has no opening balance. Balance at the end means either surplus or deficit.
5. Sides	Debit side of the account records cash receipts and credit side records cash payments.	Debit side of this account records expenses and losses and credit side records incomes and gains.
6. Capital and Revenue Items	It records receipts and payments of items of both capital and revenue nature.	It records income and expenditure of revenues items only.
7. Non-cash items	It does not record non-cash items like depreciation.	It records non-cash items like depreciation.

Format of Opening Balance Sheet

Liabilities	Amt.	Assets	Amt
Advance Subscription		Fixed Assets	
Outstanding Expenses		Investments	
Capital Fund (Balancing Figure)		Subscription Outstanding	
		Accrued Interest	
		Prepaid Expenses	
		Cash in Hand	
		Cash at Bank	

Format of Closing Balance Sheet:

Liabilities	Amt.	Assets	Amt.
Capital Fund:		Fixed Assets:	
Opening Balance		Opening Balance	
Add: Surplus (or Less: Deficit)		Add: Additions	
Specific Funds (Building Fund, Prize/Match Fund, etc.)		Less: Depreciation	
Opening Balance		Investments	
Add: Donations / Income related to such Funds		Specific Fund Investments	
Less: Expenses related to such Funds		Subscriptions Outstanding	
Subscriptions Received in Advance		Accrued Interest	
Outstanding Expenses (Salary, Rent, Taxes, etc.)		Prepaid Expenses	
		Cash in Hand	
		Cash at Bank	

Accrual Concept

Treatment of Any Expense	Income & Exp. A/c	Balance Sheet
Amount given in Payment (Cr) side of Receipts and Payments A/c	Dr Side	------
Outstanding / Due / Unpaid of Current Year	+	Liability in Closing BS
Outstanding / Due / Unpaid of Previous Year	-	Liability in Opening BS
Advance / Prepaid / Unexpired of Current Year	-	Asset in Closing BS
Advance / Prepaid / Unexpired of Last Year	+	Asset in Opening BS

Treatment of Any Income	Income & Exp. A/c	Balance Sheet
Amount given in Receipt (Dr) side of Receipts and Payments A/c	Cr Side	------
Outstanding / Due / Accrued of Current Year	+	Asset in Closing BS
Outstanding / Due / Accrued of Previous Year	-	Asset in Opening BS
Advance / Unearned of Current Year	-	Liability in Closing BS
Advance / Unearned of Previous Year	+	Liability in Opening BS

Cost of Material Consumed

Treatment of Any Consumables	Income & Exp. A/c	Balance Sheet
Amount given in Payment (Cr) side of Receipts and Payments A/c	Dr Side	------
Outstanding / Due / Unpaid of Current Year	+	Liability in Closing BS
Outstanding / Due / Unpaid of Previous Year	-	Liability in Opening BS
Advance / Prepaid / Unexpired of Current Year	-	Asset in Closing BS
Advance / Prepaid / Unexpired of Last Year	+	Asset in Opening BS
Opening Stock / Stock at the beginning	+	Asset in Opening BS
Closing Stock / Stock at the end	-	Asset in Closing BS

Fund Based Accounting:

Unrestricted

Capital Fund

Restricted

Special Fund

Used for Revenue Expense

Used for Capital Exp

Hire-Purchase

Concept of Hire-Purchase and Installment System

Example:

Price of a car is Rs. 500000.

Options of Payment:

Pay Rs. 500000 now	Pay Rs.100000 now	Pay Rs 100000 now
No Further Liability	+Rs. 40000/month	+Rs. 40000/month
	For 12 months	For 12 months
	In case of default	In case of default
	Seller can Re-possess	Seller can only sue

Difference between Hire-Purchase and Installment System

Particulars	Hire Purchase	Installment
Ownership	Ownership passes to the buyer on the payment of last installment.	Ownership passes at the time of sale.
Default in making payment	Seller can repossess the goods. Installments paid is treated as Hiring charges.	Seller can sue the buyer for the non-payment of price.
Right of sale or transfer	No right to sale or transfer since the legal position of the hirer is bailee.	Right to sale or otherwise transfer the goods.
Loss or damages to the goods.	To be borne by the seller if the buyer takes reasonable care.	To be borne by the buyer.

Accounting of Hire-Purchase Transaction

Transaction	In the books of Hire Purchaser	In the books of Hire Vendor
On transfer of Possession		
On making Down Payment		
On making Interest due on unpaid balance		
On making payment of Instalment		
On providing Depreciation		
On closure of Depreciation A/c and Interest A/c		

Disclosure in the Balance Sheet

In the Books of Hire Purchaser

In the Books of Hire Vendor

Accounting of Full Repossession

In the Books of Hire Purchaser

In the Books of Hire Vendor

Accounting of Partial Re-Possession

In the Books of Hire Purchaser

In the Books of Hire Vendor

Points to Remember

1. Cash Price = PV of all the payments

2. Loan Amortization Table should be prepared

3. Interest rate can be calculated using trial and error method through interpolation.

4. Int. amount in case of quarterly or monthly installments can be calculated using "Ratio Method".

5. If installment amount is same, Annuity Factor can be used.

6. Value of Goods Repossessed by the Vendor:

At the time of Full Repossession – This value is only relevant for Vendor and not for Hire Purchaser. For Hire Purchaser, total amount due to Vendor will be debited.

At the time of Partial Repossession – This value is actually the agreed value between Vendor and Purchaser relevant for both the parties.

7. Int. and Depreciation till date of repossession must be charged.

Insurance Claim

Step - 1

Calculate Book Value of Stock on the date of loss by preparing Memorandum Trading A/c

Step - 2

Calculate Actual Value of Stock Lost:

Book Value	XX
Deduct: Salvage Value	XX
Actual Value of Stock Lost	XX

Step – 3

Average Clause: Encourages full insurance and discourages under-insurance. The insured person also has to bear a portion of loss himself in case the value of-stock lost is more than the value of the policy.

Net Claim = Actual Loss of Stock X Policy Value / Book Value

Note: If Policy Value if more than the Book Value of Stock, Claim is the Value of Actual Loss of Stock.

Notes:

1. Stock on date of fire is either taken from Stores Ledger or calculated by preparing Memorandum Trading Account till the date of fire.

2. To calculate GP Ratio, we may need to prepare Previous Year Trading Account. Adjust GP Ratio according to information (Different GP Ratio or Different Selling Price so different GP Ratio)

3. Abnormal Goods – Double Column Trading Accounts

4. Loss of Stock is both Normal Goods and Abnormal Goods (Realisable Value)

5. Drawings of Goods, Goods distributed, Goods sent on consignment or on approval basis and other similar items need to be treated at cost only.

6. If any amount is written off from stock on account of abnormality, add it back and then treat as segregated between Normal Goods and Abnormal goods.

Claim for Loss of Profit

- Loss of Profit
- Additional Expense
- Average Clause

Steps:

1. Determine the Trend

2. Calculation of Short Sales

3. GP Ratio = (NP + I.S.C) / Sales

4. Calculate Loss of Profit due to short sale

5. Additional Expense:
   Lower of the following
   a. Actual
   b. Incremental Profit due to incremental sales in Loss period
   c. Additional Expense X GP on AATO / (GP on AATO + U.I.S.C)

Note: Trend will only be used on Current FY

6. <u>Total Loss</u>

Loss on GP	XX
Allowed Additional Expense	XX
Savings in I.S.C	(XX)

7. Claim
   Loss X Policy Value / GP on AATO

Departmental Accounts

Why Departmental Accounts:

a. **Proper Allocation**: *Expenses that relate to a particular department are estimated on an exact basis. Hence, cost and profits of each department is estimated more accurately.*

b. **Control** : *Availability of separate cost and profit figures for each department facilitates control. Proper control and fixation of responsibility is easier.*

c. **Proper absorption** : *The processing times of different products in different departments may vary. Specific cost analysis on a department-wise basis facilitates scientific cost absorption and cost assignment.*

Interdepartmental Transfer

For transferor department like sale and for transferee like purchase. In total column or Entity Trading A/c nothing will be shown.

Allocation of Expenses

Specific to any Department –	Charge to that department only
Common Allocable Expense -	Charge on suitable basis
Non Allocable Expense -	Charge to General P/L A/c

S. No	Expenses	Basis of Allocation
1	Rent, rates and taxes, repairs and maintenance, insurance of building	Floor area occupied by each department (if given) otherwise on time basis
2	Lighting and Heating expenses (e.g., energy expenses)	Consumption of energy by each department
3	Selling expenses, e.g., discount, bad debts, selling commission, freight outward, travelling sales manager's salary and other costs	Sales of each department
4.	Carriage inward/ Discount received	Purchases of each department
5.	Wages/Salaries	Time devoted by employees to each department
6.	Depreciation, insurance, repairs and maintenance of capital assets	Value of assets of each department otherwise on time basis
7.	Administrative and other expenses, e.g., salaries of managers, directors, common advertisement expenses, etc.	Time basis or equally among all departments
8.	Labour welfare expenses	Number of employees in each department
9.	PF/ESI contributions	Wages and salaries of each department

1. **Stock Reserve Accounting**

Profit element in the stock due to IDT Stock when transfer is at above cost.

Eliminate unrealised profit from Closing Stock by debiting Gen P/L

Eliminate unrealised profit from Opening Stock by crediting Gen P/L

Calculation of Stock Reserve

Stock X IDT Ratio of **Transferee** *X GP Ratio of* **Transferor**

*While calculating IDT Ratio, consider all the items in the debit side of Trading A/c except Opening Stock and Gross Profit. If IDT is 400 and Purchases, Wages etc is 1600 it means IDT Ratio to be used is "**1/5**" as the fraction*

If Opening IDT Ratio and GP Ratio is not available and neither, can it be calculated, then assume it to be same as Closing IDT Ratio and GP Ratio. (Only if it cannot be computed)

If Stock Reserve is required to be done in Departmental Trading A/c then do it in transferor department.

2. If A to B and B to C

In stock of C,

Calculate B's Loadingin C's stock and Then A's Loading in C's Stock

Branch Accounts

Types

i) Inland

a. Dependent

i. Debtors' method

ii. Stock & Debtors Method

iii. Final accounts method

b. Independent

ii) Foreign

Debtors Method

Step 1. Opening balances of assets and liabilities

Step 2. Recording transactions between HO and branch only

Step 3. Year end closing balances

Step 4. Difference is profit – T/f to G. P/L

- If GSTB at I.P, unloading to be done
- Stock reserve in closing stock and opening stock should be accounted for
- Working notes and memorandum A/cs to be prepared

Stock and Debtors Method

Complete double entry system. No memorandum accounts, all are part of the books of accounts.

Mainly the following ledger are required to be prepared:

i) Branch stock a/c (at invoice price)
ii) Branch debtors a/c
iii) Branch cash a/c
iv) Pilferage, loss in transit, abnormal loss a/c
v) Branch adjustment a/c
vi) Branch P/L a/c
vii) GSTB a/c
viii) May prepare, Branch expense, branch asset a/c

E.g.:

Opening stock at I.P = 400

GSTB = 5000

Opening debtors = 200

Opening cash = 130

Goods returned by branch = 1000

Credit sales = 3200

Cash sales = 1100

Loss in transit (I.P) = 100

Profit on cost = 25%

Insurance claim = 50

Closing stock = 600

Bad debts = 100

Collection from debtors = 2800

Expense paid = 200 by branch and 300 by HO

Final A/C Method

- Everything at cost only except sales
- GSTB like purchase

Independent Branches

1. Double entry completely by branch except capital & drawing (instead there is HO a/c)
2. HO also maintains branch a/c (like two different entities)
3. Accounting of goods in transit and cash in transit (reconciliation accounting)
4. All branches open only an HO account but HO opens an account for each branch
5. Even the transaction between two branches will be recorded by HO. (cumulating entry for a period is allowed)
6. Sometime FA of branch is maintained by HO
   * depreciation to be accounted for by branch

7. Trading & P/L account

* For HO, GSTB is like sales

* For branch GRFHO is like purchases

* HO earns GP on GSTB (for loading)

* branch earns GP on sales above I.P

* HO also earns GP on direct sales

* Stock reserve accounting to be done in HO P/L account

* Goods in transit – stock reserves to be done as well

* GRFHO and GIT relation

Independent Branch- *Incorporation entries in HO Books*

Branch

To Profit from Branch A/c

Assets

To Branch

Branch

To Liabilities

* Branch Personal A/c will become NIL.

Reconstitution of Partnership

Q 1 What is the meaning of Partnership?

Sol: Partnership is the relation between persons and who have agreed to share the profits of a business carried on by all or any of them acting for all.

Main features of Partnership are:

i) **Two or more persons:** It is an association of two or more persons for a common interest.

ii) **Agreement:** The Partnership is an agreement. It may be either oral or in writing.

iii) **Lawful Business:** Partnership is formed to carry on a business; so it must follow the law.

iv) **Profit Sharing:** Profit or loss of the firm is to share by the partners in an agreed ratio and equally where the ratio is not agreed.

Q 2 What are the rules applicable in the absence of Partnership Deed?

Sol: In the absence of Deed, provisions of Partnership Act is applicable:

(i) Profit sharing ratio will be equal

(ii) No Interest on Capital and Drawings

(iii) No Remuneration or Salary to the partners.

(iv) Interest on Loan advanced by the partner @6% p.a.

Q 3 What is the meaning of Reconstitution of Partnership?

Sol: Change in agreement. Business continues:

(i) Change in Profit Sharing Ratio

(ii) Admission of a Partner

(iii) Retirement of a Partner

(iv) Death of a Partner

Q 3 What are the adjustments required at the time of Reconstitution of Partnership?

Sol: Adjustments required are:

1. Adjustment regarding Profit Sharing Ratio
2. Revaluation of Assets and Liabilities
3. Adjustment for Goodwill
4. Adjustment for Accumulated Reserves, Profits and Losses
5. Adjustment of Capitals

Adjustment regarding Profit Sharing Ratio

OPSR

Sacrificing / Gaining Ratio

NPSR

At the time of Admission, Retirement, Death or Change in PSR, we need to know the following 3 aspects of PSR:

1. Old Profit Sharing Ratio i.e OPSR - Always given in the Question, or assume it to be equal.
2. New Profit Sharing Ratio i.e NPSR – Either Given **OR** “Old – Sacrifice” **OR** “Old + Gain”.
3. (Sacrificing Ratio) / Gaining Ratio – Either Given **OR** “Old – New”.

Examples:

1. A and B are partners sharing profit and losses in the ratio of 3 : 2. C is coming as a new partner for 1/5th share of future profit. Calculate new profit sharing and sacrificing ratio.

2. The profit sharing ratio of Arvind and Gobind is 5:3. Dipak was admitted as a new partner. Arvind sacrificed 1/5th of his share and Gobind 1/3rd of his share for Dipak. Calculate the new profit sharing and sacrificing ratio.

3. Amir, Boby and Chetan were the partners in a firm sharing profits and losses equally. Chetan has decided to retire from partnership. New profit sharing ratio of Amir and Boby would be 2:3.

4. P and Q were partners sharing profits/losses as 4 : 3. R is admitted as a new partner for 1/5th share. P and Q decide to share the balance of profits equally.

5. A, B & C were partners sharing profits/loses as 3 : 2: 1. They admitted D as a new partner giving him 1/6th share of future profits. D acquired 3/24 th share from A and 1/24 share from B. Calculate the new Profit Sharing Ratio.

Revaluation of Assets and Liabilities

Revealued Figures to be shown in BS

Revaluation Account

Old Figures to be shown in BS

Memorandum Revaluation Account

Revaluation Account

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Assets		By Assets	
To Liabilities		By Liabilities	
To Partner's Capital		By Partner's Capital	

Memorandum Revaluation Account

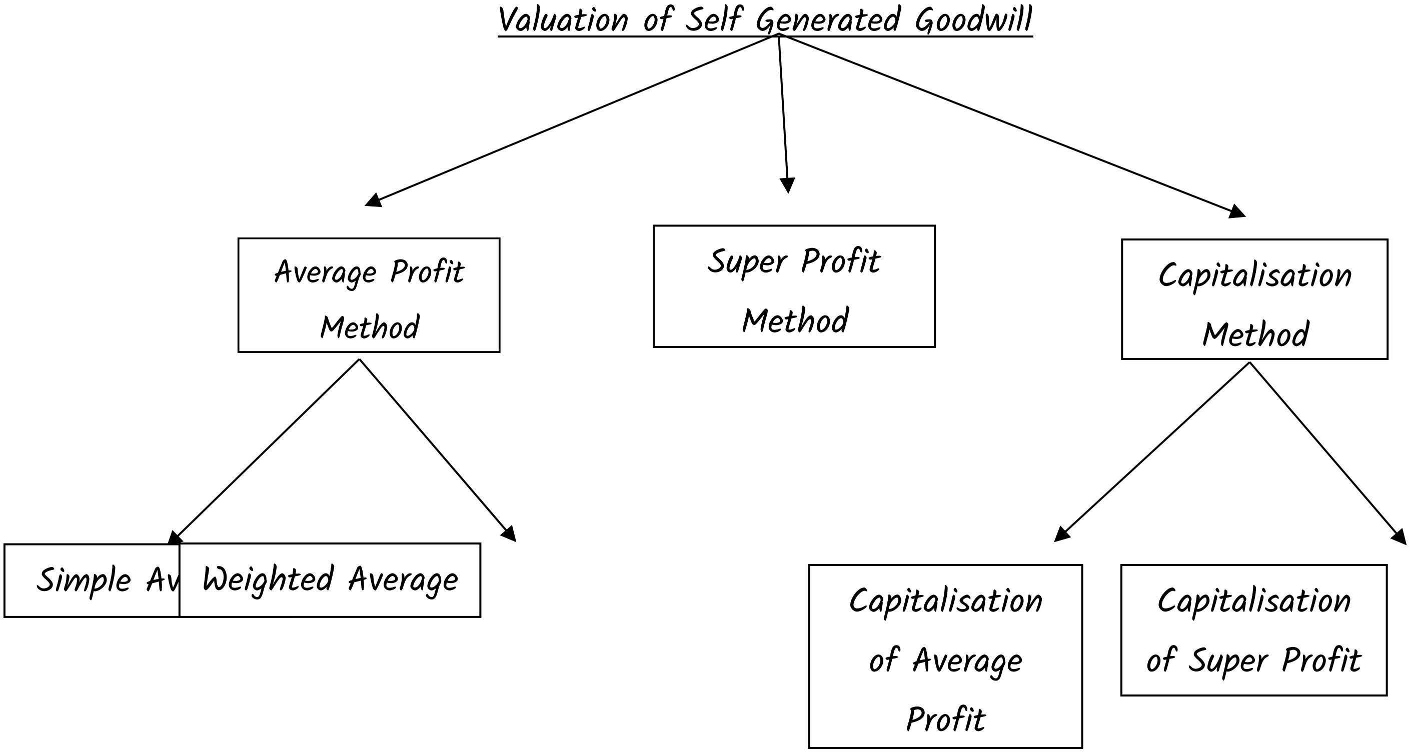
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Assets		By Assets	
To Liabilities		By Liabilities	
To Partner's Capital		By Partner's Capital	
To Assets		By Assets	
To Liabilities		By Liabilities	
To Partner's Capital		By Partner's Capital	

Goodwill:

Sum total of the reputation and other favourable attributes built up by a business.

Goodwill can be a Purchased Goodwill or Self Generated Goodwill. As per AS 26, only Purchased Goodwill can be recorded in the books. However at the time of reconstitution of Partnership (Change in PSR, Admission, Retirement, Death), Valuation of Self Generated Goodwill is done. Accounting for the same is done without recording goodwill in the books (Done through Capital Adjustments)

Valuation of Self Generated Goodwill



Note: Goodwill as per Annuity Method = Annual Super Profit X Present Value of Annuity of Rupee 1.

Accounting Treatment of Goodwill in various cases:

Case	Journal Entry
Existing Goodwill in Balance Sheet	
Gaining Partner pays the goodwill privately	
Gaining Partner brings his share of goodwill in cash or Kind.	
Sacrificing Partners withdraw premium for goodwill or its part	
Gaining Partner not in a position to bring his share of goodwill or a part of it	

Adjustment for Accumulated Reserves, Profits and Losses:

Example

A and B partners sharing profits in the ratio 3:2. C is admitted for 1/6th share.

Balances on the date of Admission:	**Rs.**
General Reserve	10000
Workmen Compensation Reserve	16000
Investment Fluctuation Fund	9000
Employees Provident Fund	4000
Investments	25000
Profit and Loss A/c Debit Balance	3000

Workmen Compensation Claim is Rs. 11000

Market value of investments is Rs. 20000

Show the treatment of reserves

When Reserve is to be maintained at the same value in Balance Sheet?

Specific treatments at the time of retirement or death

Retiring Partner or executor of the deceased partner is entitled to the following:

1. *Balance of his capital and current account at the time of retirement/death.*
2. *Share of goodwill, undistributed profit or loss, reserves and profit or loss on revaluation of assets and liabilities*
3. *Salary, commission, interest on capital, if any and all other dues till the date of retirement/death.*
4. *Any adjustment in drawings and interest thereon.*
5. *His share of profit/loss made by the firm between the last year ending and the date of his retirement or death.*

Journal Entries at the time of settlement of dues of the Retiring Partner / Executor

Journal Entry

Payment of due amount	
Transfer to Loan A/c	
Interest due on Loan	
Payment of Interest	

Retirement/Death in the middle of the year:

Retiring partner or executor of the deceased partner is entitled to the share of profit till the date of retirement or death. Generally profit is estimated on the basis of average of past profits.

Retiring Partner's Capital A/c will be credited for his share of estimated profit.

If there is change in PSR of existing partners then their capital A/c will be debited in Gaining Ratio. Otherwise, P/L Suspense A/c will be debited.

Section 37 of Indian Partnership Act, 1932:

Retiring partner or the executor of the deceased partner, is entitled to the following if any contrary is not agreed:

Maximum of:

i. Interest @ 6% p.a. on the amount due

OR

ii. Share of profit earned from the amount due

Dissolution of Firm and Insolvency

Dissolution

- Of Partnership
- Of Partnership Firm

Settlement of Accounts on Dissolution – Section 48

Losses

Assets

Insolvency of a Partner

If a partner becomes insolvent and fails to pay his debit balance of Capital A/c either wholly or in part, the unrecoverable portion is a loss to be borne by the solvent partners.

Decision in Garner vs. Murray Case

Loss arising due to the insolvency of a partner must be distinguished from an ordinary loss (including realization loss).

Unless otherwise agreed, the decision in Garner vs. Murray requires –

i. That the solvent partners should bring in cash equal to their respective shares of the loss on realization;

ii. That the solvent partners should bear the loss arising due to the insolvency of a partner in the ratio of their Last Agreed Capitals.

Criticism of the decision of Garner vs. Murray

i. *If any solvent partner has a debit balance in capital account, he must not bear the deficiency of the insolvent partner;*

ii. *This principle does not apply if there are only two partners;*

iii. *In spite of having a credit balance in capital account the solvent partner must bring cash equal to the amount of loss on reasilation; and*

If any solvent partner possess more private asset but contributes less capital, as per Garner vs. Murray decision, he will bear less amount of deficiency of the insolvent partner than the other solvent partner who possess less private assets but contributes more capital to the firm. This is not justified.

Insolvency of All the Partners

In this case, Outside liabilities cannot be paid in full. So, it should not be transferred to Realisation A/c. Outside liabilities will have to bear the deficiency.

Piecemeal Distribution:

Assets are sometimes realized gradually over a period of time. In such a case it may be agreed that different parties are to be paid in order of preference as and when assets are realized.

Order of Payment in Piecemeal Distribution:

1 ***Realisation Expenses***

2 *For **provision for expenses** that are to be made*

3 *Preferential creditors (say, Income Tax or any payment made to the **Government**)*

4 ***Secured creditors*** *– upto the amount realized from the disposal of assets by which they are secured and for the balance, if any, to be paid to unsecured creditors.*

5 ***Unsecured creditors*** *– in proportion to the amount of debts, if more than one creditor*

6 ***Partners' loan*** *– if there is more than one partner – in that case, in proportion to the amount of loan*

7 ***Partners' capital*** *– the order of payment may be made by any one of the following two methods:*

A. *Surplus Capital Method/ Proportionate Capital Method/ Highest Relative Capital Method*

B. *Maximum Possible Loss Method*