

**CMA INTER**

# P6 FINANCIAL ACCOUNTING



**Confidence  
Actions  
Success**



# Power Notes

## CMA Inter - Paper 6 Financial Accounting

Your Ultimate Guide for Exam Success

This book perfectly combines precision, clarity, and exam-focused learning, specially crafted for CMA students preparing Financial Accounting.

It offers a concise yet comprehensive approach, covering all the essential concepts in a structured, pointwise format for easy understanding, revision, and retention.

With approximately 200 pages, this book comprehensively covers the entire syllabus as per the latest ICAI Study Material (SM), ensuring that no crucial topic is missed.

Key Features:

- **Comprehensive Yet Precise** - Covers all topics concisely without compromising clarity.
- **Revision Master** - Structured to facilitate quick and effective revision.
- **ICAI SM Aligned** - Every concept is covered as per the latest syllabus.
- **Easy to Learn & Retain** - Simplified explanations and pointwise presentation for better retention.

Wishing you all the very best on your CMA journey!

Happy Learning!

CA Sai Babu

#008080 - Headings

#C84C32 - Key Words

#1F497D - Normal Text



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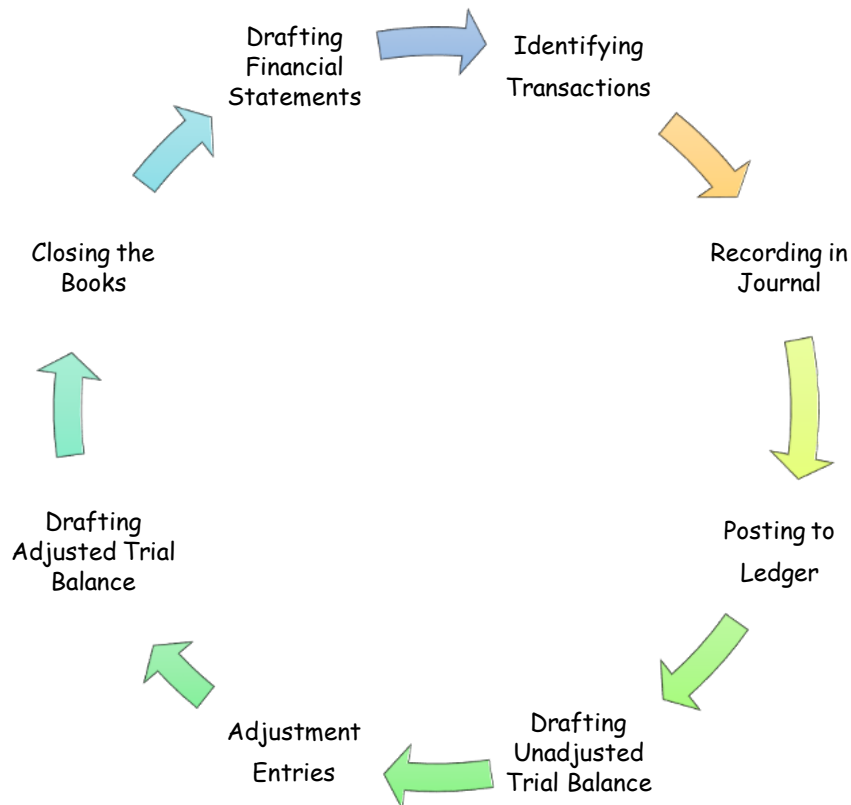


# 1. ACCOUNTING FUNDAMENTALS

## 1. Accounting & Accounting Cycle

Content	
1. Meaning of Accounting	Accounting is the art of <b>Recording, Classifying, Summarizing</b> the transactions and events which have financial Character, <b>Analyzing, Interpreting</b> and <b>communicating</b> the result there of.
2. Accounting Cycle	The Accounting Cycle is the complete <b>process</b> of <b>identifying, recording, processing, and reporting</b> an organization's financial transactions during a period, ending with the <b>preparation of financial statements</b> and <b>closing of accounts</b> . Bookkeepers are responsible for managing this cycle.

### Stages in Accounting Cycle



1.	<b>Identifying Transactions</b> Check if an event is a <b>financial transaction</b> to be recorded.
2.	<b>Recording in Books of Original Entry</b> Record the transaction in the <b>Books of Original Entry (Journal)</b> .
3.	<b>Posting to the Ledger</b> Post journal entries into the <b>respective ledger accounts</b> .
4.	<b>Drafting of Unadjusted Trial Balance</b> Prepare a <b>Trial Balance</b> to check if <b>debits = credits</b> . (Optional step)



5.	<p><b>Passing of Adjustment Entries</b> Make <b>adjusting entries</b> for items like depreciation, outstanding expenses, etc.</p>
6.	<p><b>Drafting of Adjusted Trial Balance</b> Prepare a <b>new Trial Balance</b> after adjustments.</p>
7.	<p><b>Closing of Books</b> In this stage of the accounting cycle, the <b>ledger accounts are closed and balanced</b> ("zeroed out") at the end of every accounting period.</p>
8.	<p><b>Drafting the Financial Statements</b></p> <ul style="list-style-type: none"> <li>➤ The Income Statement is prepared with the <b>closing balances of the nominal accounts</b>, while the <b>balances of real &amp; personal accounts get reflected in the Balance Sheet</b>.</li> <li>➤ Financial statements are prepared in the following order: <b>Income Statement, Statement of Retained Earnings, Balance Sheet and Statement of Cash Flows.</b></li> </ul>

## 2. Events & Transactions

Content	
1.	<p><b>Introduction</b></p> <ul style="list-style-type: none"> <li>➤ The primary purpose of financial accounting is to <b>record the transactions</b> entered into by an organisation during an accounting period. So, transactions are the <b>starting point of the accounting cycle</b>.</li> <li>➤ Transactions are created through events, but <b>all events are not transactions</b>.</li> </ul>
2.	<p><b>Event</b></p> <ul style="list-style-type: none"> <li>➤ Everything that is happening in every moment of human life is an event. Simply stated, any <b>happening is an event</b>.</li> <li>➤ Events can be <b>financial</b> (e.g., buying a book, paying cab fare, receiving a cheque) &amp; <b>non-financial</b> (e.g., visiting a bookstore, going for a walk).</li> <li>➤ An event may involve any <b>number of parties</b>, and may be complete and may be incomplete.</li> </ul>
3.	<p><b>Transaction</b></p> <ul style="list-style-type: none"> <li>➤ An accounting transaction is an <b>event</b> which has a <b>monetary impact</b> on the <b>financial position</b> of the organisation.</li> <li>➤ In order to be considered as a transaction, an event has to satisfy the following conditions: <ul style="list-style-type: none"> <li>a. It must be <b>measurable in terms of money</b>.</li> <li>b. It must involve <b>at least two parties</b>.</li> <li>c. It involves a <b>monetary exchange</b> for a goods or service.</li> <li>d. It must cause a <b>change in the financial position</b> of the entity</li> </ul> </li> </ul>

### Analysis of Transactions

Content	
1.	<ul style="list-style-type: none"> <li>➤ observing the <b>changes in financial position</b> of the organisation caused by the <b>transactions</b> entered into by it during an accounting period.</li> </ul>



➤ A change in financial position means change in one or more of the five basic elements of accounting, they being: **Assets, Liabilities, Capital/ Equity, Expenses, and Revenue.**

S. No	Transaction	Changes in Financial Position	Element(s) Changed
1.	Mr. Suman starts business with ₹5,00,000 cash	Cash increases by ₹5,00,000 Capital increases by ₹5,00,000	Asset increase Capital / Equity increase
2.	Opens bank account with ₹2,00,000 deposit	Cash decreases by ₹2,00,000 Bank balance increases by ₹2,00,000	Asset decrease Asset increase
3.	Borrows ₹1,20,000 from the bank	Bank balance increases by ₹1,20,000 Bank loan increases by ₹1,20,000	Asset increase Liability increase
4.	Purchases equipment for ₹80,000 for cash	Equipments increase by ₹80,000 Cash decreases by ₹80,000	Asset increase Asset decrease
5.	Purchases goods for ₹1,00,000 for resale out of which 60% was paid in cash, 30% by cheque & balance was due.	Purchases increase by ₹1,00,000 Cash decreases by ₹60,000 Bank decreases by ₹30,000 Creditors increase by ₹10,000	Expense increase Asset decrease Asset decrease Liability increase
6.	Sells goods for ₹1,70,000 in cash	Cash increases by ₹1,70,000 Sales increase by ₹1,70,000	Asset increase Revenue increase
7.	Sells goods on credit for ₹80,000	Debtors increase by ₹80,000 Sales increase by ₹80,000	Asset increase Revenue increase
8.	Incurs wages of ₹20,000	Wages increase by ₹20,000 Cash decreases by ₹20,000	Expense increase Asset decrease
9.	Interest on bank loan ₹3,000	Bank interest increases by ₹3,000 Bank balance decreases by ₹3,000	Expense increase Asset decrease
10.	Collects ₹20,000 from customer	Cash increases by ₹20,000 Debtors decrease by ₹20,000	Asset increase Asset decrease
11.	Pays ₹8,000 to supplier	Cash decreases by ₹8,000 Creditors decrease by ₹8,000	Asset decrease Liability decrease
12.	Withdraws ₹7,000 for personal use	Cash decreases by ₹7,000 Capital decreases by ₹7,000	Asset decrease Capital/Equity decrease

### 3. How to record transactions?

#### Double Entry System

#### Content

1.	Double Entry System of Bookkeeping is an <b>accounting system</b> where <b>every transaction</b> has <b>two aspects</b> and both aspects of the transaction are recorded in the books of accounts.
2.	It is a <b>fundamental concept</b> in modern accounting and bookkeeping.
3.	This system <b>records transactions</b> by <b>classifying them as debit or credit.</b>



4.	A debit in one account always has an equal credit in another account.
5.	This system is based on the accounting equation and requires: <ol style="list-style-type: none"> <li>Every business transaction to be recorded in at least two accounts.</li> <li>The total debits recorded = the total credits recorded.</li> </ol>
6.	The rules for deciding debit and credit can be explained using two methods: <ol style="list-style-type: none"> <li>Golden Rules of Accounting (Traditional Approach)</li> <li>Accounting Equation Method (Modern Approach)</li> </ol>

### Traditional/Golden Rules of Accounting

Personal Account	Debit the receiver or who owes to business Credit the giver or to whom business owes
Real Account	Debit what comes into business Credit what goes out of business
Nominal Account	Debit all expenses or losses Credit all income or gains

#### Personal Account:

- These are accounts related to real people like: Suresh's A/c, Anil's A/c, Rani's A/c & artificial persons (like organizations), such as: Infosys A/c, Videocon Industries A/c, ABC Bank A/c, Charitable Trust A/c
- Some are representative personal accounts, which represent a group of people  
Example: Salary Payable A/c - represents amounts payable to employees (we know the individuals, but record it collectively).

#### Real Accounts:

- These accounts relate to assets, properties, or possessions.
- They are of two types:
  - ✓ Tangible Real Accounts  
Assets that you can see and touch (physical existence).  
Examples: Cash A/c, Machinery A/c, Stock A/c, Vehicle A/c
  - ✓ Intangible Real Accounts  
Assets that cannot be seen or touched, but have value.  
Examples: Goodwill A/c, Trademark A/c, Patents A/c, Copyrights A/c

#### Nominal Account:

- These accounts are related to expenses or losses and incomes or gains  
Examples: Salary and Wages A/c, Rent of Rates A/c, Travelling Expenses A/c, Commission received A/c, Loss by fire A/c etc.

### Accounting Equation Method

Assets = Liabilities + Equity or,  
 Assets = Liabilities + [Capital + (Revenue - Expenses) - Drawings]  
 or, Assets + Expenses + Drawings = Liabilities + Capital + Revenue



This equation is considered to be the foundation of the double-entry accounting system.

For Assets	Increase in Assets	Dr.
	Decrease in Assets	Cr.
For Liabilities	Decrease in Liabilities	Dr.
	Increase in Liabilities	Cr.
For Capital	Decrease in Capital	Dr.
	Increase in Capital	Cr.
For Incomes	Decrease in Income	Dr.
	Increase in Income	Cr.
For Expense	Increase in Expense	Dr.
	Decrease in Expense	Cr.

#### Illustrative Accounting Equation Transactions

Transaction	Assets + Expenses + Drawings	Liabilities + Capital + Revenue
1. Cash introduced by proprietor	Cash (Assets) increases	Capital increases
2. Purchase of goods in cash	Inventory (Assets) increases; Cash (Assets) decreases	N.A.
3. Purchase of goods on credit	Inventory (Assets) increases	Creditors/Payables increases
4. Sale of goods in cash	Cash (Assets) increases; Inventory (Assets) decreases	N.A.
5. Sale of goods on credit	Debtors / Receivables (Assets) increases; Inventory (Assets) decreases	N.A.
6. Salaries paid	Salaries (Expense) increases; Cash / Bank (Assets) decreases	N.A.
7. Rent received	Cash/Bank (Assets) increases	Rent received (Revenue) increases
8. Goods withdrawn by proprietor	Inventory (Assets) decreases	Capital decreases

#### 4. Journal

##### Meaning

- Journal is the book of original entry/Book of Prime Entry or Books of First Entry.
- Financial transactions are firstly recorded after their occurrence here.
- Transactions are recorded in chronological order.
- The word 'Journal means' a daily record.
- Journal is derived from French word 'Jour' which means a day.
- The process of recording the transactions in a journal is called 'Journalizing'.



- Every entry in the book of original entry must be followed by a narration - a short summary which describes the particular transaction

### Example of a Transaction and its Journal Entry

Roy Brothers, on 09.02.2023 goods of Rs. 50,000 were purchased. Cash was paid immediately.

Journal entry

In the books of Roy Brothers  
Journal

Date	Particulars	Voucher No.	Ledger Folio	Dr	Cr
				(Rs)	(Rs)
09.02.2023	Purchase A/c To Cash A/c (Being goods purchased for cash)			50,000	50,000

### Types of Journal Entries

- A journal entry can be a Simple journal entry or a Compound journal entry.
- Simple journal entry: only two accounts are affected - one account is debited and another account is credited.  
For example: cash sales, credit purchases etc.
- Compound journal entry: at least two debits and at least one credit or at least one debit and two or more credit items are involved.  
For example: Cash Received from Debtors with Discount Allowed, Purchase of Assets for Cash and Cheque etc

### Types of Journal

#### Content

The books of original entry are broadly classified into two categories:

1. Special Journal
2. General Journal

### Special Journals and Their Functions

#### Content

Special Journal	Functions
1. Cash Journal or Cash Book	<ul style="list-style-type: none"> <li>➤ Recording all transactions which involve cash, whether cash inflows or cash outflows.</li> <li>➤ Records both capital and revenue transactions involving cash.</li> <li>➤ Includes date, particulars, voucher number, ledger folio, and amount.</li> </ul>
2. Purchase Journal / Purchase Day	<ul style="list-style-type: none"> <li>➤ Used to record credit purchases of goods.</li> </ul>



<p>Book or Purchase Book</p>	<ul style="list-style-type: none"> <li>➤ Does <b>not record cash purchases or purchases of long-term assets</b> (like equipment, furniture, machinery etc.).</li> <li>➤ Includes details such as purchase date, invoice number, amount, and ledger folio.</li> <li>➤ All entries in this book are made from the <b>Purchase invoices</b>.</li> </ul> <p><b>Purchase invoice:</b> a statement issued by the seller to the buyer of goods Showing the details of the goods like the date of purchase, the quantity, the rate per unit, the total amount and the terms of payment.</p>
<p>3. Sales Journal/Sales Day Book or Sales Book</p>	<ul style="list-style-type: none"> <li>➤ Used to <b>record credit sales of goods</b>.</li> <li>➤ Does <b>not include cash sales or sales of long-term assets</b> (like equipment, furniture, machinery etc.).</li> <li>➤ Includes date, particulars, outward invoice number, and amount of sales.</li> <li>➤ All entries in this book are made from the <b>Sales invoices</b>.</li> </ul> <p><b>Sales invoice:</b> a statement issued by the seller of goods to the buyer of goods reflecting the details of the goods like the date of sale, the quantity of sale, the rate per unit, the total amount and the terms of payment, if any.</p>
<p>4. Purchase Returns Journal/ Returns Outward Day Book</p>	<ul style="list-style-type: none"> <li>➤ Used to <b>record returns of goods purchased on credit from suppliers</b>.</li> <li>➤ <b>Returns</b> arising out of <b>cash purchases of goods, or return of any assets other than merchandising goods on credit does not find place</b> in this day book</li> <li>➤ Entries include date, items returned, supplier name, and debit note number.</li> <li>➤ All entries in this book are made from the <b>debit notes or credit notes</b>.</li> </ul>
<p>5. Sales Returns Journal/ Sales Returns Day Book/ Sales Returns Book.</p>	<ul style="list-style-type: none"> <li>➤ Used to <b>record returns of goods sold on credit to customers</b>.</li> <li>➤ Entries include date, items returned, customer name, and credit note number.</li> <li>➤ All entries in this day book are made from the <b>Credit Note</b> issued by the seller of goods.</li> </ul>
<p>6. Bills Receivable Journal</p>	<ul style="list-style-type: none"> <li>➤ Used to <b>record the bills of exchange received from the customers</b> to whom goods have been sold on credit.</li> <li>➤ It records the details like the details of the customer, name of drawer, name of acceptor, date of receipt of the bill, date of drawing of the bill, date of acceptance of the bill, tenure of the bill, date of maturity, ledger folio and the amount of the bill.</li> <li>➤ All entries in this book are made from the <b>bills of exchanges received</b> from the customers.</li> </ul>
<p>7. Bills Payable Journal</p>	<ul style="list-style-type: none"> <li>➤ Used to <b>record the bills of exchange issued to the suppliers</b> from whom goods have been purchased on credit.</li> </ul>



- It records the details like the details of the supplier, name of drawer, name of acceptor, date of issue of the bill, date of drawing of the bill, date of acceptance of the bill, tenure of the bill, date of maturity, ledger folio and the amount of the bill.
- All entries in this book are made from the **bills of exchanges issued** to the suppliers.

### General Journal (Journal Proper)

#### Meaning

- Transactions for which **no specific day book** is maintained are recorded here.
- Also known as **Journal Proper**

#### Types of Entries Recorded in Journal Proper

Type of Entry	Description
1. Opening Entries	➤ Entries made to <b>bring forward the balances from the previous accounting period</b> for assets, liabilities, and equity accounts.
2. Transfer Entries	<ul style="list-style-type: none"> <li>➤ Entries through which the <b>amount of an account</b> are transferred to <b>another account</b> are Transfer entries.</li> <li>➤ Required when a <b>wrong booking</b> has been made in respect of <b>any account</b> or <b>to allocate an expense/ revenue from one account to another</b>.</li> </ul>
3. Closing Entries	➤ Entries <b>made at the end of the accounting period</b> for closing nominal accounts (expenses and incomes) to profit determination accounts like Income Statement or Balance Sheet.
4. Adjustment Entries	➤ Entries <b>passed during finalization</b> to <b>adhere to accounting principles</b> (accounting concepts and accounting conventions).
5. Rectification Entries	➤ These entries are <b>passed for correcting the different errors</b> that get committed while recording, posting, casting, balancing etc. in the books of accounts.
6. Occasional / Miscellaneous Entries	➤ It means <b>entries other than above</b> for which <b>no specific subsidiary books</b> are maintained.

#### Steps in Journalising

1.	<b>Determination of Accounts involved</b> in the transaction.
2.	<b>Classifying the accounts</b> either as 'Nominal, Real and Personal' or into 'Assets, Liabilities, Capital, drawings, Expenses and Revenue'.
3.	<b>Applying the rules of debit and credit</b> for the identified accounts for identifying which account is to be debited and which accounts is to be credited.
4.	<b>Recording the details of the transaction</b> viz. date, particulars and its narration, and also the amount to be debited and credited.
5.	<b>Writing a brief summary</b> of the transactions (called <b>narration</b> ) at the end.



### Functions of the Journal

1.	<b>Historical Function:</b> It contains a <b>chronological record of the transactions</b> for future references.
2.	<b>Recording Function:</b> Recording the transactions based on <b>the principles</b> .
3.	<b>Analytical Function:</b> Each transaction is analysed into the <b>debit aspect and the credit aspect</b> .

### Advantages of the Journal

1.	<b>Chronological Record</b> It records transactions as and when it happens. So, it is possible to get <b>detailed day- to-day information</b> , and also acts as a future reference.
2.	<b>Minimising the possibility of errors</b> The nature of transaction and its effect on the financial position of the business is determined by <b>recording and analyzing into debit and credit aspect</b> .
3.	<b>Narrative explanation of the recorded transactions</b> It maintains the detailed record of transactions written immediately after passing the entry, thus provides a <b>highlight of the transaction done</b> .
4.	<b>Helps to classify the accounts</b> Journal is the <b>basis of ledger posting</b> and the <b>ultimate Trial Balance</b> .
5.	<b>Evidence in court</b> Information recorded in the journal which certainly <b>serves as a proof or evidence in the court of law</b> .

### Limitations of the Journal

➤	When a single journal is maintained, it becomes <b>unsuitable for organizations</b> that enter into a large number of transactions.
➤	It is <b>not a simple system</b> of recording of transactions.
➤	The process of journalising is a <b>time-consuming process</b> .
➤	It <b>does not facilitate internal control</b> , because in journal transactions are recorded in chronological order.

## 5. Ledger

### Meaning

1.	Ledger is the <b>book of account</b> in which transactions are <b>recorded in respective account</b> , after they have been entered in the journal.
2.	It contains various ' <b>ledger accounts</b> '.
3.	Known as the <b>Book of Final Entry</b> .
4.	The process of recording the entry in the ledger is technically known as <b>Posting</b> .
5.	The transactions are recorded in a <b>chronological order</b> .



6. It reflects the final position of each account on any particular date.
7. It forms the basis for preparation of Trial Balance.

#### Ledger account format

Dr				Cr			
Date	Particulars	J.F.	(Rs)	Date	Particulars	J.F.	(Rs)

#### Functions of Ledger

1. **Permanent Storehouse:**  
All the transactions of a concern arranged for ready reference.
2. **Summarization of Transactions:**  
Summarizes positive and negative changes in accounts, providing the balance at the end of each period.
3. **Business Analysis:**  
Enables analysis of financial status to plan future actions effectively.

#### Subdivisions of the Ledger

1. **Personal Ledger**
  - Contains personal accounts of all debtors and creditors.
  - It can be further sub-divided into:
    - a. Debtors'/Customers'/Sales ledger: Contains accounts of all customers
    - b. Creditors' / Suppliers' / Purchase/Bought ledger: Contains accounts of all the suppliers.
2. **Impersonal/General Ledger**
  - Contains the accounts other than those contained in the 'Personal Ledger'.
  - The types of accounts maintained in this ledger are Real, Nominal and Personal (except Trade Debtors and Trade Creditors).

#### Advantages

- It provides complete and detailed information of all accounts of similar nature in one book.
- It discloses the summarised information by getting the ledger accounts balanced.

#### Ledger Posting

##### Meaning

When the transaction takes place, it is recorded in the journal in the form of journal entry & this entry is posted again in the respective ledger accounts under double entry principle from the journal.



Debit and Credit Rules		
Account Type	Debit (Dr.)	Credit (Cr.)
1. Assets	Increase in assets	Decrease in assets
2. Liabilities	Decrease in liabilities	Increase in liabilities
3. Capital	Decrease in capital	Increase in capital
4. Expenses	Increase in expenses	Decrease in expenses
5. Income/Gains	Decrease in income	Increase in income

Balancing of Ledger Accounts	
Step	Key Points
1. Definition	<ul style="list-style-type: none"> <li>➤ Balancing a ledger account involves finding the <b>net effect of all transactions recorded in an account</b> by totalling both the debit and credit sides.</li> <li>➤ A debit balance occurs when the <b>debit side</b> total is <b>higher</b> than the <b>credit side</b>.</li> <li>➤ A credit balance occurs when the <b>credit side</b> total is <b>higher</b> than the <b>debit side</b>.</li> </ul>
2. Process	<ul style="list-style-type: none"> <li>➤ Add up the debits and credits in the ledger. The difference is the <b>balance of the account</b> at that point.</li> <li>➤ Nil balance occurs when the debit total equals the credit total.</li> </ul>
3. Importance	<ul style="list-style-type: none"> <li>➤ <b>Balancing</b> the accounts allows for the <b>finalization of accounts</b> and the preparation of the <b>Trial Balance</b> to ensure accuracy.</li> <li>➤ Balancing is important for <b>finalizing the financial statements</b> and ensuring all accounts are correctly posted.</li> </ul>

## 6. Cash Book, Bank Book, Bank Reconciliation Statement

A. Cash Book	
Content	
1.	<p><b>Definition</b></p> <p>The book of account that records <b>all cash receipts and cash payments of an organisation</b> is referred to as cash book.</p>
2.	<p><b>Purpose</b></p> <ul style="list-style-type: none"> <li>➤ An organisation enters into <b>many transactions</b> during an accounting period.</li> <li>➤ A majority of these involve <b>cash either received or paid</b>.</li> <li>➤ To record only such transactions, a <b>separate book is maintained</b>.</li> <li>➤ This book is called the <b>Cash Book</b> and it records only <b>cash-related transactions</b>.</li> <li>➤ Cash transactions may be in the form of <b>liquid cash, cheques, or online transfers</b>.</li> </ul>



### Features of Cash Book

#### Content

- only cash transactions are recorded
- All receipts of cash and payments involving cash are recorded in this book of account.
- Transactions are recorded in this book in chronological order
- The proforma of the cash book is similar to that of a ledger account i.e. having two sides - Debit side and Credit side.
- It is a book of account which is a book of primary entry as-well-as a book of final entry. So, it is referred to as journalized ledger.
- Its balance reflects the balance of cash available.

### Types of Cash Book

#### Content

1. **Introduction**
  - For the purpose of recording cash and bank related transactions at one place cash book is maintained.
  - These cash books can be broadly classified into two categories
    - a. Regular Cash Book and
    - b. Petty Cash Book.
2. **Regular Cash Book/Cash Book**
  - The cash book which records all cash and sometimes bank related transactions of an entity.
  - Based on the number of amount columns maintained on each side of the cash book they are classified as.
    - a. Single Column Cash Book
    - b. Double Column Cash Book
    - c. Triple Column Cash Book
    - d. Multi-Columnar Cash Book
3. **Single Column Cash Book**
  - only one amount column is maintained on each side to record transactions involving liquid cash.
  - Usually maintained by the small organisations which do not have any bank account.
  - The balance of this cash book represents cash-in-hand at a particular point of time.

#### Proforma Cash Book (Single Column)

Dr				Cr			
Date	Particulars	L.F.	Cash (Rs)	Date	Particulars	L.F.	Cash (Rs)

4. **Double Column Cash Book**
  - A cash book with two columns: one for cash transactions and one for bank transactions (instead of opening a separate bank account in the ledger).



- Reflects both **cash-in-hand** and **cash-at-bank** at a particular point of time.
- Contra Entry:
  - a. When a **transaction** involves both **Bank A/c** and **Cash A/c**, it is recorded on both sides of the Double Column Cash Book.  
Examples: Cash deposited into bank, Cash withdrawn from bank
  - b. The **letter 'C'** is written in the **Ledger Folio (L.F.)** column on both sides to indicate a contra entry.

#### Proforma Cash Book (Double Column)

Dr					Cr				
Date	Particulars	L.F.	Cash (Rs)	Bank (Rs)	Date	Particulars	L.F.	Cash (Rs)	Bank (Rs)

5. **Triple Column Cash Book**
- A cash book with **Three columns** each side: **Cash, Bank and Discount** columns
  - The discount column
    - Debit side represent **Discount Allowed & Credit side** represent **Discount Received.**
  - There are two types of discounts:
    - **Trade Discount**
    - **Cash Discount**
  - Trade Discount:
    - Given by seller to buyer **for bulk purchases.**
    - **Not recorded** in the books of account.
  - Cash Discount:
    - Given to encourage **prompt payment.**
    - **Recorded** in the discount columns of the Triple Column Cash Book.
  - The discount columns are **not balanced**; rather they are **transferred to the respective discount accounts** in general ledger.

#### Proforma Cash Book (Triple Column)

Dr.						Cr					
Date	Particulars	L.F.	Cash (Rs)	Bank (Rs)	Dis (Rs)	Date	Particulars	L.F.	Cash (Rs)	Bank (Rs)	Dis (Rs)

6. **Multi-Columnar Cash Book**
- A **customized cash book** used by businesses with **huge cash transactions** take place under certain **fixed heads**
  - Used by businesses like clubs, schools, colleges etc.



## Proforma Multi-columnar Cash Book

Dr.

Cr.

Date	Particulars	Subscription	Interest received	Date	Particulars	Salaries & wages	Rent & taxes

## Petty Cash Book

1. **Petty Cash Book**
  - In organisations with numerous cash transactions, it's difficult for one person to handle all cash and bank entries.
  - To manage this, cash handling is split into two groups.
  - Petty Cashier - manages small, frequent cash expenses.
  - Principal/Chief Cashier - handles all other major transactions.
  - This leads to the use of a special book called the Petty Cash Book.
  - It records only low-value, frequent cash transactions.
  - It helps in reducing the burden on the main cashier and ensures better control over small expenditures.
  - Petty cash is given using either the Ordinary System or the Imprest System.
2. **Ordinary System**
  - A pre-decided lump sum is given by the Chief Cashier to the Petty Cashier.
  - The Petty Cashier uses this to meet small day-to-day expenses.
  - After spending the entire amount, the Petty Cashier:
    - Submits a summary of expenses.
    - Requests reimbursement from the Chief Cashier.
3. **Imprest System**
  - Imprest System involves estimating petty expenses for a set period in advance.
  - The estimated amount is called Imprest Cash or Imprest Float.
  - This amount is advanced by the Chief Cashier to the Petty Cashier.
  - The Petty Cashier uses it to meet small, recurring expenses during the period.
  - At the end of the period, the Petty Cashier:
    - Prepares a Statement of Petty Expenses.
    - Submits it to the Chief Cashier.
  - The Chief Cashier reimburses the exact amount spent, restoring the imprest amount. Thus, at the start of every period, the same imprest balance is maintained.
  - The petty cash book is:
    - Usually in Single Column format.
    - In some organisations, a multi-column format is used with predefined expense heads on the credit side.



## B. Bank Book

### Meaning

- A Bank Book (or Bank Journal) records all **bank-related receipts and payments**.
- It is maintained **separately** instead of using a bank column in the Cash Book.
- **Large organisations** prefer it due to the **high volume of bank transactions**.
- To **reduce errors or missed entries**, separate Bank Books can be kept for each bank account.
- The format is similar to a Single Column Cash Book:  
Debit side → Bank Receipts  
Credit side → Bank Payments
- Helps in **easy and accurate Bank Reconciliation**.
- The **Bank Book is different from a Pass Book or Bank Statement**, which are issued by the bank and show the bank's view of the client's account.

## Bank Reconciliation Statement

1. **Purpose**
  - Ideally, the Cash Book (Bank Column) and Pass Book should show **the same balance**.
  - However, in practice, **differences often arise due to certain reasons** (like timing differences, unrecorded transactions, etc.).
  - **To identify and explain these differences**, a Bank Reconciliation Statement (BRS) is prepared.
  - BRS helps in **matching the balances as per the organisation's books and the bank's records**.
2. **Key Features of BRS**
  - **Not a part of the formal books of accounts**.
  - Prepared at **regular intervals** to verify accuracy of the Cash Book (Bank Column) and Pass Book.
  - **Does not rectify any errors** in the books — it only helps in **identifying the causes of differences**.
  - The main objective is to **reconcile the discrepancies** between the two books as on a specific date.
3. **Reason for Disagreement Between Cash Book and Pass Book**  
The differences mainly arise **due to timing or communication gaps** between entries made by the organisation and the bank.  
Common causes include:
  - a. **Cheque issued but not yet presented for payment**.
  - b. **Cheque deposited but not yet collected/cleared by the bank**.
  - c. **Amount directly deposited into the bank account by third parties**.
  - d. **Bank charges, incidental fees, or interest on overdraft debited by the bank**.
  - e. **Interest credited by the bank on deposits**.
  - f. **Dishonour of cheques deposited**.



- g. Clerical errors by the organisation or the bank.
  - h. Payments made by the bank as per standing instructions (e.g., EMI, insurance, rent).
- Note:** It is worth mentioning at this point that in this technologically advanced era many of the abovementioned causes of disagreement has been done away with the emergence of digital transactions.

### Methods for Preparing Bank Reconciliation Statement

1. **Without Amended Cash Book Method**
  - Start with either:
    - Cash Book (Bank Column) balance, or
    - Pass Book balance.
  - Identify the reasons for difference between the two balances.
  - Adjust each item causing disagreement by:
    - Adding or
    - Subtracting, as applicable.
  - After adjusting all items, the resulting figure should be the balance as per the other book.
  - This process helps in ensuring both Cash Book and Pass Book balances are reconciled.
2. **Amended Cash Book Method**
  - First, prepare an Amended Cash Book to find the corrected bank balance.
  - Include the following in the amended cash book:
    - Items already recorded in the Pass Book but not yet entered in the Cash Book.
    - Errors made in the original Cash Book.
  - Do not include:
    - Errors made by the bank - these are shown only in the BRS.
  - After preparing the Amended Cash Book:
    - Use the corrected balance to prepare the BRS.
    - Adjust for any remaining differences, mainly due to bank errors or timing differences.
  - This method ensures the Cash Book balance is accurate before reconciling it with the Pass Book balance.

## 7. Trial Balance (Preparation and Scrutiny)

### Content

- A Trial Balance is a statement prepared using ledger balances to check the arithmetical accuracy of accounts.
- Its primary purpose is to ensure no mathematical errors exist in ledger posting.
- With the advent of computerised accounting, the need for manual trial balance preparation has reduced significantly.
- It is a columnar statement with the following columns:  
Serial Number



Name of Ledger Account  
 Ledger Folio (L.F.)  
 Debit Amount  
 Credit Amount

- If the accounting is correct and complete, the Debit and Credit columns should tally.

### Trial Balance Proforma

Sl. No.	Ledger Accounts	L.F.	Dr. (Rs.)	Cr. (Rs.)

### Features of Trial Balance

- It is a statement, not an account.
- Not a part of the double-entry system.
- Does not appear in the formal books of accounts - prepared as a separate document.
- Prepared as on a particular date, not for a period.
- Can be prepared monthly, quarterly, half-yearly, or annually.
  - Mandatory at the end of the accounting year before final accounts.
- If books are arithmetically accurate, total debit balances = total credit balances.
- Agreement of the Trial Balance is only a prima facie evidence,
  - It does not guarantee complete accuracy of the books.

### Advantages of a Trial Balance

- Checks accuracy of ledger posting - ensures both debit and credit aspects of transactions are recorded.
- Confirms that amounts are arithmetically correct in the ledger.
- Summarises ledger balances, making it easier to prepare financial statements.
- Acts as a link between ledger accounts and financial statements.

### Limitations of a Trial Balance

- Applicable only under the Double Entry System - cannot be used by entities not following this system (e.g., small businesses).
- Agreement of trial balance is not conclusive proof of accuracy - it only gives prima facie assurance.
- Certain errors remain undetected.

### Errors Not Identified by Trial Balance

1.	Error of Omission or Duplication A transaction is completely omitted or recorded twice in the original book.
2.	Error of Commission



	<ul style="list-style-type: none"> <li>➤ Correct account is used, but wrong amount is posted, or</li> <li>➤ Wrong account is used within the same category (e.g., personal accounts).</li> </ul>
3.	<b>Error of Principle</b> Transaction is recorded against accounting principles, e.g., Capital purchase recorded as Revenue expense.
4.	<b>Error of Original Entry</b> Wrong amount entered in the subsidiary book itself.
5.	<b>Compensating Errors</b> Two or more independent errors cancel each other, making the trial balance appear correct.

### Methods of Preparing Trial Balance

1.	<b>Total Method</b> <ul style="list-style-type: none"> <li>➤ Debit and credit totals of each ledger account are taken.</li> <li>➤ Both totals are shown in the respective columns of the Trial Balance.</li> <li>➤ Can be prepared without balancing the ledger accounts.</li> </ul>
2.	<b>Balance Method</b> <ul style="list-style-type: none"> <li>➤ Prepared only after balancing each ledger account.</li> <li>➤ Only the net balance (debit or credit) of each account is shown in the Trial Balance.</li> <li>➤ This is the most commonly used method.</li> </ul>

## 8. Adjustments and Rectifications

### A. Depreciation and Amortisation

#### Concept

- Fixed Assets are bought for long-term use in business.
- Over time, their value declines due to:
  - Wear and tear
  - Passage of time
  - Obsolescence, etc.
- This gradual reduction in value is called Depreciation.
- Depreciation represents the expired cost of a tangible fixed asset during a period.
- Its purpose is to allocate the cost of the asset over its useful life.
- Depreciation is charged on all tangible fixed assets except freehold land,
  - Because land has an unlimited useful life and does not wear out.

#### Characteristics of Depreciation

- It is a reduction in the book value of fixed assets (except freehold land).
- The reduction is permanent, gradual, and ongoing in nature.
- Depreciation is a continuous annual process, caused by:
  - Usage, or
  - Passage of time.



- It usually occurs **gradually**, unless accelerated by **rapid wear, damage, or technological obsolescence**.

### Depreciation, Amortisation, and Depletion

#### Depreciation

- Refers to **wearing out, consumption, or loss of value of a tangible asset**.
- Caused by **usage, passage of time, or obsolescence (technological or market-based)**.
- It is the **systematic allocation of the cost of a tangible fixed asset over its useful life**.
- Charged on **tangible fixed assets (e.g., machinery, furniture)**.
- Not applicable to freehold land, as it has an infinite life.

#### Amortisation

- Refers to systematic **writing-off of the cost of intangible assets over their useful life**.
- Applied to assets like **patents, copyrights, trademarks, goodwill**.
- Similar to depreciation, but used for intangible (non-physical) assets.

#### Depletion

- Refers to the **reduction in value of natural resources (wasting assets)**.
- Occurs due to **extraction of resources like coal, oil, minerals**.  
Example: Coal mined from a coal field reduces the total available coal, thus representing depletion.

### Methods of Recording Depreciation

#### Content

There are two alternative methods of recording depreciation.

- When depreciation is charged to the Asset Account; &
  - When Provision for Depreciation/Accumulated Depreciation Account is opened.
- When Depreciation is charged against asset
    - Under this method, the amount of **depreciation is credited to the concerned Asset Account**.
    - Depreciation Account, being a **nominal account**, is transferred to the Profit and Loss Account at the end of every accounting period.
    - In the **Balance Sheet**, asset is shown at its **written down value (i.e., cost less depreciation provided till date)**.

Journal entries:

    - Depreciation A/c Dr  
    To Asset A/c.  
(Being the depreciation on asset charged)
    - Profit and Loss A/c Dr  
    To Depreciation A/c  
(Being the depreciation transferred to Profit and Loss A/c)
  - Provision for Depreciation





	<ul style="list-style-type: none"> <li>➤ In subsequent years, it is on book value (WDV).</li> <li>➤ Thus, amount reduces year after year.</li> <li>➤ Under this method, Depreciation p.a. is calculated as under: For newly acquired Fixed Asset = Original Cost × Rate of Depreciation For existing Fixed Asset = Opening WDV × Rate of Depreciation</li> </ul>
3.	<p><b>Sum of Years' Digit Method</b></p> <ul style="list-style-type: none"> <li>➤ Depreciation is based on the sum of the asset's useful life years.</li> <li>➤ The depreciation expense is higher in earlier years and decreases in later years.</li> <li>➤ <math>\text{Depreciation} = (n - 1) / \text{Sum of Years Digit} * (\text{Cost} - \text{Residual Value})</math></li> </ul>
4.	<p><b>Sinking Fund Method</b></p> <ul style="list-style-type: none"> <li>➤ A fund is created by setting aside a fixed amount periodically to cover the cost of asset replacement or repairs.</li> <li>➤ Amount deposited periodically accumulates for future replacement.</li> </ul>
5.	<p><b>Annuity Method</b></p> <ul style="list-style-type: none"> <li>➤ Depreciation is calculated based on a fixed annual amount using the annuity concept, considering interest and depreciation.</li> <li>➤ Regular annual payments over the asset's useful life.</li> </ul>
6.	<p><b>Insurance Policy Method</b></p> <ul style="list-style-type: none"> <li>➤ An insurance policy is taken out to cover depreciation and loss, with premiums paid over the asset's useful life.</li> <li>➤ Premiums accumulate over the asset's life to compensate for depreciation.</li> </ul>

Profit or Loss on Sale of Assets	
Content	
When No Provision for Depreciation Account is Maintained	
Transaction	Journal Entry
1. Transfer WDV of asset-to-Asset Disposal Account	Asset Disposal A/c Dr. To Asset A/c
2. Sale of the Asset	Cash/Bank A/c Dr. To Asset Disposal A/c
3. Depreciation (if any)	Depreciation (P & L A/c) Dr. To Asset Disposal A/c
4. Profit on Sale of Asset	Asset Disposal A/c Dr. To Profit & Loss A/c
5. Loss on Sale of Asset	Profit & Loss A/c Dr. To Asset Disposal A/c
Alternative Approach Adjustments through the Asset Account	
Step	Journal Entry
1. Sale of the Asset	Cash/Bank A/c Dr. To Assets A/c



2. Depreciation Adjustment	Depreciation (Profit & Loss A/c) Dr. To Assets A/c
3. Profit on Sale	Assets A/c Dr. To Profit & Loss A/c
4. Loss on Sale	Profit & Loss A/c Dr. To Assets A/c

### Change of Depreciation Method

#### Content

1.	<b>Basis of Selection</b> Depreciation method should reflect the pattern in which the future economic benefits of the asset are expected to be consumed by the enterprise.
2.	<b>Annual Review</b> The method should be reviewed at least once every year-end.
3.	<b>Change in Depreciation Method</b> <ul style="list-style-type: none"> <li>➤ If there's a significant change in expected usage pattern, the method must be revised accordingly.</li> <li>➤ Such change is treated as a change in accounting estimate (as per AS 5), not a change in policy.</li> </ul>
4.	<b>Consistency</b> Once selected, the method should be consistently applied year after year.
5.	<b>Prospective Change</b> Any change should be done prospectively (going forward), not retrospectively.

### B. Adjustment Entries

#### Concept

1.	<b>Purpose</b> Adjustment entries are passed to correct ledger balances so that they reflect the true financial position of the organisation.
2.	<b>Timing</b> They are made at the end of the accounting period before preparing final accounts.
3.	<b>Reason for Adjustment</b> Some transactions are not yet recorded or incompletely recorded during the year – these entries update the books.
4.	<b>Effect</b> They impact both the Income Statement and the Balance Sheet.
5.	<b>Basis</b> These entries are passed without source documents (like invoices or bills); they are based on the need for correct matching and accrual.
6.	<b>Importance in Accounting Cycle</b>



	Adjustments are an <b>essential part of the accounting cycle</b> and must be built into the system.
7.	<b>Next Step</b> Once all adjustment entries are passed, an <b>Adjusted Trial Balance</b> is prepared to generate final financial statements.

### Features of Adjustment Entries

- These are a **special type of journal entries**.
- These entries are **recorded on the General Journal/ Journal Proper**.
- They are passed to **reflect the reality**.
- These entries are passed to **comply with the accounting principles**.
- Adjustment entries are **passed at the end of an accounting period**.

### Classification of Adjustment Entries

1.	<b>Pre-payments and Pre-receipts</b> <b>Prepaid Expenses:</b> Amounts paid in advance for services not yet received. Example: Prepaid Insurance. <b>Unearned Revenues:</b> Money received in advance for services not yet rendered. Example: Subscription received in advance by a club.
2.	<b>Accruals</b> <b>Accrued Expenses (Outstanding Expenses):</b> Expenses incurred but not yet paid or recorded. Example: Outstanding electricity bill as on 31.03.2022. <b>Accrued Incomes:</b> Incomes earned but not yet received or recorded. Example: Interest earned but not received.
3.	<b>Non-cash Expenses (Estimates)</b> Expenses that <b>do not involve actual cash outflow</b> at the time of recording, but are estimated and provided. Examples: <ul style="list-style-type: none"> <li>• Depreciation</li> <li>• Provision for doubtful debts</li> <li>• Amortisation</li> </ul>

### Adjustment Entries

Adjustment Type	Adjustment Entry
1. Closing Stock	Stock-in-trade A/c Dr. To Purchases/Trading A/c
2. Goods Withdrawn by Owner	Drawing A/c Dr. To Purchases A/c
3. Goods Distributed as Free Samples	Advertisement A/c Dr. To Purchases A/c



4. Goods distributed as free samples to employees	Wages/Salaries A/c Dr. To Purchases A/c
5. Goods-in-transit	Goods-in-transit A/c Dr. To Purchases/ Trading A/c
6. Abnormal loss of stock	Abnormal Loss A/c Dr. To Purchase/ Trading A/c
7. Stock used as stationary	Stationery A/c Dr. To Purchases/ Stock A/c
8. Materials used for constructing Fixed Assets	Fixed Assets A/c Dr. To Purchases/ Stock A/c
9. Goods sent on approval basis, pending approval on Balance Sheet date	Sales A/c Dr. To Sale or Return Suspense A/c Stock on Sale or Return A/c Dr. To Trading A/c
10. Outstanding Expenses	Expenses A/c Dr. To Outstanding Expenses A/c
11. Prepaid Expenses	Prepaid Expenses A/c Dr. To Expenses A/c
12. Pre-received Income	Income A/c Dr. To Pre-received Income A/c
13. Accrued Incomes	Accrued Income A/c Dr. To Income A/c
14. Depreciation on Fixed Assets	Depreciation/Amortisation A/c Dr. To Fixed Assets A/c
15. Provision for Bad Debts	P/L A/c Dr. To Provision for Bad Debts A/c
16. Provision for Discount on Debtors	P/L A/c Dr. To Provision for Discount on Debtors A/c
17. Mutual Set-off (Debtors & Creditors)	Creditors A/c Dr. To Debtors A/c

### C. Accounting Treatment of Bad Debts, Provision for Doubtful Debts, Provision for Discount on Debtors & Creditors

#### Classification of Debts

##### Content

#### Meaning of Debt & Debtors

- The amount which is receivable from a person or a concern for supplying goods or services is called Debt.
- Debtors refer to those entities who take the benefit of delayed payment.
- On the basis of the chances of collection from the debtors, debts may be classified into the following three categories:



	<ul style="list-style-type: none"> <li>a. Good debts,</li> <li>b. Doubtful debts &amp;</li> <li>c. Bad debts.</li> </ul>
Good Debts	<ul style="list-style-type: none"> <li>➤ Amounts fully recoverable with no doubts.</li> <li>➤ No provision needed.</li> <li>➤ Normal business receivables.</li> </ul>
Doubtful Debts	<ul style="list-style-type: none"> <li>➤ Collection is uncertain as on the date of final accounts.</li> <li>➤ Not written off immediately.</li> <li>➤ Provision made (based on past experience) to match revenue and expense.</li> <li>➤ Follows matching principle.</li> </ul>
Bad Debts	<ul style="list-style-type: none"> <li>➤ Amounts that are definitely irrecoverable.</li> <li>➤ Treated as business loss.</li> <li>➤ Journal Entry: Bad Debts A/c Dr.     To Debtors A/c</li> <li>➤ Bad Debts A/c is a Nominal Account (represents loss).</li> <li>➤ Transferred to P&amp;L A/c at year-end or Adjusted through Provision for Doubtful Debts A/c, if provision exists.</li> </ul>

#### Journal Entries for Bad Debts and Provision for Doubtful Debts

Scenario	Journal Entry
1. For Bad Debts (in the 1st year)	Bad Debts A/c Dr. To Sundry Debtors A/c
2. For Creating Provision for Doubtful Debts (in the 1st year)	Profit and Loss A/c Dr. To Provision for Doubtful Debts A/c
3. Transferring Bad Debts to Profit & Loss (in the 1st year)	Profit and Loss A/c Dr. To Bad Debts A/c
4. Bad Debts (in 2nd/ Subsequent years)	Bad Debts A/c Dr. To Sundry Debtors A/c
5. For Adjusting Provision for Doubtful Debts (in 2nd/ Subsequent years)	If Closing Provision is greater than Opening Provision: Profit and Loss A/c Dr. To Provision for Doubtful Debts A/c If Closing Provision is less than Opening Provision: Provision for Doubtful Debts A/c Dr. To Profit and Loss A/c

#### Provision for Discount on Debtors

##### Content

1.	<p>Meaning</p> <p>Suppliers allow cash discount for prompt payment by customers.</p>
----	--



2.	<b>Purpose</b> <ul style="list-style-type: none"> <li>➤ A provision is created to cover expected loss due to such discounts.</li> <li>➤ Provision for Discount on Debtors is made on Sundry Debtors to account for likely discounts during the accounting period.</li> </ul>												
3.	<b>Reason for Provision</b> <ul style="list-style-type: none"> <li>➤ Customers may claim discounts for early payment of dues.</li> <li>➤ Hence, a provision is created to cover the expected loss from such discounts.</li> </ul>												
4.	<b>Estimation Basis</b> Provision is made at an estimated rate based on: <ul style="list-style-type: none"> <li>• Past experience, and</li> <li>• Closing balance of Sundry Debtors.</li> </ul>												
5.	<b>Computation</b> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 80%;">Gross Debtors</td> <td style="text-align: right;">xxxx</td> </tr> <tr> <td>Less: Bad Debts</td> <td style="text-align: right;">xxxx</td> </tr> <tr> <td>Less: Provision for Doubtful Debts</td> <td style="text-align: right;">xxxx</td> </tr> <tr> <td><b>Good Debtors</b></td> <td style="text-align: right;"><b>xxxx</b></td> </tr> <tr> <td>Discount Rate</td> <td style="text-align: right;">%</td> </tr> <tr> <td><b>Provision for Discount on Debtors</b></td> <td style="text-align: right;"><b>xxxx</b></td> </tr> </table>	Gross Debtors	xxxx	Less: Bad Debts	xxxx	Less: Provision for Doubtful Debts	xxxx	<b>Good Debtors</b>	<b>xxxx</b>	Discount Rate	%	<b>Provision for Discount on Debtors</b>	<b>xxxx</b>
Gross Debtors	xxxx												
Less: Bad Debts	xxxx												
Less: Provision for Doubtful Debts	xxxx												
<b>Good Debtors</b>	<b>xxxx</b>												
Discount Rate	%												
<b>Provision for Discount on Debtors</b>	<b>xxxx</b>												

Accounting for Provision for Discount on Debtors	
Scenario	Journal Entry
<b>For the First Year</b>	
1. Discount Allowed	Discount Allowed A/c Dr. To Sundry Debtors A/c
2. Transfer Discount Allowed to P&L	Profit and Loss A/c Dr. To Discount Allowed A/c
3. Provision for Discount on Debtors	Profit and Loss A/c Dr. To Provision for Dis on Debtors A/c
<b>For the Second/ Subsequent Years</b>	
4. Discount Allowed	Discount Allowed A/c Dr. To Sundry Debtors A/c
5. Provision for Discount on Debtors	Provision for Discount on Debtors A/c Dr. To Discount Allowed A/c
6. Next Year Provision Estimate	i. If New Provision is More than Old Provision: Profit and Loss A/c Dr. To Provision for Discount on Debtors A/c ii. If New Provision is Less than Old Provision: Provision for Discount on Debtors A/c Dr. To Profit and Loss A/c



Recovery of Bad Debts	
Meaning	
1.	If the amount is <b>recovered in a later year</b> , it becomes an <b>income</b> in that year.
2.	Bad debts are <b>previously written off as loss</b> and debited to Profit & Loss A/c.
Journal Entries for Recovery of Bad Debts	
a)	When Bad Debts are Recovered Cash/Bank A/c Dr. To Bad Debts Recovery A/c
b)	When Transferred to Profit & Loss Bad Debts Recovery A/c Dr. To Profit & Loss A/c

Provision for Discount on Creditors	
Content	
1.	What is Provision for Discount on Creditors? When a business purchases goods on credit, and the <b>supplier offers a discount for early payment</b> , a provision is created for this anticipated discount.
2.	Why is it Created? ➤ It is <b>created to account for discounts</b> that might be received from creditors for early payment. ➤ This ensures that the <b>anticipated income is accounted for</b> in the books.
3.	How is it Reflected? The Provision for Discount on Creditors is reflected on the <b>liabilities side of the Balance Sheet</b> , deducted from the creditors balance.

Accounting Treatment for Provision for Discount on Creditors	
Scenario	Journal Entry
Creating Provision for Discount on Creditors	Provision for Discount Received A/c Dr. To Profit & Loss A/c
Creation and maintenance of provision on creditors is a <b>violation to the conservatism convention or the doctrine of prudence</b> .	

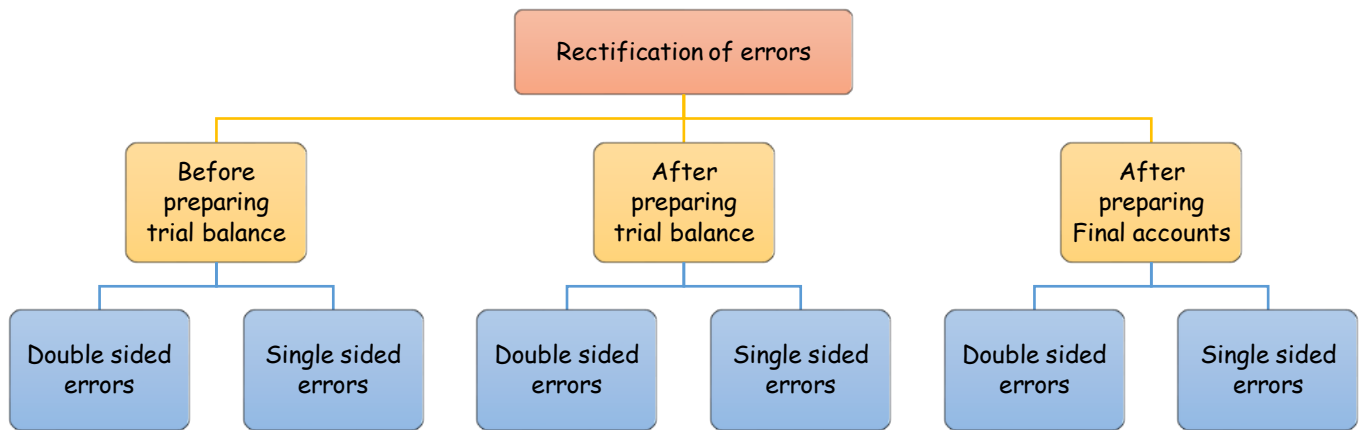
D. Rectification Entries	
Content	
1.	Meaning of Rectification Entries ➤ Entries passed to <b>correct accounting errors or mistakes</b> . ➤ Also called <b>Correction Entries</b> . ➤ <b>Recorded in Journal Proper</b> .
2.	Trial Balance Difference When T.B. doesn't tally due to <b>one-sided errors</b> , the difference is posted to <b>Suspense A/c</b> temporarily.



3. **Suspense A/c uses**
- Only for **one-sided errors** (i.e., only one account affected)
  - **Example:**  
If Sales Book total is wrong, but individual customer accounts are correct:
    - Only Sales A/c is over/under credited.
    - Causes imbalance in T.B.
  - In such cases the **rectification entry** will be passed through Suspense A/c.
  - **Once Error is Located:**
    - One part of the correction goes to correct account.
    - Other part to Suspense A/c (for one-sided errors).
  - **For Two-Sided Errors:**
    - No Suspense A/c used.
    - Entry passed by debiting correct A/c and crediting wrong A/c, or vice versa.

### Types of Errors and Their Rectification

Content		
Type of Error	Description	Rectification Method
1. Error of Principle	Entering <b>revenue expense</b> as <b>capital expense</b> or vice versa or entering <b>revenue receipt</b> as <b>capital receipt</b> or vice versa.	A journal entry is passed to give correct effect.
2. Error of Omission	Transaction forgotten to be entered in books of accounts.	Simply, the correct entry is passed.
3. Error of Commission	Entering to wrong head of account.	Debit or credit wrong A/c head and post it to correct head.
4. Compensating Errors	More than one error that could compensate effect of each other.	Pass correcting entry
5. Wrong Totalling	Wrong totalling of subsidiary books	As it affects T.B., pass through Suspense A/c
6. Posting on Wrong Side	Debited instead of credit or vice versa.	Pass an entry with double effect - one to cancel wrong side and other to give effect on correct side
7. Posting of Wrong Amount	Amount posted differs from actual figure.	Pass entry with differential amount

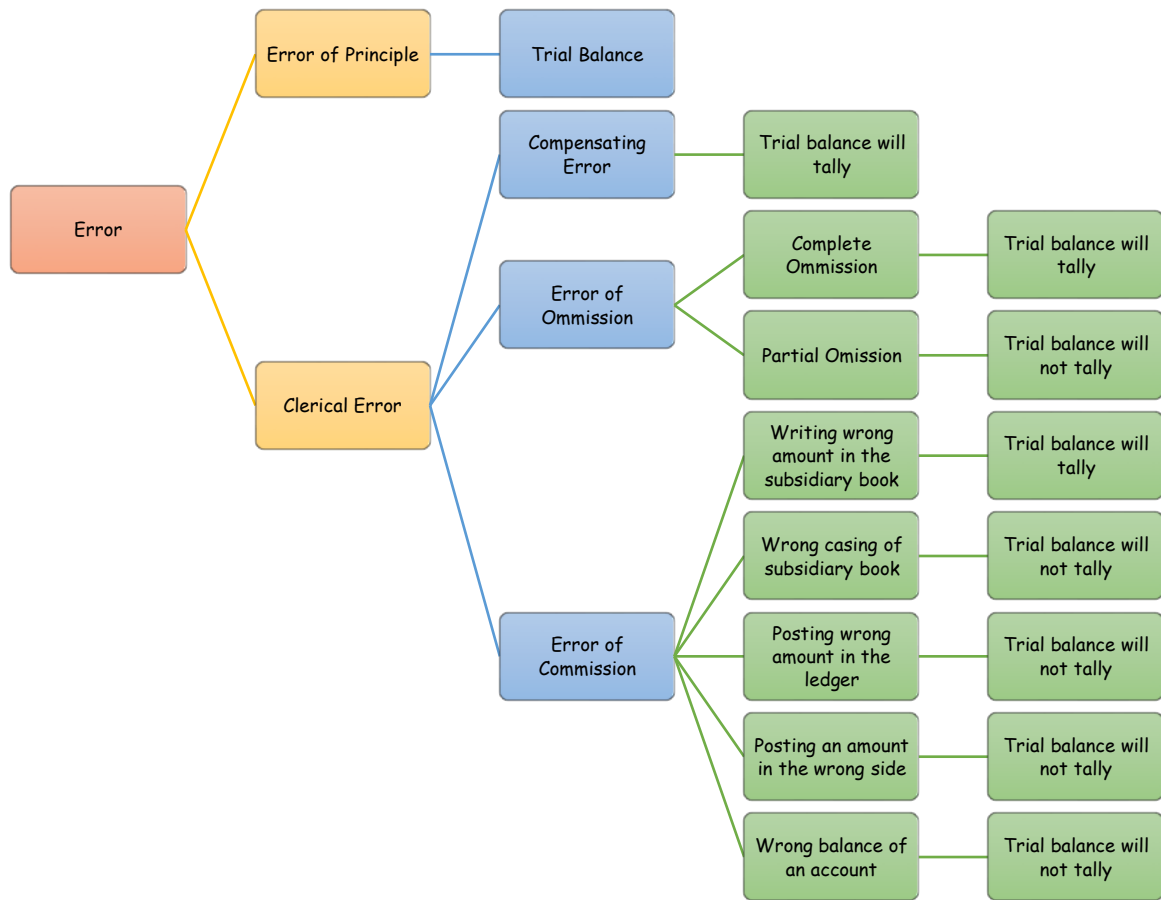


### Errors Before and After Preparation of Trial Balance

Content				
Stage	Error Type	Action	Example	Journal Entry
1. Before Preparation of Trial Balance	Double Sided Error	<ol style="list-style-type: none"> <li>Identify the correct entry.</li> <li>Identify the wrong entry.</li> <li>Rectifying Entry the error by passing a correcting entry.</li> </ol>	Purchased a Building for ₹3,00,000, but wrongly posted to Purchase Account.	<b>Correct Entry:</b> Building A/c Dr. ₹3,00,000 To Cash A/c ₹3,00,000  <b>Wrong Entry:</b> Purchase A/c Dr. ₹3,00,000 To Cash A/c ₹3,00,000  <b>Rectifying Entry:</b> Building A/c Dr. ₹3,00,000 To Purchase A/c ₹3,00,000
	Single Sided Error	If the error is one-sided, no separate entry is needed. Just rectify the account affected by posting the correct entry.	Purchase Account overcast by ₹10,000.	<b>Correct Entry:</b> purchase account should be credited by ₹ 10,000.
2. After Preparation of Trial Balance	Double Sided Error	Same as Before Trial Balance.	-	-
	Single Sided Error	For one-sided errors, rectify using Suspense A/c.	Sales Day Book was overcast by ₹ 1,000.	Sales A/c Dr. ₹1,000 To Suspense A/c ₹1,000
3. After Preparation of Final Accounts	Double Sided Error	<ul style="list-style-type: none"> <li>Same as before preparation of Trial Balance or after preparation of Trail Balance. But all the nominal accounts are to be replaced by Profit and Loss Adjustment Account. And the rest one will be same as stated earlier.</li> <li>Suspense Account will be carried forward to the next year; and</li> </ul>	Purchase a Plant wrongly debited to Purchase Account for ₹ 10,000	<b>If after Trial Balance</b> Plant A/c Dr. ₹10,000 To Purchase A/c ₹10,000  <b>If after Final Account</b> Plant A/c Dr. ₹10,000 To Profit and Loss Adjustment A/c ₹10,000



		➤ Real and Personal Accounts are to be carried forward to the next year.		
	Single Sided Error	Same principle is to be followed like after preparation of Trial Balance and all the nominal account are to be replaced by Profit and Loss Adjustment Account.	Discount allowed was not posted to discount Account.	If after Trial Balance Discount Allowed A/c Dr. To Suspense A/c  If after Final Account Profit and Loss Adjustment A/c Dr. To Suspense A/c



Effect of Errors on Profit or Loss	
Content	
1.	Only <b>Nominal Accounts</b> affect Profit or Loss. (e.g. Incomes, Gains, Expenses, Losses)
2.	Errors involving <b>Nominal Accounts</b> → Affect Profit or Loss Example: Salary paid not recorded → Understated expense → Profit overstated
3.	Errors involving <b>Real or Personal Accounts</b> → Do NOT affect Profit or Loss Example: Cash received from debtor not recorded → No impact on P&L



## 9. Four Frameworks of Accounting

1.	<p><b>Conceptual Framework</b> A set of <b>objectives and fundamentals</b> that guide financial reporting. It defines the goals and underlying concepts to recognize, measure, and report financial information.</p>
2.	<p><b>Legal Framework</b> Governed by <b>various statutes</b> that <b>control business operations</b> and provide guidelines for accounting practices.</p>
3.	<p><b>Institutional Framework</b> Guidelines issued by <b>organizations</b> entrusted by the government, such as the Institute of Chartered Accountants of India (<b>ICAI</b>).</p>
4.	<p><b>Regulatory Framework</b> Regulations by <b>various regulatory authorities</b> overseeing specific sectors like <b>banking, insurance, and telecom</b>.</p>

## 10. Accounting Principles, Concepts and Conventions

1.	<p><b>Generally Accepted Accounting Principles (GAAP)</b> GAAP provides a common <b>set of rules, conventions, standards, and procedures</b> used in accounting to ensure uniformity and consistency in financial statements.</p>
2.	<p><b>Concept of Accounting Principles, Concepts, and Conventions</b> Accounting principles provide <b>basic rules and standards</b> for recording and maintaining business transactions. Accounting concepts and conventions guide the application of these principles.</p>
3.	<p><b>Accounting Principles</b> Basic rules for recording <b>business transactions and maintaining accounts</b>. They ensure <b>uniformity and understandability</b> in financial reporting.</p> <p><b>[A] Accounting Concepts</b> Assumptions that define the parameters within which <b>accounting operates</b>, providing the <b>foundation for accounting principles</b>.</p> <p><b>[B] Accounting Conventions</b> <b>Widely accepted customs, procedures, or guidelines</b> used to apply accounting principles in practice.</p>

### Accounting Concept

a)	<p><b>Entity Concept</b> Assumes that an organization is <b>separate from its owners and managers</b>, meaning the business and personal transactions are distinct.</p>
b)	<p><b>Going Concern Concept</b> Assumes that an organization will <b>continue to exist indefinitely</b> unless evidence suggests otherwise.</p>



c)	<b>Accounting Period Concept</b> Splits the organization's infinite life into <b>smaller, equal periods</b> for financial reporting (e.g., quarterly, annually).
d)	<b>Money Measurement Concept</b> Only transactions that can be expressed in <b>monetary terms</b> are recorded in the books of accounts.
e)	<b>Accrual Concept</b> Recognizes both <b>cash and credit transactions</b> . Revenue and expenses are recognized when earned or incurred, not when cash is received or paid.
f)	<b>Dual Aspect Concept</b> Every transaction affects <b>at least two accounts</b> : one with a debit and the other with a credit.
g)	<b>Matching Concept</b> <b>Revenues and expenses</b> should be recorded in the <b>same period in which they are incurred</b> to measure the operating results accurately.
h)	<b>Realisation Concept</b> Revenue is recognized when it is <b>reasonably certain</b> that it will be <b>realized</b> , such as when goods are delivered and billed to the customer.
i)	<b>Cost Concept</b> Business assets are recorded at the <b>actual cost incurred</b> for their acquisition, including installation and other related costs, not at market value.

### Accounting Conventions

a)	<b>Convention of Conservatism</b> Assumes an <b>uncertain future</b> and advises recognizing possible losses but not future gains. This results in understatement of income and profits.
b)	<b>Convention of Consistency</b> Advocates <b>consistent application of accounting rules and practices</b> over time. Frequent changes in accounting treatment can make financial information unreliable.
c)	<b>Convention of Materiality</b> States that only <b>material information</b> that influences decision-making should be recorded, while insignificant information can be excluded.
d)	<b>Convention of Full Disclosure</b> Requires <b>full and honest disclosure</b> of all material information, whether favorable or unfavorable, in financial statements.

## 11. Capital and Revenue Transactions

### Capital and Revenue Expenditures

1.	<b>Distinction Between Capital and Revenue Transactions</b> Properly classifying transactions as either <b>capital or revenue nature</b> is essential for accurate accounting.
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2.	<p><b>Capital and Revenue Expenditures</b></p> <p>Capital Expenditure and Revenue Expenditure refer to how an entity's expenses are <b>recognized</b> based on the benefit and time period involved.</p>
3.	<p><b>Capital Expenditure</b></p> <p>Expenditures that provide benefits over <b>multiple periods</b>, usually <b>non-recurring</b>, and involve acquisition or improvement of fixed assets.</p>
4.	<p><b>Accounting Treatment (Capital Expenditure)</b></p> <p><b>Not immediately charged</b> against income. Instead, capitalized and gradually charged against profit over time (e.g., depreciation).</p>
5.	<p><b>Revenue Expenditure</b></p> <p>Expenditures that provide <b>benefits only within the current period</b> and are <b>recurring in nature</b>, necessary for regular operations.</p>

#### Comparison between Capital Expenditure and Revenue Expenditure

Point of Distinction	Capital Expenditure	Revenue Expenditure
1. Economic Benefits	Benefits are enjoyed for <b>more than one accounting period</b> .	Benefits are enjoyed for <b>only one accounting period</b> .
2. Nature	<b>Non-recurring</b> in nature.	<b>Recurring</b> in nature.
3. Cash Outlay	Typically involves <b>heavy cash outlay</b> .	Typically involves <b>lower cash outlay</b> .
4. Accounting Treatment	Reflected in the <b>Balance Sheet as an asset</b> .	Debited directly to the <b>Income Statement as an expense</b> .
5. Timing of Incurrence	Can be incurred <b>before or after the commencement of operations</b> .	Always incurred <b>after the commencement of operations</b> .
6. Impact on Earning Capacity	Tends to <b>increase earning capacity</b> or reduce operating expenses.	Helps <b>carry on activities</b> in the current accounting period.
7. Matching Against Revenue	A <b>portion</b> may be <b>matched against revenue</b> to determine the operating result.	The <b>entire amount</b> is <b>matched against revenue</b> to determine the operating result.

#### Certain Rules for Identification of Capital Expenditure

1.	<p><b>Acquiring Long-Term Assets</b></p> <p>Expenditure incurred for <b>acquiring assets</b> with a useful life of more than one accounting period, used in operations (not for resale).</p> <p><b>Example</b></p> <p>a. <b>Furniture bought by a second-hand motor car dealer for use in business (capital expenditure).</b></p> <p>b. <b>Buying motor cars for resale is revenue expenditure.</b></p>
2.	<p><b>Improving or Repairing Assets</b></p> <p>Expenditure incurred to <b>improve the condition of an existing asset</b> or put it into working condition.</p>



	<p><b>Example</b></p> <p>a. <b>Machine improvement:</b> Adding transportation and installation charges to the machine's cost.</p> <p>b. <b>Building purchase:</b> Registration and stamp duty added to building cost.</p>
3.	<p><b>Improving Earning Capacity</b></p> <p>Expenditure that improves the business's <b>earning potential</b> or <b>operational efficiency</b>.</p> <p><b>Example</b></p> <p>Expenditure on shifting the factory to a better location for easy supply of raw materials.</p>
4.	<p><b>Preliminary Expenses</b></p> <p>Expenditure incurred before business operations commence, such as <b>legal or organizational setup costs</b>.</p> <p><b>Example</b></p> <p>Legal charges for drafting the memorandum of association or commission paid to brokers for raising capital.</p>

### Deferred Revenue Expenditures

1.	<p><b>Definition</b></p> <p>Expenditure paid or liability incurred, expected to <b>benefit over a future period</b>.</p> <ul style="list-style-type: none"> <li>➤ <b>Heavy advertisement expenditure</b> before launching a new product.</li> <li>➤ <b>Development expenses</b> for a product.</li> </ul>
2.	<p><b>Accounting Treatment</b></p> <ul style="list-style-type: none"> <li>➤ <b>Expense portion</b> appears in the <b>Income Statement</b>.</li> <li>➤ <b>Unwritten-off portion</b> is shown as an <b>asset</b>.</li> </ul>
3.	<p><b>Change post-AS-26</b></p> <ul style="list-style-type: none"> <li>➤ After <b>AS-26</b> issuance, deferred revenue expenditure must be treated as a <b>revenue expense</b> in the period incurred.</li> <li>➤ <b>Research, training, advertising, and promotional expenses</b> are now recognized in the accounting period incurred.</li> </ul>

### Capital and Revenue Receipts

1.	<p><b>Capital Receipts</b></p> <p>Receipts obtained from <b>non-regular operations</b>, usually for <b>long-term purposes</b>, and do not affect operating results.</p> <p><b>Example</b></p> <p><b>Issuance of new shares</b> for raising funds (e.g., 1000 shares at 50 each raising 50,000).</p> <p><b>Accounting Treatment</b></p> <ul style="list-style-type: none"> <li>➤ Credited to <b>capital-related accounts</b>.</li> <li>➤ Reflected in the <b>Balance Sheet</b>.</li> </ul>
2.	<p><b>Revenue Receipts</b></p>



Receipts obtained from **regular business operations**, affecting profits and losses of the business.

Example

Selling goods in the normal course of business (e.g., 1000 units sold at 20 per unit, raising 20,000).

Accounting Treatment

- Recognized as **income** in the Income Statement.
- Set against **revenue expenses** to determine profit.

#### Differences between Capital Receipts and Revenue Receipts

Point of Difference	Capital Receipt	Revenue Receipt
1. Source of Receipt	Obtained from <b>non-regular operations</b> (e.g., raising funds, issuing shares).	Obtained from <b>regular day-to-day operations</b> (e.g., sales revenue).
2. Nature	Irregular and <b>non-recurring</b> in nature.	<b>Recurring</b> in nature.
3. Income Recognition	<b>Not</b> recognized as income.	<b>Recognized</b> as income.
4. Accounting Treatment	Reflected in the <b>Balance Sheet</b> .	Credited to the <b>Income Statement</b> .
5. Impact on Operating Results	Does <b>not affect</b> the operating result of an entity.	<b>Affects</b> the operating result (profits or losses).
6. Creation of Liability	May <b>result in the creation</b> of liability (e.g., loans raised, shares issued).	Does <b>not create</b> any liability.

#### Capital and Revenue Profits and Capital and Revenue Losses

1.	<b>Capital Profit</b> Profit that arises from <b>capital receipts</b> or transactions <b>not</b> related to the <b>regular operations of the business</b> .
2.	<b>Revenue Profit</b> Profit earned from <b>regular business operations</b> during an accounting period, resulting from <b>revenue receipts and expenses</b> .
3.	<b>Capital Loss</b> Loss resulting from <b>capital receipts</b> or <b>non-regular activities</b> .
4.	<b>Revenue Loss</b> Loss incurred from the <b>regular operations</b> of the business.



### Capital and Revenue Profits

1.	<p><b>Capital Profit</b> Profit arising from <b>non-operating activities</b>, non-recurring in nature, and related to capital transactions.</p> <p><b>Example</b></p> <ul style="list-style-type: none"> <li>➤ Profit prior to incorporation.</li> <li>➤ Premium received on the issue of shares.</li> <li>➤ Profit on sale of non-current assets.</li> </ul> <p><b>Accounting Treatment</b></p> <ul style="list-style-type: none"> <li>➤ Capitalized by transferring to a <b>Capital Reserve Account</b>.</li> </ul>
2.	<p><b>Revenue Profit</b> Profit arising from <b>regular business operations</b>, recurring in nature, and related to operational activities.</p> <p><b>Example</b></p> <ul style="list-style-type: none"> <li>➤ Profit from sale of merchandise.</li> <li>➤ Profit from providing regular services.</li> <li>➤ Surplus earned by non-profit organizations.</li> </ul> <p><b>Accounting Treatment</b></p> <ul style="list-style-type: none"> <li>➤ Determined in the <b>Income Statement</b>.</li> <li>➤ Distributed to <b>owners</b> or transferred to a <b>Reserve Account</b>.</li> </ul>

### Capital Loss vs Revenue Loss

1.	<p><b>Capital Loss</b> A loss that does not arise from the <b>regular operations</b> but from non-operating activities.</p> <p><b>Example</b></p> <ul style="list-style-type: none"> <li>➤ Loss from sale of assets other than inventory for less than book value. - Loss due to extraordinary events (e.g., fire, flood).</li> <li>➤ Loss from raising debt capital (e.g., debenture issued at discount).</li> </ul> <p><b>Accounting Treatment</b></p> <ul style="list-style-type: none"> <li>➤ Charged against revenue in the <b>Income Statement</b> or reflected as <b>fictitious assets</b> in the <b>Balance Sheet</b>.</li> </ul>
2.	<p><b>Revenue Loss</b> A loss that arises from the <b>regular operating activities</b> of the business.</p> <p><b>Example</b></p> <ul style="list-style-type: none"> <li>➤ Loss from bad debts.</li> <li>➤ Discounts allowed to customers for prompt payments.</li> </ul> <p><b>Accounting Treatment</b></p> <ul style="list-style-type: none"> <li>➤ Recorded in the <b>debit side</b> of the <b>Income Statement</b>.</li> </ul>



## Classification of Expenditures

## Example 1: Capital vs Revenue Expenditure

Item	Capital or Revenue Expenditure	Reason
i. Extension of railway tracks in the factory area	Capital Expenditure	It provides long-term benefit to the factory and will be useful for more than one accounting period.
ii. Wages paid to machine operators	Revenue Expenditure	It benefits only the current period as wages are paid for day-to-day operations.
iii. Installation costs of a new production machine	Capital Expenditure	The machine provides benefit over multiple periods; thus, the cost of installation is capitalized.
iv. Materials for extension to foremen's offices in the factory	Capital Expenditure	The materials are for a long-term improvement to the factory, benefiting more than one accounting period.
v. Rent paid for the factory	Revenue Expenditure	The rent is a recurring expense that benefits only the current period.
vi. Payment for computer time to operate a new stores control system	Revenue Expenditure	It is an expenditure related to the regular business operation and benefits the current period.
vii. Wages paid for building foremen's offices	Capital Expenditure	It contributes to building assets that will benefit the company for multiple periods, thus capitalized.

## Example 2: Capital vs Revenue Expenditure

Item	Capital or Revenue Expenditure	Reason
i. Rs.10,000 incurred for obtaining a license to start the factory	Capital Expenditure	The expenditure is to acquire a long-term right to carry on business.
ii. Rs.1,000 paid for removal of stock to a new site	Revenue Expenditure	It is related to normal business operations and does not add value to the asset.
iii. Rs.5,000 incurred for changing Rings and Pistons of an engine to restore full efficiency	Revenue Expenditure	The expenditure restores efficiency, but does not enhance capacity, so it is a regular expense.



iv. Rs.2,000 spent on lawyer's fee to defend a suit regarding factory title	Revenue Expenditure	The expenditure is related to <b>legal fees</b> and does not add value to the asset; it is a <b>regular operational cost</b> .
v. Rs.10,000 spent on advertising the introduction of a new product	Revenue Expenditure	Advertising is treated as <b>revenue expenditure</b> as per <b>AS-26</b> , and benefits only the current period.
vi. Rs.1,00,000 spent on constructing a factory shed	Capital Expenditure	The factory shed is a <b>long-term asset</b> , and its cost is capitalized. Similarly, costs for small huts used for <b>storing materials</b> are capitalized.



## 2. BILLS OF EXCHANGE

### 1. Negotiable Instrument

Content	
1.	<p><b>Meaning</b></p> <p>The term 'Negotiable' means <b>transferable</b> from one person to another.</p> <p>The term 'Instrument' means a <b>written document</b> that <b>creates a right</b> in favour of a person.</p>
2.	<p><b>Definition (Section 13(1))</b></p> <p>"A negotiable instrument means a <b>Promissory Note, Bill of Exchange, or Cheque</b>, payable either to <b>order or to bearer</b>."</p>
3.	<p><b>Essential Features</b></p> <ul style="list-style-type: none"> <li>➤ <b>Written Document.</b></li> <li>➤ Entitles the <b>holder</b> to a <b>certain sum</b> of money.</li> <li>➤ <b>Freely transferable</b> by delivery or by endorsement and delivery.</li> <li>➤ The transferee gets a <b>good title</b> (holder in due course).</li> </ul>
4.	<p><b>Legal Basis:</b></p> <ul style="list-style-type: none"> <li>➤ Defined under the <b>Negotiable Instruments Act, 1881.</b></li> <li>➤ The Act governs the law relating to Promissory Notes, Bills of Exchange, and Cheques.</li> </ul>

### 2. Bills of Exchange

Content	
1.	<p><b>Definition</b></p> <p>According to the Negotiable Instrument Act, 1881, 'A bill of exchange is an <b>instrument in writing</b> containing an <b>unconditional order, signed by the maker</b>, directing a <b>certain person to pay a certain sum of money</b> only to, or to the order of, a certain person or to the bearer of the instrument.</p>
2.	<p><b>Features of Bill of Exchange</b></p> <ul style="list-style-type: none"> <li>➤ <b>In writing</b> (can be in any language/form).</li> <li>➤ Drawn on a <b>particular date</b>.</li> <li>➤ Three parties: <b>Drawer, Drawee, and Payee</b>.</li> <li>➤ <b>Signed by the Drawer/maker</b>.</li> <li>➤ <b>Unconditional</b> and imperative order to pay.</li> <li>➤ Directed to a <b>certain person</b>.</li> <li>➤ Payable for a <b>certain sum of money</b>.</li> <li>➤ Requires <b>proper stamp</b> as per law.</li> </ul>
3.	<p><b>Parties Involved</b></p> <p><b>Drawer:</b> The party that <b>issues</b> a Bill of Exchange - <b>Creditor, Lender or Seller</b>. He is the <b>maker</b> of the bill and his signature is necessary.</p>



**Drawee:** The party to which the order to pay is sent - Debtor, Lendee or Purchaser. The drawee becomes the acceptor of the bill when he/she/it has written the acceptance on the bill of exchange

**Payee:** Payee or the beneficiary is the party to which the bill of exchange is payable - May be Drawer or Other Party.

#### 4. Classification of Bills

a.	<b>Documentary Bill</b> Bill supported by documents (e.g. invoice, lorry receipt) proving the sale/transaction.
b.	<b>Clean Bill</b> Bill not supported by any document — more risk, hence higher interest.
c.	<b>Demand Bill</b> Payable on demand; no fixed due date.
d.	<b>Usance Bill</b> Time-bound bill; payable after a certain period (e.g. 30 days, 60 days).
e.	<b>Inland Bill</b> Bill drawn and payable within India.
f.	<b>Foreign Bill</b> Bill drawn in one country and payable in another country.
g.	<b>Trade Bill</b> Drawn for trade purpose - sale/purchase of goods/services.
h.	<b>Accommodation Bill</b> Drawn without consideration to help another party raise funds.
i.	<b>Supply Bill</b> Drawn by a supplier or contractor on a government department.

### 3. Difference between Trade Bill & Accommodation Bill

Aspect	Trade Bill	Accommodation Bill
1. Objective	Facilitates trade transactions like sale and purchase of goods.	Drawn to help someone in need of financial assistance.
2. Consideration	Has a definite consideration for which the bill is accepted.	Drawn without consideration.
3. Extension of Credit	A form of credit extension for trade purposes.	Not a form of credit extension.
4. Proceeds	When discounted, the proceeds remain with the holder.	When discounted, proceeds may be shared between two parties in an agreed ratio.
5. Recovery	If dishonoured, the amount can be recovered easily through court.	In case of dishonour, the drawer cannot file a suit against the drawee.



#### 4. Maturity / Due Date of a Bill of Exchange and Days of Grace

Type of Bill	Key Points	Example
1. Demand Bill / At Sight / On Presentation	Payable immediately on presentation - No fixed due date - No Days of Grace	A bill dated 1st July 2025, payable on demand, is presented on 5th July 2025 → Payment due on 5th July 2025 itself
2. After Date Bill	Payable after a fixed period from the date of drawing - 3 Days of Grace allowed	A bill drawn on 1st July 2025 for 60 days after date → Due date = 30th August 2025 Add 3 days grace → Maturity Date = 2nd September 2025
3. After Sight Bill	Payable after fixed period from date of acceptance - 3 Days of Grace allowed	A bill dated 1st July 2025, but accepted on 4th July 2025 for 60 days after sight → Due date = 2nd September 2025 Add 3 days grace → Maturity Date = 5th September 2025

#### 5. Grace Period

Situation	Rule	Example
1. Period Given in Months	Count exact calendar months - Ignore number of days in month - Add 3 days grace	Bill dated 4 May 2025, 3 months → 4 Aug 2025 + 3 days = 7 Aug 2025
2. Period Given in Days	Count exact number of days - Exclude date of bill, include day of payment - Add 3 days grace	Bill dated 5 June 2025, 65 days → 25 (June) + 31 (July) + 9 (Aug) = 9 Aug + 3 days = 12 Aug 2025
3. Maturity on National Holiday	If maturity date is National Holiday, bill is payable on preceding working day	If maturity date is 26 Jan, final date = 25 Jan
4. Maturity on Emergency Holiday	If declared Emergency Holiday, maturity date is next working day	If due on 25 July, and it's emergency holiday → final date = 26 July

#### 6. Concept of Bills Receivable (B/R) and Bills Payable (B/P)

Term	Meaning	Shown in Balance Sheet
1. Bills Receivable (B/R)	When a person draws the bill and is entitled to receive payment - Treated as an asset	Asset side (of Drawer)
2. Bills Payable (B/P)	When a person accepts the bill and is liable to pay - Treated as a liability	Liability side (of Drawee)



## 7. Journal Entries for Trade Bills

Sl. No.	Transactions	In the Books of Drawer (X)	In the Books of Drawee (Y)
1.	If a bill is received by X from Y after acceptance	Bills Receivable A/c Dr To Drawee / Y A/c	Drawer / X A/c Dr To Bills Payable A/c
2.	If the bill is retained by X till due date	No entry	No entry
3.	If the bill is discounted with a Bank	Bank / Cash A/c Dr Discount A/c Dr To Bills Receivables A/c	No entry
4.	If the bill is endorsed to a Creditor (Z)	Creditor / Z A/c Dr Discount Allowed A/c (if any) Dr To Bills Receivables A/c To Discount Receivables A/c (if any)	No entry
5.	If the bill is sent to the Bank for collection	Bills for Collection A/c Dr To Bills Receivables A/c	No entry
6.	If the bill is retired before maturity	Cash / Bank A/c Dr Rebate Allowed A/c Dr To Bills Receivables A/c To Bills for Collection A/c (if already sent to Bank for collection)	Bills Payable A/c Dr To Cash / Bank A/c To Rebate Received A/c
7.	If the bill is honoured / paid on the due date (Previously retained by X)	Cash / Bank A/c Dr To Bills Receivables A/c	Bills Payable A/c Dr To Cash / Bank A/c
8.	If the bill is honoured / paid on the due date (Previously discounted with a Bank)	No entry	Bills Payable A/c Dr To Cash / Bank A/c
9.	If the bill is honoured / paid on the due date (Previously sent to the Bank for collection)	Bank A/c Dr To Bills for Collection A/c	Bills Payable A/c Dr To Cash / Bank A/c
10.	If the bill is honoured / paid on the due date (Previously endorsed to Z)	No entry	Bills Payable A/c Dr To Cash / Bank A/c



11.	If the bill is dishonoured / unpaid on due date (Previously retained by X)	Drawee / Y A/c Dr To Bills Receivables A/c To Cash / Bank A/c (For Noting charges if any)	Bills Payable A/c Dr Noting / Sundry Charges A/c (if any) Dr To Drawer / X A/c
12.	If the bill is dishonoured / unpaid on due date (Previously discounted with a Bank)	Drawee / Y A/c Dr To Bank A/c To Cash / Bank A/c (For Noting charges if any)	Bills Payable A/c Dr Noting / Sundry Charges A/c (if any) Dr To Drawer / X A/c
13.	If the bill is dishonoured / unpaid on due date (Previously sent to the Bank for collection)	Drawee / Y A/c Dr To Bills for Collection A/c To Cash / Bank A/c (For Noting charges if any)	Bills Payable A/c Dr Noting / Sundry Charges A/c (if any) Dr To Drawer / X A/c
14.	If the bill is dishonoured / unpaid on due date (Previously endorsed to Z)	Drawee / Y A/c Dr To Creditor / Z A/c (Bill value + Noting Charges if any)	Bills Payable A/c Dr Noting / Sundry Charges A/c (if any) Dr To Drawer / X A/c
15.	If the bill is renewed on due date (For old bill cancelled)	Drawee / Y A/c Dr To Bills Receivables A/c	Bills Payable A/c Dr To Drawer / X A/c
16.	If the bill is renewed on due date (For interest charged for delayed payment)	Drawee / Y A/c Dr To Interest (Received) A/c	Interest (Allowed) A/c Dr To Drawer / X A/c
17.	If the bill is renewed on due date (For part payment made in cash)	Cash / Bank A/c Dr To Drawee / Y A/c	Drawer / X A/c Dr To Cash / Bank A/c
18.	If the bill is renewed on due date (For a new bill drawn and accepted)	Bills Receivable A/c Dr To Drawee / Y A/c	Drawer / X A/c Dr To Bills Payable A/c

### 8. Dishonour of Bills

Dishonour Type	Explanation	Accounting Treatment
1. Dishonour by Non-Acceptance	Drawee refuses to accept the bill when presented.	No journal entry in the books of any party.
2. Dishonour by Non-Payment	Drawee accepts but fails to pay on maturity.	In the Books of Drawer: Drawee / Y A/c Dr To Bills Receivables A/c In the Books of Drawee: Bills Payable A/c Dr Noting Charges A/c (if any) Dr To Drawer / X A/c



3. Noting of a Bill	Noting refers to recording the fact of dishonour by a Notary Public, along with a fee (Noting Fee).	Noting Charges are an expense for the holder and are recovered from the responsible party. In the Books of Holder: Noting Charges A/c Dr To Cash/Bank A/c
4. Dishonour due to Insolvency	A bill is dishonoured due to insolvency of the drawee or acceptor. It may result in full or partial recovery.	In the Books of Drawer: Bad Debts A/c Dr To Drawee / Y A/c In the Books of Drawee: Deficiency A/c Dr To Bills Payable A/c

### 9. Renewal of Bills

Aspect	Explanation	Accounting Treatment
1. Renewal of a Bill	When the holder of a bill is unable to meet the payment on the due date, the drawee requests an extension from the drawer. If agreed, the old bill is cancelled, and a new bill with extended terms is drawn.	In the Books of Drawer: Drawee / Y A/c Dr To Bills Receivables A/c In the Books of Drawee: Bills Payable A/c Dr To Drawer / X A/c
2. Interest on Renewal	Interest is charged on the new bill for the extended payment period.	In the Books of Drawer: Interest A/c Dr To Drawee / Y A/c In the Books of Drawee: Interest A/c Dr To Drawer / X A/c

### 10. Retirement of a Bill

Aspect	Explanation	Accounting Treatment
1. Retirement of a Bill	When the drawee pays the bill before its due date, it is called retirement of the bill. This occurs with mutual understanding between the drawer and drawee.	In the Books of Drawee (Y): Bills Payable A/c Dr To Cash / Bank A/c In the Books of Drawer (X): Cash / Bank A/c Dr To Bills Receivables A/c
2. Rebate on Bill	Interest payable for the unexpired period of the bill (i.e., between the payment date and maturity date) is called rebate on the bill. This rebate is income for the drawee and an expense for the payee.	In the Books of Drawee (Y): Rebate Received A/c Dr To Cash / Bank A/c In the Books of Drawer (X): Rebate Allowed A/c Dr To Interest A/c



## 11. Accommodation Bill

## Content

1.	<b>Definition</b> Accommodation Bills are bills drawn and accepted <b>without any consideration</b> . These are often drawn between two or more persons who are not in a debtor-creditor relationship.
2.	<b>Purpose</b> The primary purpose of these bills is to help the parties involved in <b>raising funds through bill discounting</b> . After the bill is accepted, it is discounted, and the <b>proceeds are shared</b> by the parties in an <b>agreed-upon proportion</b> .
3.	<b>Relationship</b> <b>No actual goods or services</b> are exchanged between the parties. The bill is created purely for the <b>purpose of securing financing</b> .
4.	<b>Also Known As</b> Accommodation Bills are also referred to as <b>Kite Bills</b> .
5.	<b>Process</b> <ul style="list-style-type: none"><li>➤ <b>Two or more parties</b> (not in a debtor-creditor relationship) agree to draw bills on each other.</li><li>➤ They aim to <b>discount the bills</b> after acceptance.</li><li>➤ The <b>proceeds</b> from discounting the bill are <b>shared according to the agreed proportion</b>.</li><li>➤ The parties involved provide money for <b>honouring the bill at maturity</b>.</li></ul>



### 3. CONSIGNMENT

#### 1. Consignment

##### Basics - Consignment

1. **Concept and Introduction**
  - Business organisations often aim to **expand operations** by adopting different **marketing and distribution strategies**.
  - One common method is appointing **selling agents**, formally called entering into a consignment agreement.
2. **Definition**
  - Consignment is a transaction where one entity (**the consignor**) **sends goods** to another entity (**the consignee**) **for sale on its behalf**, with a predetermined **commission**.
  - It is an **agency relationship**, not a sale between consignor and consignee.
  - The **ownership of goods remains with the consignor** until the consignee sells them to a third-party buyer.

#### 3. Parties Involved

Aspect	Consignor	Consignee
Meaning	The party <b>who sends goods</b> on consignment	The party <b>who receives goods</b> and sells them on behalf of consignor
Status	<b>Principal</b> in the Principal-Agent relationship	<b>Agent</b> who sells for the principal
Ownership	<b>Retains ownership until goods are sold</b>	<b>Does not own</b> the goods
Function	<b>Sends goods</b> to consignee for sale	<b>Sells goods</b> , collects proceeds, earns commission
Business Type	May be a <b>manufacturer or wholesaler</b>	<b>Retailer or sales agent</b>
Entitlement	Entitled to <b>receive sale proceeds</b> after deducting commission/expenses	Entitled to <b>receive commission</b> and reimbursements

#### 4. Documents Related to Consignment Transactions

Document	Issued By	Issued To	Purpose & Key Features
<b>Proforma Invoice</b>	Consignor	Consignee	<ul style="list-style-type: none"> <li>➤ Sent along with goods - Contains details like:                             <ul style="list-style-type: none"> <li><b>Quantity</b></li> <li><b>Cost/Invoice Price</b></li> <li><b>Expenses incurred</b></li> <li><b>Minimum selling price</b></li> </ul> </li> <li>➤ Used as <b>proof of dispatch</b></li> <li>➤ Format <b>similar to an invoice</b>, but not a sale invoice</li> </ul>



	Account Sales	Consignee	Consignor	<ul style="list-style-type: none"> <li>➤ Sent after goods are sold Contains:                             <ul style="list-style-type: none"> <li>Quantity sold</li> <li>Sale price</li> <li>Expenses incurred</li> <li>Commission charged</li> <li>Net amount due to consignor</li> </ul> </li> <li>➤ Acts as a report of sale performance</li> </ul>
5.	Revenue Recognition			Revenue for the consignor is recognized once the goods are sold by the consignee.

Proforma		
XYZ Cloth Merchant		
Proforma Invoice		
Goods sent on Consignment to:		
Kamal Garments		
80A, Nehru Road,		
Guwahati - 781005. Date: March 17, 2023		
Particulars	(Rs.)	(Rs.)
1,200 T-Shirts @ Rs. 1,000 each		12,00,000
500 Formal Shirts @ Rs. 800 each		4,00,000
Charges:	(Rs.)	16,00,000
Packing	25,000	
Carriage	42,000	
Insurance	13,000	80,000
Goods despatched vide A.W.B. No. 85138 dated 17.3.2023	Total	16,80,000
E.&O.E. Ahmedabad	For XYZ Cloth Merchant Suresh Barua Partner	

Proforma:		
Account Sales for Wrist Watches & Wall Clocks sold by Prime Watch Dealers on behalf of GMT Watch Makers		
Particulars	(Rs.)	(Rs.)
Gross Sale Proceeds:		
1,050 wrist watches @ Rs. 2,400 each	25,20,000	
180 wall clocks @ Rs. 600 each	1,08,000	26,28,000
Less: Charges:		
Unloading & Carriage to godown	4,500	
Godown rent & insurance	96,000	
Selling expenses	12,500	



Commission @ 5% on Rs. 26,28,000	1,36,800	2,49,800
Net Sale Proceeds		23,78,200
Less: Advance (by Bank Draft No. .... dated ....)		10,00,000
		13,78,200
Less: Amount remitted (by Bank Draft No. .... dated ....)		10,00,000
Balance Due		3,78,200
E.&O.E. New Delhi	For Prime Watch Dealers ..... (Signature)	

### 2. Consignment Sales Vs Regular Sales

Point	Consignment Sales	Normal Sales
Nature	A method of <b>business expansion</b>	A firm's <b>primary business</b> activity
Usage	Entered into by some <b>specific entities</b>	Entered into by <b>all commercial organisations</b>
Parties Involved	<b>Consignor and Consignee</b>	<b>Seller and Buyer</b>
Relationship	<b>Principal-Agent</b> relationship	<b>Debtor-Creditor</b> relationship
Ownership & Risk	Remain with <b>Consignor</b> until goods are sold	<b>Transfer to Buyer</b> immediately upon sale
Expenses	Borne by <b>Consignor</b> , including those incurred by consignee	Borne by <b>Seller</b> until transfer of ownership
Pricing	Goods sent at <b>Cost or Invoice Price</b>	Goods sold at <b>Selling Price</b> (above cost)
Document Issued	<b>Proforma Invoice</b> issued by Consignor	<b>Sales Invoice</b> issued by Seller
Return of Goods	Consignee can <b>return</b> unsold goods	Buyer generally <b>cannot return</b> , unless agreed

### 3. Consignment Related Transactions

1.	<p><b>Goods Sent on Consignment</b></p> <ul style="list-style-type: none"> <li>➤ Consignor <b>sends goods</b> to Consignee for sale.</li> <li>➤ <b>Ownership</b>, risk, and title remain with <b>Consignor</b>.</li> <li>➤ Consignee <b>doesn't pass</b> any journal entry.</li> <li>➤ Consignor <b>adjusts Purchases A/c</b> or <b>Trading A/c</b>.</li> <li>➤ Goods can be recorded at:                             <ul style="list-style-type: none"> <li>• <b>Cost Price (CP)</b>, or</li> <li>• <b>Invoice Price (IP) = CP + Load (Profit Margin %)</b></li> </ul> </li> </ul>
2.	<p><b>Advance by Consignee to Consignor</b></p> <ul style="list-style-type: none"> <li>➤ Consignee may give <b>advance</b> to consignor Via Bank Draft or Bills of Exchange.</li> <li>➤ Later <b>adjusted</b> against <b>final sale settlement</b>.</li> <li>➤ <b>Security Deposit / Caution Money</b>:</li> </ul>



	<ul style="list-style-type: none"> <li>• Sometimes demanded <b>as per agreement</b>.</li> <li>• Proportion relating to <b>unsold stock is retained &amp; carried forward</b> to the next period.</li> </ul>
3.	<p><b>Expenses on Consignment</b></p> <p>a. The expenses in relation to the consignment business may be incurred either by the <b>consignor or by the consignee</b>.</p> <p>b. <b>Expenses By Consignor</b> Nature:</p> <ul style="list-style-type: none"> <li>• Incurred to send goods to the consignee.</li> <li>• Always <b>Non-recurring</b> in nature.</li> </ul> <p>Examples:</p> <ul style="list-style-type: none"> <li>❖ Carriage &amp; Freight to consignee</li> <li>❖ Packing Charges</li> <li>❖ Loading Charges</li> <li>❖ Export Duty</li> <li>❖ Transit Insurance</li> </ul> <p>Included in Valuation of:</p> <ul style="list-style-type: none"> <li>❖ <b>Unsold Consignment Stock</b></li> <li>❖ <b>Abnormal Loss</b></li> <li>❖ <b>Goods-in-Transit</b></li> </ul> <p>c. <b>Expenses by Consignee</b> Nature:</p> <p>Incurred by the consignee for <b>storage, handling, or selling of goods</b> after receipt.</p> <p>Recovery:</p> <ol style="list-style-type: none"> <li><b>Not reimbursed</b> directly by the consignor.</li> <li><b>Adjusted</b> against sale proceeds in the Account Sales sent to consignor.</li> </ol> <p>Valuation Impact:</p> <p>Only <b>non-recurring</b> expenses are considered for:</p> <ul style="list-style-type: none"> <li>• <b>Unsold Consignment Stock</b></li> <li>• <b>Abnormal Loss</b> (at consignee's premises)</li> </ul>
4.	<p><b>Consignment Sale</b></p> <p>a. Nature:</p> <ul style="list-style-type: none"> <li>• Goods are sold by the <b>consignee on behalf of the consignor</b> under a consignment contract.</li> <li>• The revenue belongs to the <b>consignor, not the consignee</b>.</li> </ul> <p>b. <b>Mode of Sale:</b> Cash basis, or Credit basis</p> <p>c. <b>Accounting Treatment:</b></p> <ul style="list-style-type: none"> <li>• Cash Sales: Recorded in <b>both consignor's and consignee's books</b>.</li> <li>• Credit Sales: <ul style="list-style-type: none"> <li>✓ <b>If Del-Credere Commission is paid</b> → Recorded by <b>consignee</b> (as they bear bad debt risk).</li> <li>✓ <b>If not paid</b> → Not recorded by consignee; <b>only consignor</b> records it.</li> </ul> </li> </ul>



d. Collection & Remittance:

- Consignee collects the sale proceeds.
- Remits the net amount to the consignor after deducting:
  - Consignee's expenses
  - Commission
  - Any advance already paid (if applicable)

4. Commission

Meaning

- Commission is the reward given to the consignee for acting as an agent of the consignor.
- It is not paid in cash, but deducted by consignee from sale proceeds in the Account Sales.

Types of Commission

- |    |   |
|----|---|
| 1. | <p><b>Ordinary Commission</b><br/>                     For performing normal consignment activities (selling on behalf of consignor).<br/>                     Basis of Calculation: % on Gross Sales</p>   |
| 2. | <p><b>Del-credere Commission</b><br/>                     For bearing bad debt risk on credit sales and responsibility of collection.<br/>                     Basis of Calculation: % on Gross Sales unless otherwise agreed upon</p>  |
| 3. | <p><b>Over-riding Commission</b><br/>                     Extra incentive for:</p> <ul style="list-style-type: none"> <li>• Selling above fixed price, or</li> <li>• Exceeding sales targets. Also called Special Commission.</li> <li>• Basis of Calculation: Calculated on the excess amount achieved over target / fixed price.</li> </ul> |

5. Loss of Goods in Consignment Business

- |    |   |
|----|---|
| 1. | <p><b>Loss of Goods Sent on Consignment</b><br/>                     Goods sent on consignment may get lost due to various reasons, categorized into Normal Loss and Abnormal Loss.</p>   |
| 2. | <p><b>Normal Loss</b></p> <ul style="list-style-type: none"> <li>➤ Occurs due to inherent nature of goods.<br/>                         Examples: Evaporation, spillage, drying, leakage.</li> <li>➤ Unavoidable and expected.</li> <li>➤ Not recorded separately.</li> <li>➤ Loss is absorbed in the cost of remaining goods (increases per unit cost).</li> </ul> |
| 3. | <p><b>Abnormal Loss</b></p> <ul style="list-style-type: none"> <li>➤ Occurs due to avoidable or accidental events.<br/>                         Examples: Theft, fire, accident, natural calamities.</li> <li>➤ Recorded separately in books.</li> <li>➤ Not part of normal cost of goods sold.</li> </ul>  |
| 4. | <p><b>Stage-wise Treatment of Abnormal Loss</b></p>   |



(a) Abnormal Loss during Transit

- Occurs while goods move from consignor to consignee.
- Valuation includes:
  - ❖ Cost of goods
  - ❖ Consignor's expenses only (e.g., freight, insurance).
  - ❖ Ignore consignee's expenses.

(b) Abnormal Loss at Consignee's Premises

- Occurs after goods are received by consignee.
- Valuation includes:
  - ❖ Cost of goods
  - ❖ Consignor's expenses
  - ❖ Consignee's non-recurring expenses

6. Valuation of Unsold Stock with Consignee

Content							
1. Meaning	<ul style="list-style-type: none"> <li>➤ Goods not sold by consignee at the end of accounting period are called Consignment Stock.</li> <li>➤ Ownership remains with the consignor, though physically lying with the consignee.</li> </ul>						
2. Purpose	<ul style="list-style-type: none"> <li>➤ To ensure accurate profit/loss determination for the consignment transaction.</li> <li>➤ Must be included in closing stock of the consignor.</li> </ul>						
3. Valuation Basis	<table border="1"> <thead> <tr> <th>Method of Recording Goods Sent</th> <th>Valuation Approach</th> </tr> </thead> <tbody> <tr> <td>At Cost</td> <td>Stock valued at Cost of goods + Consignor's expenses + non-recurring expenses incurred by consignee</td> </tr> <tr> <td>At Invoice Price (IP)</td> <td>Stock valued at Invoice Price + Consignor's + Consignee's non-recurring expenses - Load (excess over cost) needs to be removed</td> </tr> </tbody> </table> <p><b>Note:</b> As per AS-2, unsold stock is to be valued at 'Cost' or 'Net Realisable Value (NRV)', whichever is lower. When the NRV of the unsold stock fall below its cost, in that case the consignment statement is to be valued at the lower NRV.</p>	Method of Recording Goods Sent	Valuation Approach	At Cost	Stock valued at Cost of goods + Consignor's expenses + non-recurring expenses incurred by consignee	At Invoice Price (IP)	Stock valued at Invoice Price + Consignor's + Consignee's non-recurring expenses - Load (excess over cost) needs to be removed
Method of Recording Goods Sent	Valuation Approach						
At Cost	Stock valued at Cost of goods + Consignor's expenses + non-recurring expenses incurred by consignee						
At Invoice Price (IP)	Stock valued at Invoice Price + Consignor's + Consignee's non-recurring expenses - Load (excess over cost) needs to be removed						

7. Valuation of Goods-in-Transit

Content	
1. Meaning	Goods that have been dispatched by the consignor but have not yet reached the consignee's premises at the end of the accounting period.
2. Ownership	Remains with the consignor until the goods are delivered to the consignee.
3. Need for Valuation	



	Such goods must be <b>shown as an asset</b> in the consignor's books for proper presentation in financial statements.
4.	<p><b>Valuation Method</b>                  Valued at:  <b>Cost of goods</b>  <b>Plus:</b> Expenses incurred by the consignor (e.g., freight, packing, loading, transit insurance)  <b>No expenses incurred by the consignee</b> should be added to the value of goods-in-transit.</p>

**8. Accounting for Consignment Transactions**

**A. Books of the Consignor**

1.	<p><b>Consignment Account</b></p> <ul style="list-style-type: none"> <li>➤ A <b>profit</b> determining account.</li> <li>➤ All <b>expenses and losses</b> are debited, and <b>revenues</b> are credited.</li> <li>➤ The resulting <b>profit or loss</b> is transferred to the <b>Profit and Loss A/c</b>.</li> </ul>
2.	<p><b>Goods Sent on Consignment Account</b></p> <ul style="list-style-type: none"> <li>➤ Records the <b>value of goods sent on consignment</b>.</li> <li>➤ Also includes <b>returns from consignee</b>, if any.</li> </ul>
3.	<p><b>Consignee's Account</b></p> <ul style="list-style-type: none"> <li>➤ A <b>personal account</b> that records all transactions with the consignee (e.g., advances, expenses, sales).</li> <li>➤ Shows the <b>amount receivable</b> from the <b>consignee</b> at period-end.</li> </ul>
4.	<p><b>Consignment Stock Account</b></p> <p>Reflects the <b>value of unsold stock</b> lying with the consignee at the <b>close of the accounting period</b>.</p>
5.	<p><b>Consignment Debtors Account</b></p> <ul style="list-style-type: none"> <li>➤ Opened only when <b>credit sales</b> are made by consignee and <b>del-credere commission</b> is not paid.</li> <li>➤ Records <b>credit sales, collections, bad debts, discounts allowed</b>, etc.</li> </ul>

**B. Books of the Consignee**

1.	<p><b>Consignor Account</b></p> <ul style="list-style-type: none"> <li>➤ Records <b>all transactions with the consignor</b> relating to consignment.</li> <li>➤ The <b>closing balance</b> indicates the <b>amount due to the consignor</b>.</li> </ul>
2.	<p><b>Commission Account</b></p> <p>Separate accounts are maintained for:</p> <ul style="list-style-type: none"> <li>• <b>Ordinary Commission</b></li> <li>• <b>Del-Credere Commission</b></li> <li>• <b>Over-riding / Special Commission</b></li> </ul>
3.	<p><b>Consignment Debtors Account</b></p> <ul style="list-style-type: none"> <li>➤ <b>Maintained</b> when <b>del-credere commission</b> is payable by the consignor.</li> </ul>



	➤ Records credit sales, collections, bad debts, and discounts allowed.
4.	<p><b>Consignment Inwards Account</b></p> <ul style="list-style-type: none"> <li>➤ Usually, no entry is made for receipt of goods.</li> <li>➤ However, a special account may be opened to track movement of goods received.</li> </ul>

**9. Journal Entries**

Transaction	Books of Consignor	Books of Consignee
Opening Stock on Consignment	At Cost: Consignment A/c Dr. To Consignment Stock A/c	No entry
	At IP: Consignment A/c Dr. To Consignment Stock A/c	
Cancellation of load on Opening Stock	Stock Reserve A/c Dr. To Consignment A/c	No entry
Goods Sent on Consignment	At Cost: Consignment A/c Dr. To Goods Sent on Consignment A/c	No entry
	At IP: Consignment A/c Dr. To Goods Sent on Consignment A/c [Note: Load to be cancelled]	
Cancellation of load on goods sent	Goods Sent on Consignment A/c Dr. To Consignment A/c	No entry
Advance received from consignee by consignor	Bank A/c / Bills Receivable A/c Dr. To Consignee A/c	Consignor A/c Dr. To Bank A/c / Bills Payable A/c
Discounting of Bills Receivable by consignor	Bank A/c Dr. Discount on Bill A/c Dr. To Bills Receivable A/c	No entry
Expenses incurred by consignor	Consignment A/c Dr. To Cash/ Bank A/c	No entry
Goods-in-Transit	At Cost: Goods-in-Transit A/c Dr. To Consignment A/c	No entry
	At IP: Goods-in-Transit A/c Dr. To Consignment A/c [Note: Load to be cancelled]	
Cancellation of load on Goods-in-Transit	Consignment A/c Dr. To Goods-in-Transit A/c	No entry
Expenses paid by consignee	Consignment A/c Dr.	Consignor A/c Dr.



	To Consignee A/c	To Bank / Cash A/c
Sale of goods by consignee (For cash)	Consignee A/c Dr. To Consignment A/c	Bank A/c Dr. To Consignor A/c
Sale of goods by consignee (For credit)	Del-credere commission provided: Consignee A/c Dr. To Consignment A/c	Consignment Debtors A/c Dr. To Consignor A/c
	Del-credere commission not provided: Consignment Debtors A/c Dr. To Consignment A/c	No entry
Commission payable by consignor to consignee	Consignment A/c To Consignee A/c	Consignor A/c Dr. To Commission A/c
Amount received from Consignment Debtors (Del-credere commission provided)	No entry	Bank A/c Dr. To Consignment Debtors A/c
Amount received from Consignment Debtors (Del-credere commission not provided)	Consignee A/c Dr. Bank A/c Dr. [if directly collected by consignor] To Consignment Debtors A/c	Bank A/c Dr. To Consignor A/c
Bad Debt in connection to consignment business (Del-credere commission provided)	No entry	Bad Debt A/c Dr. To Consignment Debtors A/c Commission A/c Dr. To Bad Debt A/c
Bad Debt in connection to consignment business (Del-credere commission not provided)	Consignment A/c Dr. To Consignment Debtors A/c	No entry
Goods returned by consignee (At Cost)	Goods Sent on Consignment A/c Dr. To Consignment A/c	No entry
Goods returned by consignee (At IP)	Goods Sent on Consignment A/c Dr. To Consignment A/c	No entry
Abnormal Loss of goods (in Transit / Consignee's premises - At Cost)	Abnormal Loss A/c Dr. To Consignment A/c	No entry
Abnormal Loss of goods (in Transit / Consignee's premises - At IP)	Abnormal Loss A/c Dr. To Consignment A/c [Note: Load to be cancelled]	No entry
Cancellation of loading of abnormal goods (At IP)	Consignment A/c Dr. To Abnormal Loss A/c	No entry
Insurance claim received / admitted against Abnormal Loss	Bank A/c (Amount received) Dr. Insurance Claim A/c Dr. (Amount admitted but not realised) Consignee A/c Dr. (Amount received by consignee) P/L A/c (Net Loss) Dr.	Bank A/c Dr. To Consignor A/c [Amount received from Insurance Co. on behalf of the consignor]



	To Abnormal Loss A/c	
Closing Stock on Consignment (At Cost)	Consignment Stock A/c Dr. To Consignment A/c	No entry
Closing Stock on Consignment (At IP)	Consignment Stock A/c Dr. To Consignment A/c	No entry
Cancellation of loading on goods sent (If goods sent at IP)	Consignment A/c Dr. To Stock Reserve A/c	No entry
Closing of Goods Sent on Consignment A/c	Goods Sent on Consignment A/c Dr. To Purchases / Trading A/c	No entry
Profit/Loss on Consignment	In case of Profit: Consignment A/c Dr. To P/L A/c	No entry
	In case of Loss: P/L A/c Dr. To Consignment A/c	No entry
Final Remittance received by consignor from consignee	Bank A/c / Bills Receivable A/c Dr. To Consignee A/c	Consignor A/c Dr. To Bank A/c / Bills Payable A/c

## 4. JOINT VENTURE

### 1. Joint Venture

Content	
1.	<b>Definition</b> A Joint Venture is a <b>short-term</b> business undertaking by <b>two or more persons</b> who share the profits and losses in an <b>agreed ratio</b> .
2.	<b>Nature of organisation</b> It is a <b>temporary</b> business organization, <b>not intended for long-term</b> operations.
3.	<b>Purpose</b> Formed to <b>execute specific projects</b> involving high risk, large investment, or multi-skill requirements.
4.	<b>Need for Collaboration</b> When an individual <b>lacks resources or expertise</b> , others may combine their strengths.
5.	<b>Temporary Partnership</b> This collaboration creates a <b>temporary partnership</b> , specifically for a defined objective.
6.	<b>Formal Agreement</b> A <b>written</b> Memorandum of Undertaking ( <b>MOU</b> ) is signed outlining terms and conditions.

Parties in a Joint Venture	
Content	
1.	<b>Co-venturers / Joint Venturers</b> The parties involved in a joint venture are called <b>Co-venturers or Joint Venturers</b> .
2.	<b>Relation to Partnership</b> <ul style="list-style-type: none"> <li>➤ It is similar to a <b>partnership</b>, except that it is temporary and ends after the venture is completed.</li> <li>➤ Generally, a <b>firm name is not used</b> since the venture is short-term in nature.</li> <li>➤ It is a <b>temporary partnership</b>, formed with or without a firm name.</li> </ul>
3.	<b>Profit Sharing</b> In the <b>absence of an agreement</b> , profits and losses are shared <b>equally among all co-venturers</b>

### Difference Between Joint Venture and Partnership

Aspect	Joint Venture	Partnership
1. Firm's Name	No firm name required.	Firm name is used.
2. Participants	Participants are called <b>co-venturers</b> .	Participants are called <b>partners</b> .
3. Duration	<b>Temporary</b> , formed for a specific job/project.	<b>Long-term</b> , formed for various projects or ongoing business.
4. Governance	No specific legal enactment, treated as a partnership.	Governed by the <b>Partnership Act, 1932</b> .



5. Number of Participants	No limit to the number of co-venturers.	Limited to 10 in banking and 20 in other businesses.
6. Liability	Limited to the project or task.	Unlimited liability, which may extend to personal assets.

Difference Between Joint Venture and Consignment

Aspect	Joint Venture	Consignment
1. Relationship	Co-venturers are owners of the joint venture.	Consignor and consignee have a principal-agent relationship.
2. Sharing of Profits	Co-venturers share profits according to an agreed ratio.	Consignee receives commission, not a share of profits.
3. Ownership of Goods	Co-venturers are co-owners of the goods or project.	Ownership remains with the consignor.
4. Contribution of Funds	All co-venturers contribute funds in agreed proportions.	Only the consignor invests; consignee only handles goods.
5. Continuity of Business	No continuity after the project is completed.	Consignment is typically a continuous process.

2. Accounting of Joint Venture

content

There are different methods of recording joint venture transactions. They can be broadly classified into two following methods:

- I. When Separate Set of Books are Maintained
- II. When Separate Set of Books are Not Maintained

Method I: When Separate Set of Books are Maintained for the Joint Venture

Content

- As the business duration is short, the books of accounts are not very comprehensive.
- The basic purpose is to ascertain the profit or loss on account of the joint venture.
- Generally, under this approach, the following accounts are maintained:
  - a) Joint Venture Account
  - b) Joint Bank Account
  - c) Co-venturers' Accounts
- a) Joint Venture Account
  - Records all expenses (paid personally or through joint bank), regardless of capital or revenue nature - on debit side.
  - Records all sales (to outsiders or co-venturers) - on credit side.
  - Used to find profit or loss of the venture.
- b) Joint Bank Account
  - Acts as the cash book of the venture.
  - Debit side: Initial contributions by co-venturers, sales proceeds.



	<ul style="list-style-type: none"> <li>➤ <b>Credit side:</b> Expenses, settlement to co-venturers.</li> <li>➤ Final balance is used to <b>settle claims of co-venturers.</b></li> </ul>
c)	<p><b>Co-venturer's Account</b></p> <ul style="list-style-type: none"> <li>➤ Records transactions related to <b>individual co-venturers.</b></li> <li>➤ Similar to <b>capital accounts</b> in partnership.</li> <li>➤ Shows amount <b>due to/from each co-venturer.</b></li> <li>➤ Settled through the <b>Joint Bank Account.</b></li> </ul>

Journal Entries

Transaction	Journal Entry
1. <b>Contribution made by Co-Venturers</b>	Joint Bank A/c Dr. To Co-Venturer A/c
2. <b>Expenses paid through Joint Bank Account</b>	Joint Venture A/c Dr. To Joint Bank A/c
3. <b>Expenses paid or goods supplied by Co-Venturer</b>	Joint Venture A/c Dr. To Co-Venturer A/c
4. <b>Sale proceeds or collections</b>	Joint Bank A/c Dr. To Joint Venture A/c
5. <b>Collections received by Co-Venturer</b>	Co-Venturer A/c Dr. To Joint Venture A/c
6. <b>Assets taken over by Co-Venturer</b>	Co-Venturer A/c Dr. To Joint Venture A/c
7. <b>Liabilities taken over by Co-Venturer</b>	Joint Venture A/c Dr. To Co-Venturer A/c
8. <b>Profit on Joint Venture</b>	Joint Venture A/c Dr. To Co-Venturer A/c
9. <b>Loss on Joint Venture</b>	Co-Venturer A/c Dr. To Joint Venture A/c
10. <b>Final settlement made to Co-Venturer</b>	Co-Venturer A/c Dr. To Joint Bank A/c

Method II: When Separate Set of Books Are Not Maintained

	Content
1	Used when the venture is <b>very short-term</b> and <b>no separate books</b> are maintained jointly.
2	Co-venturers do <b>not maintain separate books</b> for the joint venture.
3	<b>No joint bank account</b> is opened.
4	<b>No cash contribution</b> is made by co-venturers.
5	Goods are supplied <b>from own stock.</b>
6	Expenses are <b>incurred and settled individually by co-venturers.</b>
7	Accounts Maintained by Each Co-Venturer:



	<ul style="list-style-type: none"> <li>• <b>Joint Venture Account:</b> To record all joint venture transactions.</li> <li>• <b>Other Co-venturer's Account:</b> To record transactions related to the other co-venturer.</li> </ul>
8	Each co-venturer calculates profit or loss independently in their own books.
9	This method is suitable when: <ul style="list-style-type: none"> <li>• The <b>business is small</b>, and</li> <li>• Co-venturers operate from <b>different locations</b>.</li> </ul>

When each co-venturer keeps record of all transactions																															
	Content																														
1	Each co-venturer prepares: <ul style="list-style-type: none"> <li>• <b>Joint Venture Account</b> (to record all venture-related transactions)</li> <li>• <b>Other Co-venturer's Account</b> (to record the transactions with the other party)</li> </ul>																														
2	Profit or loss is calculated <b>separately</b> by each <b>co-venturer in their own books</b> .																														
3	<b>Each co-venturer</b> records <b>all transactions</b> both those done by self and on behalf of/by the other co-venturer.																														
	<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 50%; text-align: center;">In Books of Co-Venturer A</th> <th style="width: 50%; text-align: center;">In Books of Co-Venturer B</th> </tr> </thead> <tbody> <tr> <td colspan="2" style="text-align: center;"><b>When goods are supplied and expenses paid by A</b></td> </tr> <tr> <td style="padding: 5px;">                     Joint Venture A/c Dr.                          To Purchases A/c                          To Cash/Bank A/c                 </td> <td style="padding: 5px;">                     Joint Venture A/c Dr.                          To A's A/c                 </td> </tr> <tr> <td colspan="2" style="text-align: center;"><b>When goods are supplied by B and expenses paid by B</b></td> </tr> <tr> <td style="padding: 5px;">                     Joint Venture A/c Dr.                          To B's A/c                 </td> <td style="padding: 5px;">                     Joint Venture A/c Dr.                          To Purchases A/c                          To Cash/Bank A/c                 </td> </tr> <tr> <td colspan="2" style="text-align: center;"><b>When advance is given by A to B or bill accepted by A</b></td> </tr> <tr> <td style="padding: 5px;">                     B's A/c Dr.                          To Cash/Bank A/c                          To B/P A/c                 </td> <td style="padding: 5px;">                     Cash/Bank A/c Dr.                      B/R A/c Dr.                          To A's A/c                 </td> </tr> <tr> <td colspan="2" style="text-align: center;"><b>When sale proceeds are received by A</b></td> </tr> <tr> <td style="padding: 5px;">                     Cash/Bank A/c Dr.                          To Joint Venture A/c                 </td> <td style="padding: 5px;">                     A's A/c Dr.                          To Joint Venture A/c                 </td> </tr> <tr> <td colspan="2" style="text-align: center;"><b>When sale proceeds are received by B</b></td> </tr> <tr> <td style="padding: 5px;">                     B's A/c Dr.                          To Joint Venture A/c                 </td> <td style="padding: 5px;">                     Cash/Bank A/c Dr.                          To Joint Venture A/c                 </td> </tr> <tr> <td colspan="2" style="text-align: center;"><b>For unsold goods taken over by A</b></td> </tr> <tr> <td style="padding: 5px;">                     Goods A/c Dr.                          To Joint Venture A/c                 </td> <td style="padding: 5px;">                     A's A/c Dr.                          To Joint Venture A/c                 </td> </tr> <tr> <td colspan="2" style="text-align: center;"><b>For unsold goods taken over by B</b></td> </tr> <tr> <td style="padding: 5px;">                     B's A/c Dr.                 </td> <td style="padding: 5px;">                     Goods A/c Dr.                 </td> </tr> </tbody> </table>	In Books of Co-Venturer A	In Books of Co-Venturer B	<b>When goods are supplied and expenses paid by A</b>		Joint Venture A/c Dr. To Purchases A/c To Cash/Bank A/c	Joint Venture A/c Dr. To A's A/c	<b>When goods are supplied by B and expenses paid by B</b>		Joint Venture A/c Dr. To B's A/c	Joint Venture A/c Dr. To Purchases A/c To Cash/Bank A/c	<b>When advance is given by A to B or bill accepted by A</b>		B's A/c Dr. To Cash/Bank A/c To B/P A/c	Cash/Bank A/c Dr. B/R A/c Dr. To A's A/c	<b>When sale proceeds are received by A</b>		Cash/Bank A/c Dr. To Joint Venture A/c	A's A/c Dr. To Joint Venture A/c	<b>When sale proceeds are received by B</b>		B's A/c Dr. To Joint Venture A/c	Cash/Bank A/c Dr. To Joint Venture A/c	<b>For unsold goods taken over by A</b>		Goods A/c Dr. To Joint Venture A/c	A's A/c Dr. To Joint Venture A/c	<b>For unsold goods taken over by B</b>		B's A/c Dr.	Goods A/c Dr.
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B's A/c Dr.	Goods A/c Dr.																														



To Joint Venture A/c	To Joint Venture A/c
For profit on joint venture business	
Joint Venture A/c Dr. To B's A/c To P&L A/c	Joint Venture A/c Dr. To A's A/c To P&L A/c
For loss on joint venture business	
B's A/c Dr. P&L A/c Dr. To Joint Venture A/c	A's A/c Dr. P & L A/c Dr. To Joint Venture A/c
After closure the business of joint venture, the co-venturer who has received surplus cash will remit it to the other co-venturer	

Memorandum Method for Joint Venture Accounting

Content

- Each co-venturer maintains only own transactions in a personal account called: "Joint Venture with Co-venturer A/c" (like a personal venture ledger)
- A Memorandum Joint Venture A/c is prepared separately (not part of double-entry).
- It records transactions of both co-venturers, shown separately under each name.
- It is used to ascertain total profit or loss of the venture.
- Each co-venturer sends a periodic statement of joint venture transactions to the other.
- On receiving the statement, both prepare the Memorandum Joint Venture A/c.
- This account is not a double-entry account.
- It is a memorandum statement prepared for profit/loss calculation only.

Accounting Entries

Transaction	In the Books of Co-Venturer
Amount received from co-venturer in cash / cheque or B/R	Cash/Bank/B/R A/c Dr. To Joint Venture with Co-Venture's A/c
Discounting of Bills Receivable	Bank A/c Dr. Joint Venture with Co-venturer .... A/c (Discount) Dr. To B/R A/c
Purchase of goods	Joint Venture with Co-venturer .... A/c Dr. To Cash/Bank A/c To JV Creditors A/c
Making payment to creditors (including discount received)	JV Creditors A/c Dr. To Cash/Bank/B/P A/c To Joint Venture with Co-venturer .... A/c (Discount received)
Goods supplied by co-venturer from own stock	Joint Venture with Co-venturer .... A/c Dr. To Purchases A/c/Goods Sent to JV A/c



Payment of expenses	Joint Venture with Co-venturer .... A/c Dr. To Cash/Bank A/c
Sale of goods	Cash/Bank/JV Debtors A/c Dr. To Joint Venture with Co-venturer .... A/c
Collection from customer (including bad debts and discount allowed)	Cash/Bank A/c Dr. Joint Venture with Co-venturer .... A/c Dr. (Amount of bad debts and discount allowed) To JV Debtors A/c
Taking away of unsold goods	Goods Sent to JV A/c Dr. To Joint Venture with Co-venturer .... A/c
Co-venturer entitled to commission / salary etc.	Joint Venture with Co-venturer .... A/c Dr. To Commission/Salary A/c
Share of profit on joint venture	Joint Venture with Co-venturer .... A/c Dr. To Profit & Loss A/c
Share of loss on joint venture	Profit & Loss A/c Dr. To Joint Venture with Co-venturer .... A/c
Settlement of balance of JV	<b>In case of debit balance:</b> Cash/Bank A/c Dr. To Joint Venture with Co-venturer .... A/c <b>In case of credit balance:</b> Joint Venture with Co-venturer .... A/c Dr. To Cash/Bank A/c

**Note:**

The following transactions are **not recorded** in the books of either co-venturer:

- Transactions effected by other co-venturer; and
- Transactions not involving cash receipt or cash payment

**3. Conversion of Consignment into Joint Venture**

	Content
1.	<b>Accounting Until Conversion:</b> Till the date of conversion, <b>normal consignment accounting</b> is followed in the books of both Consignor and Consignee.
2.	<b>Treatment of Unsold Stock</b> On the date of conversion, the <b>unsold stock on consignment</b> is transferred to the Joint Venture Account.
3.	<b>After Conversion</b> From the date of conversion onwards, all transactions are accounted using the <b>joint venture accounting principles</b> .



#### 4. Joint Ventures Running for More than One Accounting Period

	Content
1.	<p><b>Special Issue - Closing Stock:</b> When a joint venture continues beyond one accounting period, valuation of closing stock becomes necessary.</p>
2.	<p><b>Stock Valuation Basis:</b> Closing stock is valued at: Cost + Proportionate Non-recurring Expenses (e.g., freight, customs, insurance, etc.)</p>
3.	<p><b>Treatment in Memorandum Joint Venture A/c:</b></p> <ul style="list-style-type: none"> <li>• End of Year 1: Stock is shown on the credit side</li> <li>• Start of Year 2: Same stock is shown on the debit side</li> </ul>
4.	<p><b>Treatment of Other Accounts:</b> All other accounts (like Joint Venture with Co-venturer A/c) are prepared in the usual manner.</p>
5.	<p><b>Interim Settlement Option:</b> If co-venturers want to settle accounts at the end of the year:</p> <ul style="list-style-type: none"> <li>• They record their share in closing stock in their respective 'Joint Venture with Co-venturer A/c'.</li> <li>• The share in stock is shown on the debit side of that account and carried forward.</li> </ul>



## 5. PREPARATION OF FINAL ACCOUNTS OF COMMERCIAL ORGANISATIONS

### 1. Objective of accounting

	Content
1.	<p><b>Objective of Accounting</b></p> <ul style="list-style-type: none"> <li>➤ Besides record-keeping, a key objective of accounting is:           <ul style="list-style-type: none"> <li>• Determination of <b>operating results</b> &amp;</li> <li>• Disclosure of <b>financial position</b>.</li> </ul> </li> <li>➤ In commercial organisations:           <p style="margin-left: 20px;"><b>Operating result = Profit earned or Loss suffered during a specific period</b></p> </li> <li>➤ This is done through preparation of Financial Statements</li> </ul>
2.	<p><b>Components of Financial Statements</b></p> <ol style="list-style-type: none"> <li>a. <b>Income Statement</b></li> <li>b. <b>Balance Sheet</b></li> <li>c. <b>Cash Flow Statement (excluded from this chapter)</b></li> </ol>

### 2. Income Statement

	Content						
1.	<p><b>Meaning</b></p> <ul style="list-style-type: none"> <li>➤ 'Income Statements' is a <b>generic term</b>.</li> <li>➤ Refers to components of Financial Statements used for: Determination of operating result i.e. <b>Ascertainment of profit or loss</b></li> <li>➤ Income Statements include:           <ul style="list-style-type: none"> <li>Trading Account</li> <li>Profit &amp; Loss Account (P/L A/c)</li> <li>Profit &amp; Loss Appropriation Account (in case of partnership only)</li> </ul> </li> </ul> <table border="1" style="width: 100%; margin-top: 10px;"> <thead> <tr> <th>Form of Organisation</th> <th>Components of Income Statement</th> </tr> </thead> <tbody> <tr> <td>Proprietary Organisation</td> <td>Trading A/c, Profit &amp; Loss A/c</td> </tr> <tr> <td>Partnership Organisation</td> <td>Trading A/c, Profit &amp; Loss A/c, Profit &amp; Loss Appropriation A/c</td> </tr> </tbody> </table>	Form of Organisation	Components of Income Statement	Proprietary Organisation	Trading A/c, Profit & Loss A/c	Partnership Organisation	Trading A/c, Profit & Loss A/c, Profit & Loss Appropriation A/c
Form of Organisation	Components of Income Statement						
Proprietary Organisation	Trading A/c, Profit & Loss A/c						
Partnership Organisation	Trading A/c, Profit & Loss A/c, Profit & Loss Appropriation A/c						

### 3. Trading Account

	Content
1.	Objective: Determine <b>Gross Profit / Gross Loss</b> .
2.	<p>Based on:</p> <ul style="list-style-type: none"> <li>• <b>Matching of Sales and COGS</b>.</li> <li>• Considers <b>direct incomes and direct expenses</b> only.</li> <li>• It is a <b>Nominal Account</b>, closed by transferring the balance to P/L A/c.</li> </ul>



3.	<p><b>Items in the Trading Account (Debit Side)</b></p> <p>a. <b>Opening Stock:</b> Finished goods from the Trial Balance.</p> <p>b. <b>Purchases:</b> Cash + Credit Purchases. Less:</p> <ul style="list-style-type: none"> <li>• Purchase Returns</li> <li>• Goods withdrawn by proprietor</li> <li>• Free samples distributed</li> </ul> <p>c. <b>Other Direct Expenses</b> Costs from purchase till making goods saleable. E.g.: Freight Inward, Octroi, Wages, etc.</p> <p>d. <b>Gross Loss:</b> If Dr. side &gt; Cr. side, Gross Loss is transferred to P/L A/c.</p>
4.	<p><b>Items in the Credit Side of Trading Account</b></p> <p>a. <b>Sales Revenue:</b> From regular business activities. Less: Sales Returns As per Accrual Concept, sales are recorded when earned.</p> <p>b. <b>Closing Stocks/Inventories:</b> Only finished goods. Valued at Cost or NRV, whichever is lower (as per Conservatism).</p> <p>c. <b>Gross Profit:</b> If Cr. side &gt; Dr. side, Gross Profit is transferred to P/L A/c.</p>

#### Trading Account for the year ended

Particulars	Amount	Particulars	Amount
To Opening Stock		By Sales	
To Purchases		Less: Sales Returns	
Less: Purchase Returns		By Closing Stock	
To Wages		By Profit and Loss A/c (Gross Loss transferred)	
To Other Direct Expenses			
To Profit and Loss A/c (Gross Profit transferred)			

#### 4. Profit & Loss Account

	Content
1.	<p><b>objective</b> The second income statement, prepared after determining Gross Profit or Gross Loss. It determines the Net Profit or Net Loss for the accounting period.</p>
<b>Debit Side of Profit &amp; Loss A/c</b>	
2.	<p><b>Cost of Sales</b> Refers to the cost of goods sold, which could be manufactured or directly related to goods.</p>
3.	<p><b>Other Expenses</b></p>



	<p>Expenses not directly related to the main business activity, including:</p> <ul style="list-style-type: none"> <li>➤ Administrative Expenses (e.g., office staff salary, salesmen commission, insurance, audit fees)</li> <li>➤ Selling &amp; Distribution Expenses (e.g., advertising, bad debts, free samples)</li> <li>➤ Items like loss on sale of fixed assets, interest, and provisions.</li> </ul>
4.	<p><b>Abnormal Losses</b></p> <p>Losses that are unusual or unexpected, such as stock destroyed by fire or goods lost in transit.</p>
<b>Credit Side of Profit &amp; Loss A/c</b>	
5.	<p><b>Revenue Incomes</b></p> <p>Incomes from ordinary business activities, such as commission received, discount received, etc.</p>
6.	<p><b>Other Incomes</b></p> <p>Incomes unrelated to the main business activity, including items like interest received and dividends received.</p>
7.	<p><b>Transfer of Result to Balance Sheet</b></p> <p>The Net Profit or Net Loss is transferred to the balance sheet as an addition or reduction in owners' equity. In a company, the profit figure is shown separately.</p>

**Profit & Loss Account for the year ended**

Particulars	Particulars
To Trading A/c (Gross Loss transferred)	By Trading A/c (Gross Profit transferred)
To Administrative Expenses	By Other Income
To Office Salaries	By Interest Received
To Communication	By Commission Received
To Travel & Conveyance	By Profit on Sale of Assets
To Office Rent	By Rent Received
To Advertising	By Capital A/c
To Audit Fees	(Net Loss Transferred)
To Insurance	
To Repairs & Maintenance	
To Selling & Distribution Expenses	
To Bad Debts	
To Salesmen Commission	
To Interest on Loans	
To Depreciation and Amortization	
To Financial Expenses	
To Bank Charges	
To Loss on Sale of Assets	
To Capital A/c (Net Profit Transferred)	



## 5. Profit & Loss Appropriation Account

	Content
1.	<b>Profit &amp; Loss Appropriation Account</b> Shows how the <b>net profit is appropriated (distributed)</b> among the <b>partners</b> in a partnership business.
2.	<b>Applicability</b> <b>Not</b> required for <b>sole proprietorship</b> businesses.
3.	<b>Uses of Net Profit</b> The net profit can be used for: ✓ <b>Distributing dividends</b> ✓ <b>Creating reserves, etc.</b>
4.	<b>Purpose of P/L Appropriation A/c</b> It is used to <b>show the distribution adjustments of profits</b> . Profit appropriation does not mean an expense.
5.	<b>Effect on Owner's Equity</b> After making the distribution entries, the <b>remaining surplus is added to the owner's equity</b> .

### Profit and Loss Appropriation Account for the year ended

Particulars		Particulars	
To Proposed Dividend		By P/L A/c	
To Reserves (Transfer)		(Net Profit Transferred)	
To Capital A/c			

## 6. Manufacturing Account

	Content
1.	<b>Manufacturing Account</b> ➤ Prepared by businesses that <b>manufacture goods</b> to show the <b>cost of goods manufactured</b> . ➤ It is an <b>extension of the Trading Account</b> .
2.	<b>Purpose</b> To <b>determine the cost of producing goods</b> and then transferring this cost to the Trading Account.

### Manufacturing Account for the year ended

Particulars		Particulars	
To Opening Stock of Raw Materials and WIP		By Closing Stock of Raw Materials and WIP	
To Purchase of Raw Materials Less: Purchase Returns		By Cost of Goods Manufactured transferred to Trading Account	
To Wages			
To Other Direct Expenses			



1.	<b>Trading Account</b> Prepared after the Manufacturing Account to show <b>Gross Profit or Gross Loss</b> .
2.	<b>Purpose</b> To match the <b>cost of goods manufactured</b> with the <b>sales revenue</b> to calculate <b>Gross Profit</b> .

#### Trading Account for the year ended

Particulars	Particulars
To Opening Stock of Finished Goods	By Sales Less: Sales Returns
To Cost of Goods Manufactured (Transferred from Manufacturing Account)	
By Profit and Loss A/c (Gross Profit transferred)	By Closing Stock of Finished Goods
	By Profit and Loss A/c
	To Profit and Loss A/c (Gross Loss transferred)

### 7. Balance Sheet

	Content
1.	<b>Balance Sheet</b> A financial statement showing the <b>financial position</b> of an organization at a <b>specific date</b> . It includes assets and liabilities at a <b>particular point in time</b> .
2.	<b>Types of Balance Sheet Formats</b> <ul style="list-style-type: none"> <li>➤ <b>Horizontal Format:</b> Liabilities on the left, assets on the right (traditional format).</li> <li>➤ <b>Vertical Format:</b> Liabilities and assets appear in a top-down order.</li> </ul>
3.	<b>Marshalling of Items</b> The order in which items appear in the Balance Sheet. It can follow: <ul style="list-style-type: none"> <li>✓ <b>Rigidity Order</b> (Assets listed from most permanent to current, and liabilities from long-term to short-term).</li> <li>✓ <b>Liquidity Preference Order</b> (Reverse ordering, current assets and short-term liabilities appear first).</li> </ul>
4.	<b>Preparation of Final Accounts</b> Final accounts are prepared from the <b>ledger balances</b> and include: <ul style="list-style-type: none"> <li>✓ <b>Income Statements</b> (e.g., Trading Account, Profit &amp; Loss Account).</li> <li>✓ <b>Balance Sheet</b>. Adjustments may be made for accounting principles or errors.</li> </ul>
5.	<b>Important Adjustments</b> Adjustments/rectifications may include: <ul style="list-style-type: none"> <li>✓ <b>Closing stock, Outstanding expenses, Prepaid expenses, Accrued income, Income received in advance</b></li> <li>✓ <b>Goods sold on approval basis, Goods withdrawn by proprietor, Depreciation, Bad debts, Provision for doubtful debts, etc.</b></li> </ul>





c)	If Closing Stock appears in the Trial balance means it was already adjusted with purchases. Now the purchases given in trial balance are Adjusted purchases. Then the closing inventory is not entered in the trading account, it is shown only in the balance sheet.
d)	The valuation principle for inventory is cost or net realisable value whichever is lower.

1.	<p><b>Outstanding expenses or Accrued expenses:</b></p> <ul style="list-style-type: none"> <li>➤ If outstanding expenses given as adjustment, then it is added to relevant expense in P&amp;I and outstanding expense is shown under Liabilities side.</li> <li>➤ If outstanding expenses given under Trial balance, then it is shown under Liabilities side only.</li> </ul>
2.	<p><b>Prepaid expenses:</b></p> <ul style="list-style-type: none"> <li>➤ If Prepaid expenses given as adjustment, then it is reduced from relevant expense in P&amp;I and Prepaid expense is shown under Assets side.</li> <li>➤ If Prepaid expense given under Trial balance, then it is shown under Assets side only.</li> </ul>
3.	<p><b>Accrued income:</b></p> <ul style="list-style-type: none"> <li>➤ If Accrued income given as adjustment, then it is added to relevant income in P &amp; L and Accrued income is shown under Assets side.</li> <li>➤ If Accrued income given under Trial balance, then it is shown under Assets side only.</li> </ul> <p><b>Income received in advance:</b></p> <ul style="list-style-type: none"> <li>➤ If Income received in advance is given as adjustment, then it is reduced from relevant income in P &amp; L and Income received in advance is shown under Liabilities side.</li> <li>➤ If Income received in advance given under Trial balance, then it is shown under Liabilities side only.</li> </ul>
4.	<p><b>Goods sold on approval basis:</b></p> <ul style="list-style-type: none"> <li>➤ If approval received before the end of financial year or reasonable time period expired, it is treated as sales and added to current year revenue.</li> <li>➤ If approval not yet received before the end of financial year and reasonable time not yet expired, then it is treated as stock lying with customer and will show along with closing stock in Trading A/c.</li> </ul>
5.	<p><b>Goods distributed as free samples:</b> It is reduced from purchases in Trading A/c and shown as expense in P&amp;L.</p>
6.	<p><b>Goods withdrawn by proprietor:</b> It is reduced from purchases in Trading A/c and shown as reduction from capital in Balance sheet.</p>
7.	<p><b>Abnormal loss of stock:</b> It is initially shown under credit side in Trading A/c to match with purchased goods. Later, based on amount of recovery from Insurance company balance amount debited under P&amp;L as loss from abnormal loss.</p>
8.	<p><b>Bad debts, Provision for doubtful debts, Provision for discount on debtors:</b> Previously discussed under Introduction to FA chapter.</p>



## 6. PREPARATION OF FINAL ACCOUNTS OF NOT-FOR-PROFIT ORGANISATIONS

### 1. Non-profit Organisations

	Content
1.	<p><b>Meaning of NPO</b></p> <ul style="list-style-type: none"> <li>➤ Organisations formed primarily to offer <b>services to society</b> rather than to earn profit.</li> <li>➤ Their main objective is to operate for adding value to different sections of the society and the <b>funds are utilized</b> maximum for the <b>benefits of the society</b>.</li> <li>➤ Examples include educational institutions, charitable trusts, social clubs, religious institutions, etc.</li> </ul>
2.	<p><b>Features of Non-profit Organisations</b></p> <p>The salient features of such non-trading entities are:</p> <ul style="list-style-type: none"> <li>➤ This organization is governed by <b>elected body or trustee board</b>.</li> <li>➤ Its operation is <b>not driven by any profit motive</b> unlike trading concerns.</li> <li>➤ Main purpose of the organization is to provide <b>social service</b>.</li> <li>➤ Main source of their income comes from <b>donation and membership subscription</b>.</li> <li>➤ The funds are utilized <b>maximum for the benefits of the society</b>.</li> <li>➤ The <b>membership</b> process for this concern is <b>non-transferable</b>.</li> <li>➤ The <b>method of accounting</b> that is followed here is <b>entity concept</b>.</li> </ul>
3.	<p><b>Financial Statements of Non-profit Organisations</b></p> <p>The different components of the financial statements of non-profit organisations are:</p> <ul style="list-style-type: none"> <li>➤ <b>Receipts &amp; Payments Account;</b></li> <li>➤ <b>Income &amp; Expenditure Account; &amp;</b></li> <li>➤ <b>Balance Sheet</b></li> </ul>

### 2. Preparation of Receipts and Payments Account

	Concept
1.	<p><b>Type of Account</b></p> <ul style="list-style-type: none"> <li>➤ This is the <b>summarized form of the cash book</b> of a non-profit organisation.</li> <li>➤ Entries are made on <b>cash basis</b> and</li> <li>➤ Items pertaining to <b>previous year or current year or subsequent years</b> are also recorded.</li> </ul>
2.	<p><b>Nature of the Account</b></p> <ul style="list-style-type: none"> <li>➤ It is a <b>real account</b></li> <li>➤ Records only <b>actual cash/bank transactions</b>.</li> </ul>
3.	<p><b>Account Structure &amp; Contents</b></p> <ul style="list-style-type: none"> <li>➤ The account begins with the <b>opening balance of cash and bank</b> and ends with the <b>closing balance of cash and bank</b>.</li> </ul>



- It is a **memorandum account** in which the **receipts** are shown on **left side** and **payments** are shown on the **right side**.
- **Capital** as well as **revenue items** are entered in the Receipts and Payments Account.
- **No provisions** are recorded in this account.

#### Proforma of Receipts and Payments Account

Receipts	(Rs.)	Payments	(Rs.)
Starts with opening balance			
All receipts (capital & revenue)		All payments (capital & revenue)	
May relate to previous, current, or subsequent periods		May relate to previous, current, or subsequent periods	
		Ends with closing balance	

### 3. Preparation of Income and Expenditure Account

Content	
1.	<b>Type of Account</b> It is the <b>income statement</b> of a non-profit organisation, similar to the Profit & Loss Account of profit-oriented entities.
2.	<b>Nature of the Account</b> It is a <b>nominal account</b> - only revenue items are recorded (no capital items).
3.	<b>Basis of Accounting</b> Prepared on the <b>accrual basis</b> - incomes and expenses are recorded when they are earned or incurred, not when cash is received or paid.
4.	<b>Period Coverage</b> Only items pertaining to the <b>current accounting period</b> are included.
5.	<b>Account Structure</b> <b>Revenue Incomes</b> → shown on the <b>credit side</b> . <b>Revenue Expenditures</b> → shown on the <b>debit side</b> .
6.	<b>Result/Balancing Figure</b> If <b>incomes &gt; expenditures</b> , the result is <b>Surplus</b> . If <b>expenditures &gt; incomes</b> , the result is <b>Deficit</b> .

#### Proforma of Income and Expenditure Account:

Dr. Expenses	(Rs.)	Cr. Income	(Rs.)
Only revenue expenses		Only revenue receipts	
Only related to the current period		Only related to the current period	
Shows either Surplus or Deficit			



#### 4. Preparation of Balance Sheet

Content	
1.	<b>Date of Preparation</b> It is prepared as on the <b>last day of the accounting period</b> .
2.	<b>Contents</b> Shows the organisation's <b>Assets and Liabilities</b> , similar to any other entity.
3.	<b>Basis</b> Prepared based on the Accounting Equation: <b>Assets = Liabilities + Capital Fund</b>
4.	<b>Capital Representation</b> There is <b>no Capital Account</b> . Instead, a <b>Capital Fund</b> (also called <b>General Fund</b> ) is shown under <b>liabilities</b> .
5.	<b>Surplus/Deficit Adjustment</b> The Surplus or Deficit from the Income & Expenditure Account is <b>added to or deducted from the Capital Fund at year-end</b> .
6.	<b>Structure</b> <ul style="list-style-type: none"> <li>➤ <b>Assets include</b> Fixed Assets, Investments, Cash/Bank, Receivables, etc.</li> <li>➤ <b>Liabilities include</b> Outstanding Expenses, Subscriptions Received in Advance, Loans, etc.</li> <li>➤ <b>Capital Fund</b> appears on the liabilities side, representing accumulated surplus.</li> </ul>

#### 5. Difference between Receipts and Payments Account and Income and Expenditure Account

Receipts & Payments Account	Income & Expenditure Account
1. It is a <b>summarized Cash Book</b>	1. It closely resembles the <b>Profit &amp; Loss Account</b> of a trading concern.
2. <b>Receipts</b> are debited and <b>Payments</b> are credited.	2. <b>Incomes</b> are credited and <b>Expenditures</b> are debited.
3. Transactions are recorded on a <b>Cash basis</b> .	3. Transactions are recorded on an <b>Accrual basis</b> .
4. Amounts related to <b>previous or future periods</b> may remain included. Outstanding amounts for the current year are <b>excluded</b> .	4. Transactions are recorded on <b>accrual basis</b> . All amounts <b>not related to the current period</b> are <b>excluded</b> . Outstanding amounts of the current period are added.
5. It records both <b>Capital and Revenue</b> transactions.	5. It records only <b>Revenue</b> transactions.
6. It serves the purpose of a <b>Real Account</b> .	6. It serves the purpose of a <b>Nominal Account</b> .
7. It starts with the <b>opening Cash and Bank balances</b> and ends with the <b>closing Cash and Bank balances</b> .	7. It does not record such balances; rather, its final balance shows a <b>surplus or deficit</b> for the period.
8. It does not record <b>notional losses or non-cash expenses</b> like bad debts, depreciation, etc.	8. It considers all such <b>expenses</b> (e.g., bad debts, depreciation, etc.) for <b>matching against revenues</b> .



9. Its closing balance is carried forward to the same account of the next accounting period.	9. Its closing balance is transferred to Capital Fund, General Fund, or Accumulated Fund in the same period's Balance Sheet.
10. It helps to prepare an Income & Expenditure Account.	10. It helps to prepare a Balance Sheet.

## 6. Accounting Treatment of Various Inflows in Non-Profit Organisations

Content	
1.	<p><b>Entrance Fees</b></p> <ul style="list-style-type: none"> <li>➤ Received at the time of admission of a new member; generally one-time and non-recurring.</li> <li>➤ Can be capitalised (treated as capital receipt) or treated as revenue, based on the institution's policy.</li> <li>➤ If admissions are regular, it may be treated as a revenue receipt.</li> </ul>
2.	<p><b>Donations</b></p> <ul style="list-style-type: none"> <li>➤ Donations may be used to meet capital or revenue expenses.</li> <li>➤ <b>Specific Purpose Donations:</b> Credited to a separate fund; amounts are spent for the intended purpose only.</li> <li>➤ Such funds may be invested, and the income earned is also credited to the same fund.</li> <li>➤ <b>General/Small Donations (not earmarked):</b> Treated as revenue receipts and credited to the Income &amp; Expenditure A/c.</li> </ul>
3.	<p><b>Legacy</b></p> <ul style="list-style-type: none"> <li>➤ Many times trusts are formed in the memory of certain persons by their will.</li> <li>➤ In such case after the demise of the person, the funds pass on to the institution.</li> <li>➤ Such legacies are of course one-time and therefore should be taken to the capital fund.</li> </ul>
4.	<p><b>Endowments</b></p> <ul style="list-style-type: none"> <li>➤ Sometimes, donations are also in the form of endowments to be used as per instructions of the donor.</li> <li>➤ These are to be treated as capital receipts.</li> </ul>
5.	<p><b>Life Membership Fees</b></p> <ul style="list-style-type: none"> <li>➤ These could be taken as capital receipts and every year a charge is debited.</li> <li>➤ In other words, when received, it could be treated as deferred receipt in the balance sheet and every year a specific amount is credited to Income &amp; Expenditure A/c.</li> </ul>
6.	<p><b>Subscriptions</b></p> <ul style="list-style-type: none"> <li>➤ These are annual receipts and therefore taken as revenue receipts.</li> <li>➤ These must be recognised as revenue on the accrual concept</li> </ul>

## 7. Fund Asset Accounting and its peculiarities

Content	
i.	<p><b>Capital Fund</b></p> <ul style="list-style-type: none"> <li>➤ Also called General Fund or Accumulated Fund.</li> </ul>





- Annual Subscription apportioned out of that is credited to Income & Expenditure Account and deducted from the liability. Thus, the balance is carried forward till the contribution by a member is fully exhausted.
- If any member dies before hand, the balance of his life Membership contribution is transferred to Capital Fund or General Fund.

## 8. Restaurant Trading and Bar Trading

### Content

1. **Restaurant/Bar Trading**  
Some clubs have Restaurant and Bar facilities for members and outsiders. Under the circumstances, Restaurant Trading or Bar Trading Account is opened to ascertain the Restaurant or Bar profit, it is just like Trading Account which is opened in case of a trading concern.
2. **Profit Transfer**  
The Restaurant or Bar profit so ascertained from Restaurant Trading or Bar Trading is transferred to the Income and Expenditure Account as we generally transfer the Gross Profit from Trading Account to Profit and Loss Account in case of Trading concern.



# 7. PREPARATION OF FINAL ACCOUNTS FROM INCOMPLETE RECORDS

## 1. Single Entry System

### Content

1.	<p><b>Introduction</b></p> <ul style="list-style-type: none"> <li>➤ <b>Transactions</b> occur in every business organisation.</li> <li>➤ Primary function of accounting is to <b>record these transactions</b>.</li> <li>➤ Transactions should be recorded in a <b>systematic and scientific manner</b>, as per the <b>Double Entry System</b>.</li> <li>➤ However, some entities <b>do not follow the double entry system</b>.</li> <li>➤ Such entities are generally <b>small-time traders</b> e.g., grocery stores, kirana shops, etc.</li> <li>➤ They maintain records in a <b>casual and sketchy manner</b>.</li> <li>➤ This leads to <b>incomplete recording</b> of transactions.</li> <li>➤ This incomplete method is referred to as the <b>Single-Entry System</b> of account keeping.</li> </ul>
2.	<p><b>Meaning of Single-Entry System</b></p> <ul style="list-style-type: none"> <li>➤ Does <b>not follow double entry principles</b>.</li> <li>➤ Some transactions: <ul style="list-style-type: none"> <li>▪ <b>Fully recorded</b></li> <li>▪ <b>Partially recorded</b></li> <li>▪ <b>Not recorded at all</b></li> </ul> </li> <li>➤ Term '<b>Single Entry</b>' = Misnomer</li> <li>➤ Better term: '<b>Incomplete Records</b>'</li> </ul>
3.	<p><b>Features of Single-Entry System</b></p> <ul style="list-style-type: none"> <li>➤ <b>Unscientific</b> method of recording.</li> <li>➤ <b>Mix of: No entry, Single entry, and Double entry</b></li> <li>➤ <b>Used by: Small businesses, semi-skilled service providers, workers, etc.</b></li> <li>➤ <b>No uniformity in recording.</b></li> <li>➤ <b>Only Cash A/c and Personal A/cs</b> are usually maintained.</li> <li>➤ <b>Original vouchers kept for reference; Relevant accounts not prepared</b></li> </ul>
4.	<p><b>Limitations / Defects of Single-Entry System</b></p> <ul style="list-style-type: none"> <li>➤ <b>Trial Balance not possible</b> - No double entry → no arithmetical accuracy.</li> <li>➤ <b>Profit/Loss only estimated</b> - No Nominal A/cs maintained.</li> <li>➤ <b>Balance Sheet can't be prepared</b> - Real A/cs not available.</li> <li>➤ <b>Errors &amp; Frauds not traceable</b> - Lack of checks.</li> <li>➤ <b>Improper valuation</b> - Assets &amp; liabilities not correctly shown.</li> <li>➤ <b>Not reliable for external users</b> - e.g., Banks can't assess creditworthiness.</li> <li>➤ <b>Business &amp; personal transactions may get mixed up.</b></li> </ul>



## 2. Difference Between Single Entry System and Double Entry System

Aspect	Single Entry System	Double Entry System
1. Approach	Casual and unscientific recording of transactions.	Scientific and systematic method of recording transactions.
2. Recording Transactions	Only one aspect (debit or credit) of a transaction is recorded, or sometimes both aspects are recorded incompletely.	Both debit and credit aspects of every transaction are recorded.
3. Subsidiary Books	No subsidiary books (except cash book).	Subsidiary books such as sales, purchases, etc., are maintained.
4. Ledger	Ledger contains only cash and personal accounts.	Ledger contains personal, real, and nominal accounts.
5. Trial Balance	Cannot be prepared.	Can prepare a trial balance to verify accuracy.
6. Financial Statements	Only a rough profit or loss estimate is made, and a Statement of Affairs is prepared, resembling a balance sheet.	Trading, Profit & Loss Accounts, and Balance Sheet are prepared.
7. Fraud Detection	Greater likelihood of fraud or misappropriation.	Less likelihood of fraud, due to the checks and balances in the system.
8. Usage	Followed by small businesses, sole traders, professionals, and partnerships who can't afford formal books of accounts.	Followed by most businesses, including large corporations, to ensure accuracy and reliability of financial records.

## 3. Accounting from Incomplete Records & Preparation of Final Accounts

Content	
1.	Entities not following double entry have no uniformity in recording.
2.	Transactions recorded as per personal needs; no proper books maintained.
3.	TB & FSs can't be prepared directly.
4.	Still, such entities want to know: Operating results (Profit/Loss) & Financial position (Assets/Liabilities)
5.	But partial/incomplete records don't give accurate info.

### Methods to prepare Final Accounts from Incomplete Records

- a. Balance Sheet Approach (Net Worth Approach / Comparison Approach)
- b. Conversion Approach



#### 4. Approach 1: Balance Sheet / Net Worth / Comparison Approach

	Content																																									
1.	<p>How it Operates?</p> <ul style="list-style-type: none"> <li>➤ Profit/Loss = Change in Net Worth over two periods.</li> <li>➤ Capital (Net Worth) at two dates is compared.</li> <li>➤ Statement of Affairs is prepared to find capital on both dates.</li> <li>➤ Difference in capital = Operating Result (after adjustments).</li> </ul>																																									
2.	<p>Statements Prepared Under Balance Sheet Approach</p> <ol style="list-style-type: none"> <li>a. Statement of Affairs</li> <li>b. Statement of Profit &amp; Loss</li> <li>c. Final Statement of Affairs</li> </ol>																																									
3.	<p>Statement of affairs:</p> <p>It is a statement of financial position that is prepared with the balances of various assets and liabilities to ascertain the capital/ net worth at the beginning and end of the accounting period.</p>																																									
4.	<p>Statement of profit &amp; loss:</p> <ul style="list-style-type: none"> <li>➤ This statement is prepared for determination of the profit/ loss) of the entity.</li> <li>➤ Firstly, the trading profit/loss is determined by comparing the capital / net worth as at the beginning and end of the accounting period.</li> <li>➤ Thereafter, effect is to be given for the necessary adjustments for determination of the net profit/ loss for the accounting period.</li> </ul> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="text-align: center;">Particulars</th> <th style="text-align: center;">(Rs.)</th> <th style="text-align: center;">(Rs.)</th> </tr> </thead> <tbody> <tr> <td>Capital (at the end)</td> <td style="text-align: center;">xx</td> <td></td> </tr> <tr> <td>Less: Capital (at the beginning)</td> <td style="text-align: center;">xx</td> <td style="text-align: center;">xx</td> </tr> <tr> <td>Add: Drawings</td> <td></td> <td style="text-align: center;">xx</td> </tr> <tr> <td></td> <td></td> <td style="text-align: center;">xx</td> </tr> <tr> <td>Less: Further Capital Introduced (if any)</td> <td></td> <td style="text-align: center;">xx</td> </tr> <tr> <td>Profit/Loss</td> <td></td> <td style="text-align: center;">xx</td> </tr> <tr> <td>Less: Adjustments, if any say, Bad debts, Depreciation etc.</td> <td></td> <td style="text-align: center;">xx</td> </tr> <tr> <td>Net Profit/Loss for the Period</td> <td></td> <td style="text-align: center;">xx</td> </tr> <tr> <td>Less: Appropriation Items:</td> <td></td> <td></td> </tr> <tr> <td>(i) Interest on Partner's Capital</td> <td style="text-align: center;">xx</td> <td></td> </tr> <tr> <td>(ii) Partners' Salaries etc.</td> <td style="text-align: center;">xx</td> <td style="text-align: center;">xx</td> </tr> <tr> <td>Divisible Profit</td> <td></td> <td style="text-align: center;">xx</td> </tr> </tbody> </table>			Particulars	(Rs.)	(Rs.)	Capital (at the end)	xx		Less: Capital (at the beginning)	xx	xx	Add: Drawings		xx			xx	Less: Further Capital Introduced (if any)		xx	Profit/Loss		xx	Less: Adjustments, if any say, Bad debts, Depreciation etc.		xx	Net Profit/Loss for the Period		xx	Less: Appropriation Items:			(i) Interest on Partner's Capital	xx		(ii) Partners' Salaries etc.	xx	xx	Divisible Profit		xx
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(ii) Partners' Salaries etc.	xx	xx																																								
Divisible Profit		xx																																								
5.	<p>Final statement of affairs:</p> <ul style="list-style-type: none"> <li>➤ This statement is to be prepared at the end of the accounting period with the closing balances of the assets and liabilities after providing for the necessary adjustments viz. Depreciation, provision for bad &amp; doubtful debts etc.</li> <li>➤ It is also known as the revised statement of affairs.</li> </ul>																																									



## Difference between 'Statement of Affairs' &amp; 'Balance Sheet'

Aspect	Statement of Affairs	Balance Sheet
1. Preparation Method	Prepared by entities following the <b>single-entry system</b> .	Prepared by entities following the <b>double entry system</b> .
2. Purpose	Determines <b>Capital or Net Worth</b> at two different points in time.	Discloses the <b>financial position</b> of the entity.
3. Reliability	Reflects an <b>estimated financial position</b> .	Reflects the <b>true financial position</b> .
4. Reliability of Information	The information is comparatively <b>less reliable</b> .	The information is <b>more reliable</b> due to the double-entry system.
5. Capital Account Balance	The capital balance is calculated as the <b>excess of assets over liabilities</b> .	The capital balance is available from <b>regular accounting records</b> .
6. Format	<b>No statutory format</b> is specified.	The <b>Balance Sheet format</b> is specified under various statutes, e.g., Companies Act, Banking Regulations Act.

## Statement of Profit &amp; Loss and Profit &amp; Loss Account

Aspect	Statement of Profit & Loss	Profit & Loss Account
Preparation Method	Prepared by entities following the <b>single-entry system</b> .	Prepared by entities following the <b>double entry system</b> .
Profit/Loss Determination	Profit or loss is determined by <b>comparing capital/net worth</b> at two points in time.	Profit or loss is determined by <b>matching expenses and losses against incomes and gains</b> .
Reliability of Profit/Loss	Reflects the <b>estimated profit or loss</b> of an entity.	Reflects the <b>true profit or loss</b> of an entity.
Disclosure of Items	<b>Not all items</b> of expenses, losses, incomes, and gains are properly disclosed.	<b>All items</b> of expenses, losses, incomes, and gains are properly disclosed.
Reliability of Information	The information is comparatively <b>less reliable</b> .	The information is <b>reliable</b> , as it follows the double-entry system.

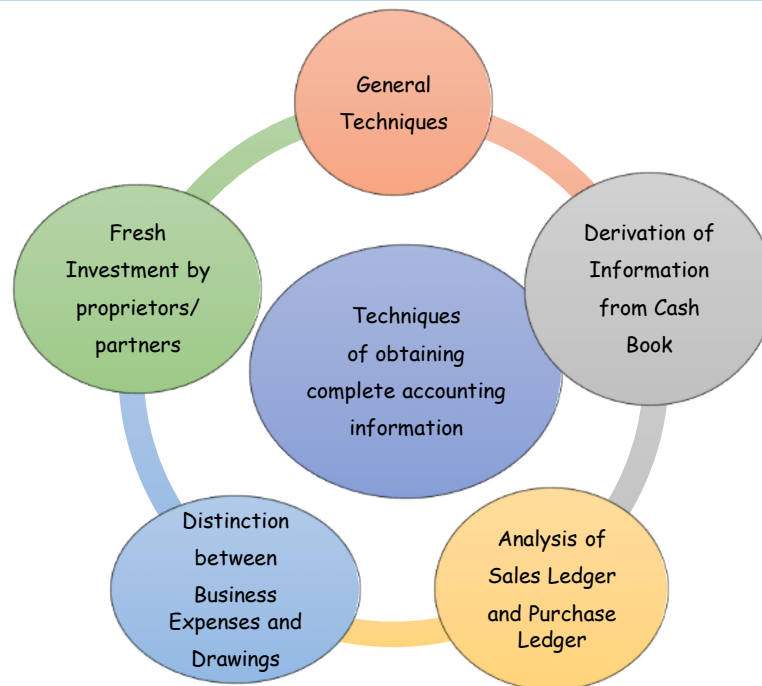
## 5. Approach 2: Conversion Method

	Content
1.	<p><b>Key Points:</b></p> <ul style="list-style-type: none"> <li>➤ Used when only <b>some transactions</b> are recorded (incomplete data).</li> <li>➤ Direct preparation of financial statements is <b>not possible</b> (no full ledger balances).</li> <li>➤ <b>Available data</b> is converted into double entry form and then to draw up the Profit and Loss Account and the Balance Sheet, instead of determining the amount of profit/loss by preparing the statement of affairs.</li> <li>➤ Prepare accounts like: Debtors A/c Creditors A/c Cash Book Asset A/cs, etc.</li> </ul>



- Missing info (e.g., Credit Sales, Cash Paid) is calculated using balancing figures.
- No fixed steps - depends on available data in each case.
- Called **Conversion Approach** as single entry data is converted to double entry.

2.



3.

From exam point of view

In the examination they would be given:

- a. Opening and closing assets and liabilities
- b. Cash transactions
- c. Other information

From this we have to prepare

- a. Trading Account
- b. Profit and loss account
- c. Balance Sheet

How to proceed?

STEP I:

Prepare format of

1. Trading Account for the year
2. Profit and loss account for the year
3. Balance Sheet at the end of the year

And various other accounts as working notes as follows

1. Opening Balance Sheet
2. Cash Book (with two separated Cash and Bank column if possible)
3. Total Debtors Account
4. Bills Receivable Account (if required)
5. Total creditors Account
6. Bills payable Account (if required)
7. Any particular fixed asset (if required)



## 8. Any other account as required

## STEP II

- a. Do the **posting** of opening balances in the opening balance sheet and as opening balance in concerned account.
- b. Do the **posting** of all the transactions on the basis of **double entry**.
- c. Take in to account **all the information** given.
- d. Close all the accounts one by one logically, **finding out missing figures** and posting them to second account concerned. e.g. you can find cash collected from debtors from cash account, then post it to debtors account and find closing debtors etc.
- e. Complete the **trading account, profit and Loss account and then balance sheet**.



## 4. Some Important Points

- Single entry problem is just like su do ku, one must be able to find out **missing figures logically and sequentially**.
- The main items are:
  - a. **Rent of premises** commonly used for residential as well as business purposes.
  - b. **Common electricity and telephone bills**.
  - c. **Life insurance premiums** of proprietor/partners paid from business cash.
  - d. **Household expenses** met from business cash.
  - e. **Private loan** paid to friends and relatives out of business cash.
  - f. **Personal gifts** made to any friends and relatives out of business cash.
  - g. **Goods or services** taken from the business for personal consumption.
  - h. **Cash withdrawals** to meet family expenses.
  - i. **Amount collected from debtors** directly used for meeting personal expenses.

So, it is necessary to scan the summary of cash transactions, business resources and their utilization to assess the nature of drawings and its amount.
- Fresh Investment by proprietors / partners
  - a. Money collected and put in the business on **maturity of Life Insurance Policy** of the proprietors.
  - b. Interest and dividend of **personal investment** of the proprietors collected and put in the business.
  - c. Income from **non-business property** collected and put in the business.
  - d. Payments made to creditors **out of personal cash**.



## 8. PARTNERSHIP ACCOUNTING

### 1. Admission of Partner

#### Partnership Definition

- The term 'partnership' refers to 'the relation between **two or more persons** who have agreed to **share the profits** of a business carried on by **all or any of them acting for all.**'
- The persons who have entered into **partnership agreement** with each other are referred to as **Partners**, and they are collectively referred to as the **Partnership Firm**.

#### Admission of New Partner

- To meet the need for **additional capital, technical expertise, or better managerial efficiency**, a partnership firm may admit a **new partner** with the consent of all existing partners.
- A new partner can be admitted only with the **consent of all existing partners**, unless agreed otherwise.
- Admission of a new partner is a form of **partnership reconstruction**, as it ends the existing partnership and creates a new one.

#### Accounting Adjustments on Admission

1.	Computation of New Profit-Sharing Ratio
2.	Revaluation of Assets and Liabilities
3.	Memorandum Revaluation of Asset and liabilities (to bring the asset and liabilities to the book value)
4.	Distribution of Reserves, Accumulated Profits and Losses
5.	Adjustment for Goodwill
6.	Adjustments regarding Capital Contribution of new partner and the Capitals of the existing partners
7.	Adjustment for Life Policy

#### 1. New Profit-Sharing Ratio

- The new profit-sharing ratio is computed based on how the existing partners will **sacrifice** their share of profit for the new partner. This is known as the **Sacrificing Ratio**.
- **Sacrificing Ratio = (Old Ratio - New Ratio).**
- New ratio may be **mutually agreed** upon or unchanged.

#### 2. Revaluation of Assets and Liabilities

- At the time of admission (or any reconstruction), assets and liabilities are **revalued to reflect their fair values** and to uncover any hidden profits or losses.



- Profit arises from an increase in asset values or decrease in liabilities, while loss results from a decrease in assets or increase in liabilities.

## Journal Entries

	Revaluation Event	Journal Entry
Assets	Upward Revaluation of Asset	Asset A/c Dr. To Revaluation A/c
	Downward Revaluation of Asset	Revaluation A/c Dr. To Asset A/c
	Recording of Unrecorded Asset	Asset A/c Dr. To Revaluation A/c
Liabilities	Upward Revaluation of Liability	Revaluation A/c Dr. To Liability A/c
	Downward Revaluation of Liability	Liability A/c Dr. To Revaluation A/c
	Recording of Unrecorded Liability	Revaluation A/c Dr. To Liability A/c
Revaluation Expenses	Revaluation Expenses Paid by the Firm	Revaluation A/c Dr. To Bank A/c
	Revaluation Expenses Paid by a Partner	Revaluation A/c Dr. To Partner's Capital A/c

## 3. Memorandum Revaluation Account

## Content

- ❖ When a firm chooses not to alter the Balance Sheet values of assets and liabilities, a Memorandum Revaluation Account is prepared.
- ❖ The steps involved are:
  - a. Record increase/decrease in asset and liability values.
  - b. Share resulting profit/loss among old partners in old ratio.
  - c. Reverse the changes made to assets and liabilities.
  - d. Calculate profit/loss after reversal.
  - e. Share this among all partners (including the new partner) in new ratio.

## Proforma: Memorandum Revaluation Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Assets (Decrease)	x	By Assets (Increase)	x
To Liabilities A/c (Increase)	x	By Liabilities A/c (Decrease)	x
To Partners' Capital A/c (Share of Revaluation Profit)	x	By Partners' Capital A/c (Share of Revaluation Loss)	x
(Old partners in old profit-sharing ratio)		(Old partners in their old profit-sharing ratio)	



To Reversal of Items b/d	x	By Reversal of Items b/d	x
To Partners' Capital A/c	x	By Partners' Capital A/c	x
(Revaluation Profit amount, all partners in new profit-sharing ratio)		(Revaluation loss amount, all partners in their new profit-sharing ratio)	
Total	xxx	Total	xxx

#### 4. Distribution of Reserves/Profits/Losses

##### Content

These are **undistributed profits or losses** from previous periods.

- Reserves/Accumulated Profits are credited to **old partners' capital accounts** in the old ratio.
- Accumulated Losses are **debited to old partners' capital accounts** in the old ratio.

##### Journal Entries

Type	Fluctuating Capital Method	Fixed Capital Method
Reserves / Accumulated Profits	Reserves A/c Dr. Profit and Loss A/c Dr. To Partners' Capital A/c (Among old partners in the old profit-sharing ratio)	Reserves A/c Dr. Profit and Loss A/c Dr. To Partners' Current A/c (Among old partners in the old profit-sharing ratio)
Accumulated Loss	Partners' Capital A/c Dr. To Profit and Loss A/c (Among old partners in the old profit-sharing ratio)	Partners' Current A/c Dr. To Profit and Loss A/c (Among old partners in the old profit-sharing ratio)

#### 5. Adjustment for Goodwill

##### Introduction

- Goodwill exists due to **efforts of old partners**.
- It enables the firm to earn **super-normal profits**.
- A **new partner benefits** from these profits upon joining.
- Therefore, the **new partner must bring in an extra amount** besides capital.
- This extra amount is called **Premium for Goodwill**.

##### Accounting of Goodwill

- ❖ AS-26 provides clear guidance on recognition and treatment of goodwill.
- ❖ It applies to **all intangible assets**, including goodwill—whether tangible or intangible, assets must meet recognition criteria.
- ❖ Asset recognition criteria:
  - Expected **future economic benefits**
  - **Reliable measurement** of cost
- ❖ **Internally generated goodwill** usually fails these criteria, especially reliable measurement.
- ❖ Therefore, goodwill is generally **not shown in the books** as an asset.



- ❖ Since goodwill cannot be shown in the books of Account, the treatment will be as below under different situations through new partner's capital/current Account.

Scenario	Journal Entry
When Premium for Goodwill is Paid by New Partner	Bank/Cash/Other Mode A/c Dr. To Old Partners' Capital / Current A/c (in sacrificing ratio)
When New Partner Does Not Pay Premium for Goodwill	New Partner's Capital/Current A/c Dr. To Old Partners' Capital / Current A/c (in sacrificing ratio)
When New Partner Pays Partly for Goodwill	New Partner's Capital/Current A/c Dr. (to the extent not paid) Bank/Cash/Other Mode A/c Dr. To Old Partners' Capital / Current A/c (in sacrificing ratio)
Goodwill Already Shown in the Balance Sheet	<ul style="list-style-type: none"> <li>❖ Goodwill may be already shown in the balance sheet before admission.</li> <li>❖ It is not disturbed because its nature (purchased or self-generated) is not known.</li> <li>❖ New partner will not bring premium for such goodwill.</li> <li>❖ Old partners are assumed to have already received its benefit.</li> <li>❖ If the question asks to write off goodwill, do so among old partners in old ratio.</li> </ul> Old Partners' Capital A/c Dr. To Goodwill A/c (in old profit-sharing ratio)

#### Valuation of Inherent or Non-Purchased Goodwill

##### 1. Average Profits Method

Value of Goodwill = Agreed Number of Years (Purchase) × Average Maintainable Profits

Average Maintainable/Profit:

Average Annual Profits [Simple average or may be weighted average considering the trend of profits]	00
Less: Exceptional/Casual Income	00
Add: Abnormal Loss	00
	00
Add: Capital Expenditure wrongly charged against profits	00
	00
Less: Provision for Taxation	00
Adjusted Maintainable Profits	000
("Adjustments for undercharged or overcharged Depreciation or under or over valuation of stocks to be made, if required)	

- Fluctuating Profits → Use Simple Average
- Increasing Trend in Profits → Use Weighted Average



- Consistently Decreasing Profits → Consider Lowest Profit (after adjustments)
- Exceptional income/expense (one-time, non-recurring) should not distort regular profit trends. Adjust these items only in that particular year.
- Later Years Often Get Higher Weight in Weighted Average

## 2 Super Profits Method

Super Profit = Future maintainable profits - Normal Return on Capital Employed

Goodwill = Super Profit × No. of years of purchase

Steps (a) Calculation of Capital employed OR Average Capital Employed

Sundry Assets	00
Excluding:	
Goodwill But including Goodwill at Cost Paid for	
Non-trading assets &	
Fictitious Assets	
Less:	
Current Liabilities & Provisions	-00
Contingent & Probable Liabilities	-00
(Trading) Capital Employed	00
Less:	
$\frac{1}{2}$ of Current years trading profits after taxation (if the profits remain undistributed)	-00
Average Capital Employed	000

Step (b) Average Annual Adjusted Profits (Maintainable)

Step (c) Calculate Normal Return on Capital Employed or Average Capital Employed

Step(d) Deduct Normal Return (c) from Average Maintainable Profits (b).

The difference is called Annual Super Profit

Step (e) Goodwill = Annual Super Profit × No. of Years for which the Super Profit can be maintained.

## 3 Capitalization of Profits Methods

### A. Profits

Under the method follow these steps -

- a. Calculate Annual Maintainable Profit as shown above.
- b. Calculate normal Capital Employed capitalizing the above profit by applying the normal rate of return.  

$$\text{Normal Capital Employed} = \text{Maintainable Profit} / \text{Normal Rate of Return} \times 100$$
- c. Calculate actual Capital Employed
- d. Goodwill = Normal Capital Employed - Actual capital Employed.

### B. Super Profits

- a. Calculate Super profit as said under Method 2.
- b. Goodwill = Super Profit / Normal Rate of Return × 100

## 4 Annuity Method



- It is a derivative of super profit concept.
- If super profit is expected to be earned uniformly over a number of years, Goodwill is computed with the help of Annuity Table.
- Calculate Super Profit as discussed before
- $\text{Goodwill} = \text{Annual Super Profit} \times \text{Present Value of Annuity of Rs.1.}$

#### 6. Adjustments regarding Capital Contribution of new partner and the Capitals of the existing partners

##### Concept

- New partner brings capital as cash or other assets, as mutually agreed.
- Revaluation profit/loss, reserves, and goodwill adjustments are made in books.
- After adjustments, capital account balances are finalized.
- These adjusted capitals are shown in the post-admission Balance Sheet.
- Partners may decide to maintain capital balances in a fixed ratio.

#### 7. Adjustment for Life Policy

##### Content

- JLIP covers lives of all partners.
- Premium is paid by the firm.
- On admission of a new partner, use the Surrender Value of the policy for accounting.
- Maturity Value is not considered at this stage.

## 2. Retirement of Partner

##### Content

1. Retirement of Partner
  - A partner may retire from the firm for various reasons.
  - Retirement usually happens with the consent of all partners or through proper notice.
  - As per Section 32 of the Indian Partnership Act, 1932, a partner can retire:
    - With consent of all partners, or
    - As per an express agreement, or
    - By written notice in case of a Partnership at Will.
2. Reconstitution of Firm  
Like admission, retirement of a partner is another mode of reconstitution of partnership firm.

#### Adjustments After Retirement

##### Content

- ❖ After retirement of a partner, the other partners may continue the business.
- ❖ For paying off the retiring partner(s), some specific adjustments are required to be done in the books of the firm.



1. Calculate new profit-sharing ratio and gaining ratio.
2. Distribute reserves and accumulated profits/losses.
3. Revalue assets and liabilities.
4. Adjust goodwill of the firm.
5. Adjust Joint Life Policy (JLP), if applicable.
6. Settle final amount payable to the retiring partner.
7. Adjust capital accounts of continuing partners.

### 1. New Profit-Sharing Ratio

- ❖ On retirement, the retiring partner's share is taken over by continuing partners.
- ❖ The New Profit-Sharing Ratio is the ratio in which the remaining partners will share future profits.
- ❖ The Gaining Ratio is the ratio in which they acquire the retiring partner's share.
- ❖  $\text{Gaining Ratio} = \text{New Ratio} - \text{Old Ratio}$  (for each continuing partner).

### 2. Distribute reserves and accumulated profits/losses

Reserves or profits are shared among all partners (including the retiring one) in their old profit-sharing ratio.

### 3. Revaluation of Assets & Liabilities

- ❖ The logic for revaluation of Assets and liabilities at the time of retirement of a partner is same as that at the time of admission of a new partner.
- ❖ In case of retirement, the revaluation profit or loss is distributed among all the partners in the Old Profit-Sharing Ratio.

### 4. Adjustment for Goodwill

#### Content

- ❖ Goodwill was created by all partners, including the retiring one.
- ❖ So, continuing partners must compensate the retiring partner for their share of goodwill.
- ❖ Compensation is made in the Gaining Ratio.
- ❖  $\text{Gaining Ratio} = \text{New Ratio} - \text{Old Ratio}$  (for continuing partners).

#### Accounting Entry

Gaining Partners' Capital A/c Dr. (in gaining ratio)  
    To Outgoing Partner's A/c (with retiring partner's share of goodwill)

### 5. Adjustment for Joint Life Policy (JLP)

- ❖ JLP covers the lives of all partners; premium is paid by the firm.
- ❖ On reconstitution (Admission, Retirement, Change in Ratio), Surrender Value is considered for accounting.
- ❖ The Surrender Value can be:



- a. Adjusted through partners' capital accounts, or
- b. Shown as an asset in the books.

❖ Maturity Value is not relevant for such accounting adjustments.

### 6. Settlement of Final Balance of Retiring Partner

1.	<b>Final Amount Due</b> Calculated after all adjustments (goodwill, revaluation, reserves, JLP, etc.).
2.	<b>Mode of Settlement</b> As per Partnership Deed, or If deed is silent, then mutual agreement among partners.
3.	<b>Payment Methods</b> Immediate Payment: Full amount paid in cash/bank. Deferred Payment: If not enough funds, pay in instalments via a Loan Account opened in the name of the retiring partner.
4.	<b>Legal Right - Section 37 of Indian Partnership Act, 1932</b> The retiring partner is entitled to the higher of the following two: <ol style="list-style-type: none"> <li>a. Share in Profits: Calculated from retirement date till final payment, based on adjusted capital ratio.</li> <li>b. Interest @ 6% p.a.: On amount due from the date of retirement till actual settlement.</li> </ol>

### Retirement-cum-Admission

1.	<b>Retirement-cum-Admission</b> This occurs when an existing partner retires and another partner joins the firm at the same time.
2.	<b>Accounting Principles</b> The accounting principles for both admission and retirement are followed.
3.	<b>Combined Effect</b> The combined effect is managed by incorporating two sets of transactions simultaneously.
4.	<b>No Separate Treatment</b> No separate treatment is needed; the same principles for admission and retirement are applied.

### 3. Death of Partner

#### Death of Partner - Reconstitution of Partnership

➤ If a continuing partner dies, then it leads to reconstitution of partnership firm.

#### Adjustments After Death

##### Content

➤ In the event of death of a partner, the other partners may decide to continue the business.



- Certain adjustments to be made in the books of accounts of the existing partnership firm which are as follows
1. Calculation of new profit-sharing ratio and gaining ratio,
  2. Distribution of reserves and accumulated profits and losses,
  3. Revaluation of assets and liabilities,
  4. Adjustment for goodwill,
  5. Adjustment for Joint Life Policy (JLP),
  6. Adjustment for interim period's profit/loss,
  7. Settlement of final balance of the deceased partner to his Executor.

### 1. New Profit-Sharing Ratio

1.	When a partner dies, remaining partners continue the firm.
2.	They decide a new way of sharing profits - called New Profit-Sharing Ratio.
3.	The share of the deceased partner is taken over by the remaining partners.
4.	The Gaining Ratio = New Share - Old Share (of continuing partners).
5.	Gaining Ratio is used to compensate the deceased partner's share of goodwill.

### 2. Distribution of Reserves & Profits

- The balance of reserves or undistributed profit (as represented by balance of Profit & Loss Account) are distributed among all the partners (including the Executor of deceased partner) in their old profit-sharing ratio in the event of death of a partner.

### 3. Revaluation of Assets & Liabilities

1.	The logic for revaluation of Assets and liabilities at the time of death of a partner is same as that at the time of admission of a new partner.
2.	In case of death, the revaluation profit or loss is distributed among all the partners (including the Executor of the deceased partner) in the Old Profit-Sharing Ratio.

### 4. Adjustment for Goodwill

1.	The goodwill of the firm, created by all partners (including the deceased), needs to be adjusted.
2.	The continuing partners compensate the deceased partner's share in the Gaining Ratio.

### 5. Adjustment for Joint Life Policy (JLP)

1.	Accounting treatment of JLP depends on firm's policy: Treated either as Asset or Expense.
2.	On death of a partner, only the Maturity Value is relevant.
3.	Surrender Value is ignored in such cases (unlike in admission/retirement).
4.	Maturity amount received is credited to all partners in their profit-sharing ratio.







## Approach 1: Surrender Value Method

## Accounting Entries

- One Account maintained - Joint Life Policy A/c (JLP A/c).  
For Premium paid every year:  
JLP A/c  
To Bank A/c
- For ensuring that this JLP A/c is maintained at its 'surrender value'  
P/L A/c (the excess of premium paid over the increase in surrender value)  
To JLP A/c

## Approach 2: JLP Reserve Method

## Accounting Entries

- Two accounts are maintained: JLP A/c and JLP Reserve A/c.
- Premium is recorded as an investment in the JLP A/c  
JLP A/c  
To Bank A/c Dr
- The insurance premium paid on the joint life policy is considered as an 'appropriation of profit'.  
P/L Appropriation A/c Dr.  
To JLP Reserve A/c
- For ensuring that JLP A/c and JLP Reserve A/c are maintained at its 'surrender value'  
JLP Reserve A/c Dr.  
To JLP A/c (the excess of premium paid over the increase in surrender value)  
Note: Both the JLP A/c and JLP Reserve A/c appear in the Balance Sheet of the firm in the Asset-side and Liabilities side respectively.

## On change in constitution of firm (i.e. Admission, Retirement, Change in profit sharing ratio)

- **Surrender Value Method:** JLP is considered as an asset and shown at the surrender value. As such no further accounting treatment is required.
- **JLP Reserve Method:** Both JLP A/c and JLP Reserve A/c appear at surrender value in the Balance Sheet.

## Accounting Entries

Situation	Transaction under Surrender Value Method	Transaction under JLP Reserve Method
1. If the partners decide not to maintain JLP Reserve A/c	Write-back JLP Reserve A/c and distribute among existing partners in old P.S.R. JLP Reserve A/c Dr. To Existing Partners' Capital A/c (in old P.S.R.)	N/A



2. If the partners decide to maintain JLP Reserve A/c	Adjustment through Capital A/c for gaining and sacrificing partners' share. Gaining Partners' Capital A/c Dr. To Sacrificing Partners' Capital A/c	Adjustment through Capital A/c for gaining and sacrificing partners' share. Gaining Partners' Capital A/c Dr. To Sacrificing Partners' Capital A/c
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### On the event of death of a partner

The JLP matures, and the maturity value of the policy is received by the firm. Thereafter it gets distributed among all the existing partners in their old p.s.r.

#### Accounting Entries

1. On Death of a Partner (Maturity of JLP)	JLP Receivable A/c Dr. To JLP A/c (with maturity value)	JLP Receivable A/c Dr. To JLP A/c (with maturity value)
2. On receipt of maturity value	Bank A/c Dr. To JLP Receivable A/c	Bank A/c Dr. To JLP Receivable A/c
3. Closing of JLP Reserve A/c	N/A	JLP Reserve A/c Dr. To JLP A/c (with last recorded surrender value)
4. Closing of JLP A/c	JLP A/c Dr. To All Partners' Capital A/c (with difference between last recorded surrender value and maturity value in old P.S.R.)	JLP A/c Dr. To All Partners' Capital A/c (with difference between current year premium paid, if any, and maturity value in old P.S.R.)

## 5. Dissolution of Partnership Firms including Piecemeal Distribution

### Dissolution of Firm and Settlement of Accounts on Dissolution

#### Basics

1.	A partnership is dissolved when: <b>Mutual Consent:</b> All partners agree or follow a contract. [Section 40]
2.	<b>Notice:</b> A written notice by any partner if the partnership is at will. [Section 43]
3.	<b>Happening of Certain Events:</b> [Section 42] a. Expiry of a fixed-term partnership b. Completion of the partnership's defined adventure c. Death of a partner d. Partner's adjudication as insolvent
4.	<b>Compulsory Dissolution:</b> [Section 41] a. All partners or all but one are adjudged insolvent b. The partnership becomes unlawful to carry on
5.	<b>Dissolution by Court:</b> [Section 44] Court can dissolve the firm for reasons such as:



	<ul style="list-style-type: none"> <li>a. Insanity of a partner</li> <li>b. Permanent incapability of a partner to perform duties</li> <li>c. Misconduct of a partner affecting the business</li> <li>d. Breach of agreement by a partner</li> <li>e. Transfer of share to a third party or charging the share</li> <li>f. Court deems the business can't be carried on without loss</li> <li>g. Other reasons that make dissolution just and equitable</li> </ul>
6.	<p><b>Settlement of Accounts on Dissolution</b></p> <p>After dissolution, accounts must be settled based on:</p> <p><b>Losses</b></p> <p>Losses are paid in this order:</p> <ul style="list-style-type: none"> <li>a. Profits first,</li> <li>b. Capital next,</li> <li>c. Individual partners if necessary, in profit-sharing ratio. [Section 48(1)]</li> </ul>
7.	<p><b>Assets</b></p> <p>Assets of the firm are distributed in this order:</p> <ul style="list-style-type: none"> <li>a. Pay debts to third parties</li> <li>b. Pay advances due to each partner (separate from capital)</li> <li>c. Pay capital due to each partner</li> <li>d. Any residue is divided among partners in profit-sharing ratio. [Section 48(2)]</li> </ul>

#### A. Realization of Assets and Payment of Liabilities

Item/Purpose	Journal Entry	Special Points to Note
1. Transfer of Book Values of Assets	Realization A/c Dr. To Sundry Assets (Book Value)	Cash or Bank A/c are not credited unless the firm is sold as a going concern.
	Realization A/c Dr. To Debtors A/c	Debit balance of Capital A/c or P/L A/c are not transferred to Realization A/c.
	Provision for Bad Debts A/c Dr. To Realization A/c	If there's a Provision for Bad Debts, debit Realization A/c and credit Debtors A/c with the gross figure, then adjust Provision accordingly.
2. Realization/Sale of Assets	Cash/Bank A/c (Amount Realized) Dr. Partners Cap. A/c Dr. (agreed value at which a partner takes over an asset/assets) To Realization A/c	If assets are taken over by a partner, the entry will be Partners' Capital A/c Dr. (agreed value) To Realization A/c.



3. Shares Received as Purchase Consideration	In exchange of the firm's assets. Shares A/c Dr. To Realization A/c (Agreed Value)	a) Alternatively - this entry may be passed (combining 4,5 & 6) Liability A/c Dr. To Bank A/c (actual amt. paid) OR, To Partners Cap. A/c (agreed value) To Realization A/c (Discount, if any received on payment/discharge)
4. Closing the External Liabilities	External Liabilities A/c Dr. (creditors, outstanding expenses, Bank Loan etc) To Realization A/c (Book Value)	
5. External Liabilities Paid Off	Realization A/c Dr. To Cash/Bank A/c (Actual Amount Paid)	b) Where assets and liabilities are taken over by another business on making some lump sum payment, separate entries for realization of assets and / payment of liabilities need not be made.
6. External Liabilities Taken Over by a Partner	Realization A/c Dr. To Particular Partner's Capital A/c (Agreed Value)	
7. Unrecorded Asset Sold or Taken Over by a Partner	Cash/Bank A/c Dr. Partners Cap. A/c Dr. To Realization A/c	
8. Unrecorded Liability Paid	Realization A/c Dr. To Cash/Bank A/c (Actual Amount Paid)	-
9. Shares Received and Sold or Transferred to partners	Cash/Bank A/c Dr. Or Partners Cap. A/c Dr. [excluding insolvent partner] To Shares A/c	Profit/loss on sale is transferred to Realization A/c.
10. Payment of Expenses of Realization	Realization A/c Dr. To Cash/Bank A/c (If Paid by the Firm)	If a partner bears expenses personally, no entry is required.
	Realization A/c Dr. To Partner's Capital A/c (If Paid by a Partner)	
11. Balance of Realization Account (Profit/Loss)	Realization A/c Dr. To Partners' Capital A/c (Profit shared in Profit Sharing Ratio)	-
	Partners' Capital A/c Dr. To Realization A/c (Loss shared in Profit Sharing Ratio)	



## [B] Settlement of Partners Dues - through Capital Accounts

Item/Purpose	Journal Entry	Special Points to Note
1. Prepare Capital Accounts (Before dissolution)	By Balance b/d (Cr. Balance) To Balance b/d (Dr. Balance)	Capital accounts are updated before dissolution as per the balances in the Balance Sheet.
2. Transfer of Current A/c (If any)	Partner's Current A/c Dr. To Partner's Capital A/c (Credit Balance)	Transfer of credit balance in current account to capital account.
	Or Partner's Capital A/c Dr. To Partner's Current A/c (Debit Balance)	Transfer of debit balance in capital account to current account.
3. Transfer Undistributed Profit, Reserves, etc.	Profit & Loss (Cr.) A/c Dr. To Partner's Capital A/c (Profit Sharing Ratio)	Undistributed profits and reserves like Joint Life Policy Reserve, Contingency Reserve, etc., are transferred to capital accounts.
	Or Any Reserve A/c Dr. To Partner's Capital A/c (Profit Sharing Ratio)	
4. Transfer Undistributed Loss, Fictitious / Unrealizable Assets	Partners' Capital A/c Dr. To Profit & Loss (Dr.) A/c	Undistributed losses and unrealizable assets (e.g., Advertisement Suspense A/c) are transferred to capital accounts in profit-sharing ratio.
	Or Partners' Capital A/c Dr. To Fictitious Assets A/c (Profit Sharing Ratio)	
5. Repayment of Loan Taken from Any Partner	Partner's Loan A/c Dr. To Cash/Bank A/c	Loan repayment takes priority over capital repayment. Loans from partners are settled first as per Section 48.
6. Loan Given to Any Partner	Cash/Bank A/c Dr. To Partner's Loan A/c	If loan is given to a partner, the loan account is debited and cash is credited.
	Or Partner's Capital A/c Dr. To Partner's Loan A/c	Alternatively, adjust capital account against the loan.
7. Debit Balance in Partner's Capital A/c	Cash/Bank A/c Dr. To Particular Partner's Capital A/c	If a partner has a debit balance in their capital account, cash is brought in to cover the shortfall.
		If the deficient partner is insolvent, special treatment is applied as per insolvency laws.
8. Payment of Credit Balance (After Final Balancing)	Particular Partner's Capital A/c Dr. To Cash/Bank A/c	Credit balance in capital accounts is paid off in cash after final adjustments.



Liabilities of Retiring/Deceased Partners	
1.	<p><b>Debts Due on the Date of Retirement/Death</b></p> <p>The <b>retiring partner</b> and the <b>estate of the deceased partner</b> are liable for all <b>debts</b> of the firm on the date of their retirement or death.</p> <p>They are liable to the extent of their <b>share in the firm</b>.</p>
2.	<p><b>Debts Incurred After Retirement</b></p> <p>If the <b>retiring partner</b> did not publish a notice of retirement, they remain liable for <b>debts incurred after retirement</b>.</p>
3.	<p><b>Deceased/ Insolvent Partner's Liability</b></p> <p>The estate of a deceased or bankrupt partner <b>will not be liable</b> for debts contracted by the firm <b>after the death or bankruptcy</b>.</p>

Applicability of Section 37 of the Partnership Act (Unsettled Dues)	
Content	
1.	<p><b>Introduction</b></p> <p>In case of retirement, the retiring partner or in case of death, the executor of the deceased partner, if the <b>dues are not settled</b>, then such retired partner or the executor is entitled to the following:</p> <p><b>Maximum of:</b></p> <ol style="list-style-type: none"> <li><b>Interest @ 6% per annum on the unsettled amount.</b></li> <li><b>Share of profit earned on the unsettled capital.</b></li> </ol>
2.	<p><b>Conditions:</b></p> <ol style="list-style-type: none"> <li>The surviving partners/continuing partners <b>continue to carry on the business</b> of the firm.</li> <li>The business is carried on <b>without any final settlement of accounts</b> between the continuing partners and the outgoing partners or his estate.</li> <li>There is <b>no contract to the contrary</b> of the options contained in Section 37 i.e. share in the profits or interest @ 6% p.a. on the unsettled capital.</li> </ol>
3.	<p><b>Example (Unsettled Capital)</b></p> <p>Unsettled capital of C 52,000 (Date of retirement: 30.09.22, financial year 2022-2023).            Net Profit earned by the firm after C's retirement 25,000.            Capitals of A: 57,000 and B: 76,000</p> <p>C is entitled to the maximum of the following:</p> <ol style="list-style-type: none"> <li>Interest on unsettled capital = <math>52,000 \times 6\% \times 6 \text{ months} = 1,560</math></li> <li>Profit earned out of unsettled capital = Profit <math>\times</math> Retired or Deceased Partner's unsettled Dues/ Total Capital of the firm (including the amount due to the retired or deceased partner) = <math>(25,000 \times 52,000)/(52,000 + 57,000 + 76,000) = 7,027</math>.</li> </ol>



### Insolvency of a Partner (Garner vs. Murray Case)

#### Loss Due to Insolvency

1. If a partner becomes insolvent and cannot pay their debit balance in the capital account, the loss is shared by solvent partners.
2. Prior to the decision in the leading case of Garner vs. Murray this loss was borne by the solvent partners in the profit-sharing ratio just like ordinary losses.

#### Garner vs. Murray Case (Decision)

1. The loss arising due to the insolvency of a partner must be distinguished from an ordinary loss (including realization loss).
2. 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.
3. Last Agreed Capital Meaning:
  - Fixed Capital System: Use capital balances from the last balance sheet.
  - Fluctuating Capital System: Adjust capital for:
    - Reserves
    - Undistributed profits/losses
    - Drawings, interest, errors
    - But exclude realization profit/loss
4. If a partner has a nil or negative capital balance, they contribute nothing to the loss.

#### Criticism of Garner vs. Murray

5.
  - ✓ If a solvent partner has a debit balance, they should not bear the deficiency of the insolvent partner.
  - ✓ The principle does not apply if there are only two partners.
  - ✓ A solvent partner with more private assets but less capital may bear less deficiency, which may seem unfair.

### Insolvency of All Partners

#### Content

- Since all partners are insolvent, creditors cannot expect to be paid in full. In such a case Sundry Creditors should not be transferred to Realization Account.
- Cash in hand together with the amount realized on sale of assets and surplus from private estate of partners, if any, less expenses will be applied in making payment to the creditors.
- The balance of Creditors Account represents the deficiency to be borne by them which to be transferred to a Deficiency Account.
- The balance of Capital Accounts should also to be transferred to the Deficiency Account to close the books.



- Alternatively, the deficiency to be borne by the Creditors may be directly adjusted in between Creditors Account and Capital Accounts.

## Accounting Entries

Item/Purpose	Journal Entry
i. Paying off the creditors	Creditors A/c Dr. (Total Creditors) To Bank A/c (Amount paid) To Deficiency A/c (Amount unpaid)
ii. Transferring deficiency	Deficiency A/c Dr. To Partners' Capital A/c
Alternative treatment (adjusting deficiency directly between creditors and capital accounts)	Creditors A/c Dr. To Partners' Capital A/c (Adjustment of deficiency directly)

## Return of Premium on Dissolution Before Expiry of Term

1.	<p>Conditions for Refund</p> <ol style="list-style-type: none"> <li>1. A partner was admitted for a <b>fixed term period</b>.</li> <li>2. The partner paid a <b>premium for goodwill</b> at the time of admission.</li> <li>3. The <b>partnership firm dissolves</b> before the expiry of the fixed term.</li> </ol>
2.	<p>Exceptions (No Claim)</p> <p>The partner is not entitled to a refund if:</p> <ol style="list-style-type: none"> <li>1. The firm is dissolved due to the <b>death</b> of a partner.</li> <li>2. The dissolution is due to the <b>misconduct</b> of the partner claiming a refund.</li> <li>3. The dissolution is in pursuance of an <b>agreement</b> containing no provision for the return of the premium or any part of it.</li> </ol>
3.	<p>Amount of Refund</p> <p>The amount of refund is determined based on:</p> <ol style="list-style-type: none"> <li>1. The <b>terms</b> upon which the partner was admitted.</li> <li>2. The <b>length of the period</b> agreed upon and the period that has already expired.</li> </ol>
4.	<p>Liability of Other Partners</p> <p>The <b>refund payable</b> will be borne by the <b>other partners</b> in their <b>profit-sharing ratio</b>.</p>

## Piecemeal Distribution of Assets

## Content

1.	<p>Meaning</p> <ul style="list-style-type: none"> <li>➤ on the dissolution of a partnership, assets are sometimes <b>realized gradually over a period of time</b>.</li> <li>➤ In such cases, payments may be made to parties <b>in a fixed order</b> as assets are gradually realised, <b>without waiting for all assets to be sold</b>.</li> </ul>
2.	<p>Order of Payment</p> <ol style="list-style-type: none"> <li>a. <b>Realisation expenses</b></li> </ol>



- b. For provision for expenses that are to be made
- c. Preferential creditors (say, Income Tax or any payment made to the Government)
- d. 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
- e. Unsecured creditors - in proportion to the amount of debts, if more than one creditor
- f. Partners' loan - if there is more than one partner - in that case, in proportion to the amount of loan
- g. Partners' capital - the order of payment may be made by any one of the following two methods:
  - I. Surplus Capital Method/ Proportionate Capital Method/ Highest Relative Capital Method
  - II. Maximum Possible Loss Method

### I. Surplus Capital Method / Proportionate Capital Method / Highest Relative Capital Method

1. **Objective**  
To compare the **actual capital** of partners at the time of **dissolution** with their **proportionate capital** (based on the minimum capital per unit of profit).
2. **Calculation of Surplus Capital**  
**Surplus capital** is determined by comparing the actual capital of each partner with their proportionate capital.
  - a. **Adjusted Capital:** Adjust partners' capital accounts with undistributed profits, losses, drawings, and reserves.
  - b. **Base Capital:** Divide the adjusted capital by the unit of the profit share (for example, 5:3:2 ratio).
  - c. **Proportionate Capital:** Multiply the base capital by the unit of the profit share (e.g., base capital of ₹20,000, multiply by 5, 3, and 2).
  - d. **Surplus Capital:** Subtract proportionate capital from adjusted capital to calculate surplus capital. Continue the process until an absolute surplus is reached.
3. **Payment of Surplus Capital**  
**Surplus capital** is paid **first** to the partners.
4. **Distribution of Remaining Capital**  
Any remaining balance is distributed among the partners in the **profit-sharing ratio**.
5. **Final Balance Settlement**  
After the surplus capital is paid, the final balances reflect each partner's share of **realization profit/loss**, so no further settlement is needed at that point.



## Maximum Possible Loss Method

## Content

1.	Alternative method for distributing capital among partners. The calculation depends on the maximum possible loss that could be faced.						
2.	<p><b>Steps</b></p> <p>a) Prepare a statement showing distribution of cash</p> <p>b) Pay off the external Liabilities</p> <p>c) After all the payment is made for the external liabilities, the partners will be paid off.</p> <table style="margin-left: 20px;"> <tr> <td>Total Due of Partners</td> <td style="text-align: right;">xxx</td> </tr> <tr> <td>Less: Net/Balance of Realisation</td> <td style="text-align: right;">(x)</td> </tr> <tr> <td>Maximum Loss</td> <td style="text-align: right;">xxx</td> </tr> </table> <p>d) The maximum loss shall be shared amongst the partners in their profit-sharing ratio, as if, there will be no further realisation.</p> <p>e) If any of the partner capitals, after step (4) is negative, that partner shall be treated like an insolvent partner.</p> <p>f) The deficiency of the insolvent partner as per step (5) shall be shared by the other solvent partners (i.e. those partners who has positive capital balances) in their capital contribution ratio as per Garner vs. Murray Rule.</p> <p>g) Repeat the steps (3) to (6) till final realisation.</p>	Total Due of Partners	xxx	Less: Net/Balance of Realisation	(x)	Maximum Loss	xxx
Total Due of Partners	xxx						
Less: Net/Balance of Realisation	(x)						
Maximum Loss	xxx						

## 6. Amalgamation of Partnership Firms

Step	Action						
Step 1	Prepare the Balance Sheet on the date of dissolution.						
Step 2	Open a Realisation Account and transfer all assets and liabilities at their book values.						
Step 3	Transfer all undistributed reserves, profits, or losses to the partners' capital accounts.						
Step 4	<p>Calculate Purchase Consideration based on the agreed terms between the parties.</p> <table style="margin-left: 20px;"> <tr> <td>Agreed value of assets taken over</td> <td style="text-align: right;">xxxx</td> </tr> <tr> <td>Less: Agreed value of liabilities assumed</td> <td style="text-align: right;">xxxx</td> </tr> <tr> <td>Purchase consideration</td> <td style="text-align: right;">xxxx</td> </tr> </table>	Agreed value of assets taken over	xxxx	Less: Agreed value of liabilities assumed	xxxx	Purchase consideration	xxxx
Agreed value of assets taken over	xxxx						
Less: Agreed value of liabilities assumed	xxxx						
Purchase consideration	xxxx						
Step 5	Credit the Realisation Account with the amount of purchase consideration.						
Step 6	Record unrecorded assets or liabilities if any exist.						
Step 7	Transfer the profit or loss on realisation (balancing figure) to the capital account of the proprietor.						
Step 8	Close the accounts of the sole proprietorship business.						

## Accounting Entries for Amalgamation of Sole Proprietors into a New Partnership Firm

Step/Purpose	Journal Entry
1. Transfer of Sundry Assets to Realisation Account	Realisation A/c Dr. To Sundry Assets A/c [Individually]



2. Transfer of Sundry Liabilities to Realisation Account	Liabilities A/c Dr. To Realisation A/c [Individually]
3. Amount of Purchase Consideration	New Firm A/c Dr. To Realisation A/c
4. Assets Taken Over by the Proprietor	Capital A/c Dr. To Realisation A/c
5. Realisation of Assets Not Taken Over by the New Firm	Bank A/c Dr. To Realisation A/c
6. Recording of Unrecorded Assets	Assets A/c Dr. To Capital A/c
7. Realisation of Unrecorded Assets	Bank A/c Dr. To Assets A/c
8. Payment of Liabilities Not Taken Over	Realisation A/c Dr. To Bank A/c
9. Recording of Unrecorded Liabilities	Capital A/c Dr. To Liabilities A/c
10. Payment of Unrecorded Liabilities	Liabilities A/c Dr. To Bank A/c
11. Liabilities Taken Over by the Proprietor	Realisation A/c Dr. To Capital A/c
12. Realisation Expenses	Realisation A/c Dr. To Bank A/c
13. Profit on Realisation	Realisation A/c Dr. To Capital A/c
14. Loss on Realisation	Capital A/c Dr. To Realisation A/c
15. Transfer of Accumulated Profits/Reserves	Reserves A/c Dr. Profit and Loss A/c Dr. To Capital A/c
16. Transfer of Accumulated Losses	Capital A/c Dr. To Profit and Loss A/c
17. Settlement of Purchase Consideration by the New Firm	Capital in New Firm A/c Dr. To New Firm A/c
18. Final Adjustment	Capital A/c Dr. To Capital in New Firm A/c To Bank A/c



Accounting Entries in the Books of the New Firm	
Situation	Journal Entry
1. Net Acquired Assets Equal to Purchase Consideration	Assets A/c Dr. [Acquired value] To Liabilities A/c [Assumed value] To Partners' Capital A/c [Purchase consideration]
2. Net Acquired Assets Greater Than Purchase Consideration	Assets A/c Dr. [Acquired value] To Liabilities A/c [Assumed value] To Partners' Capital A/c [Purchase consideration] To Capital Reserve A/c [Purchase consideration - Net assets]
3. Net Acquired Assets Less Than Purchase Consideration	Assets A/c Dr. [Acquired value] Goodwill A/c Dr. [Purchase consideration - Net assets] To Liabilities A/c [Assumed value] To Partners' Capital A/c [Purchase consideration]

### 7. Conversion of Partnership Firm into a Company and Sale of Partnership Firm to a Company

Accounting Treatment in the Books of the Selling Partnership Firm	
Step/Purpose	Journal Entry
1. Transfer of Assets to Realisation Account	Realisation A/c Dr. [Individually] To Sundry Assets A/c
2. Transfer of Liabilities to Realisation Account	Liabilities A/c Dr. [Individually] To Realisation A/c
3. Purchase Consideration Due	Purchasing Co. A/c Dr. To Realisation A/c
4. Assets Taken Over by the Proprietor	Capital A/c Dr. To Realisation A/c
5. Realisation of Assets Not Taken Over by the Company	Bank A/c Dr. To Realisation A/c
6. Recording of Unrecorded Assets	Assets A/c Dr. To Capital A/c
7. Realisation of Unrecorded Assets	Bank A/c Dr. To Assets A/c
8. Payment of Liabilities Not Taken Over	Realisation A/c Dr. To Bank A/c
9. Recording of Unrecorded Liabilities	Capital A/c Dr. To Liabilities A/c
10. Payment of Unrecorded Liabilities	Liabilities A/c Dr. To Bank A/c
11. Liabilities Taken Over by the Proprietor	Realisation A/c Dr. To Capital A/c



12. Realisation Expenses	Realisation A/c Dr. To Bank A/c
13. Profit on Realisation	Realisation A/c Dr. To Capital A/c
14. Loss on Realisation	Capital A/c Dr. To Realisation A/c
15. Transfer of Undrawn Profits/Reserves	Reserves A/c Dr. Profit and Loss A/c Dr. To Capital A/c
16. Transfer of Accumulated Losses	Capital A/c Dr. To Profit and Loss A/c
17. Transfer of Partners' Current Accounts (Credit Balances)	Partners' Current A/cs Dr. To Partners' Capital A/cs
18. Settlement of Purchase Consideration by the Company	Shares in Purchasing Co. Dr. Debentures in Purchasing Co. Dr. Cash A/c Dr. To Purchasing Co. A/c
19. Final Adjustment	Partners' Capital A/cs Dr. To Shares in Purchasing Co. A/c To Debenture in Purchasing Co. A/c To Cash A/c

#### Accounting Entries in the Books of the Purchasing Company

Situation	Journal Entry
1. 1. Assets and Liabilities Taken Over	
i. When Net Assets Taken Over is Less Than Purchase Consideration	Assets A/c Dr. (Agreed Value) Goodwill A/c Dr. (Balancing Figure) To Liabilities A/c (Agreed Value) To Firm A/c (Purchase Consideration)
ii. When Net Assets Taken Over is More Than Purchase Consideration	Assets A/c Dr. (Agreed Value) To Liabilities A/c (Agreed Value) To Firm A/c (Purchase Consideration) To Capital Reserve A/c (Balancing Figure)
2. Discharge of Purchase Consideration	Firm A/c Dr. (Purchase Consideration) To Share Capital A/c (Face value of shares issued) To Securities Premium A/c (if any) To Debentures A/c To Bank A/c



## 8. Accounting of Limited Liability Partnership

### Limited Liability Partnership (LLP)

1.	<p><b>Definition</b></p> <p>A Limited Liability Partnership (LLP) is a hybrid business form combining the features of a partnership and a company, with limited liability for partners.</p>
2.	<p><b>Governing Act</b></p> <p>Governed by the Limited Liability Partnership Act, 2008 (effective from April 1, 2009).</p>
3.	<p><b>Liability of Partners</b></p> <p>Partners' liability is limited to their capital contribution, similar to a company. Personal assets of partners are not liable for the firm's debts.</p>
4.	<p><b>Applicability of Indian Partnership Act</b></p> <p>Indian Partnership Act, 1932 does not apply to LLPs.</p>

### Nature of Limited Liability Partnership (LLP)

1.	<p><b>Legal Entity</b></p> <p>An LLP is a body corporate, meaning it is a separate legal entity from its partners.</p>
2.	<p><b>Existence</b></p> <p>A change in partners does not affect the existence, rights, or liabilities of the LLP.</p>

### Features of LLP

1.	<p><b>Formation</b></p> <p>Formed and incorporated under the LLP Act, 2008.</p>
2.	<p><b>Minimum Partners</b></p> <p>A minimum of two partners is required to form an LLP.</p>
3.	<p><b>Designated Partners</b></p> <p>At least two designated partners are required, and at least one must be a resident of India.</p>
4.	<p><b>Name of LLP</b></p> <p>The name of the LLP must include the words "Limited Liability Partnership" or the acronym "LLP".</p>

### Books of Accounts of LLP

1.	<p><b>Books of Accounts Maintenance</b></p> <p>LLPs must maintain proper books of accounts either on a cash or accrual basis.</p>
2.	<p><b>Accrual Basis and Double Entry</b></p> <p>Accounts should be kept under double-entry system to reflect financial transactions.</p>
3.	<p><b>Required Books</b></p> <p>Books should disclose:</p> <ol style="list-style-type: none"> <li>Receipts and Expenditures of the LLP.</li> <li>Assets and Liabilities of the LLP.</li> </ol>



	3. Statements of goods purchased, inventories, work-in-progress, finished goods, and cost of goods sold.
4.	<b>Period for Preserving Accounts</b> Books must be preserved for <b>8 years</b> from the date they were made.

#### Statement of Account and Solvency

1.	<b>Filing with Registrar</b> LLPs must file a <b>Statement of Account and Solvency</b> every year within <b>six months</b> of the end of the financial year.
2.	<b>Forms to Be Filed</b> The <b>Statement of Account and Solvency</b> must be filed in <b>Form 8</b> within <b>30 days</b> after six months from the end of the financial year.
3.	<b>Required Documents</b> <ol style="list-style-type: none"> <li>1. Statement of Assets and Liabilities</li> <li>2. Statement of Income and Expenditure</li> </ol>
4.	<b>Signature</b> The statement must be signed by <b>designated partners</b> of the LLP.
5.	<b>Inspection</b> Filed statements are available for <b>inspection</b> by any person, with applicable fees.

#### Statement of Assets and Liabilities

Particulars	Figures as at the end of the current reporting period (in ₹)	Figures as at the end of the previous reporting period (in ₹)
<b>(I) CONTRIBUTION AND LIABILITIES</b>		
<b>(1) Partner's funds</b>		
Contribution received		
Reserves and surplus (including surplus being the profit/loss made during year)		
<b>(2) Liabilities</b>		
Secured loans		
Unsecured loans		
Short-term borrowings		
Creditors/Trade payables		
Advance from customers		
Amount of other liabilities		
Other liabilities (to specify)		
Provisions		
For taxation		



For contingencies		
For insurance		
Other provisions (if any)		
Total		
(II) ASSETS		
Gross Fixed assets (including intangible assets)		
Less: Depreciation and amortization		
Net fixed assets		
Investments		
Loans and advances		
Inventories		
Debtors/trade receivables		
Cash and cash equivalents		
Amount of other assets		
Other assets (to specify)		
Total		

## Disclosure of Contingent Liabilities

Contingent Liabilities		
(a) Whether there are any contingent liabilities to report?		Yes/No
(b) Contingent Liabilities		

(b)	(c)	(d)
S. No.	Description of contingent liability	Amount

## Income Statement Format

Particulars	Figures for the period (Current reporting period) From (DD/MM/YYYY) To (DD/MM/YYYY (in Rs.))	Figures for the period (Previous reporting period) From (DD/MM/YYYY) To (DD/MM/YYYY (in Rs.))
Income		
Gross Turnover	r	
Less: Excise duty or service tax		
Net Turnover Details		
(I) Domestic turnover		
(a) Sale of goods manufactured		
(b) Sale of goods traded		



(c) Sale or supply of services		
(II) Export turnover		
(a) Sale of goods manufactured		
(b) Sale of goods traded		
(c) Sale or supply of services		
Other income		
Increase/ (decrease) in stocks including for raw materials, work in progress and finished goods		
Total Income		
Expenses		
Raw material consumed		
Purchases made for re-sale		
Consumption of stores and spare parts		
Power and fuel		
Personnel Expenses		
Administrative expenses		
Payment to auditors		
Selling expenses		
Insurance expenses		
Depreciation and amortization		
Interest		
Other expenses		
Total expenditure		
Net Profit or Net Loss (before taxes)		
Provision for Tax		
Profit after Tax		
Profit transferred to Partners' account		
Profit transferred to Reserves and Surplus		



## Penalties and Compliance Requirements for LLPs

Provision	Explanation	Penalties
1. Failure to Maintain Books of Accounts	LLPs must maintain books of accounts and prepare Statement of Account and Solvency as per Section 34.	✓ Fine: ₹25,000 to ₹5,00,000 for the LLP.
		✓ Fine: ₹10,000 to ₹1,00,000 for each designated partner.
2. Annual Return Filing	Every LLP must file an Annual Return with the Registrar within 60 days of the closure of the financial year.	✓ Fine: ₹25,000 to ₹5,00,000 for the LLP.
		✓ Fine: ₹10,000 to ₹1,00,000 for each designated partner.
3. False Statements in Annual Return	If any statement in the annual return is false (knowing it to be false) or omits material facts, it will be penalized.	✓ Imprisonment: Up to 2 years.
		✓ Fine: ₹1,00,000 to ₹5,00,000.
4. Audit of Books of Accounts	LLPs are required to have an audit of their accounts according to prescribed rules.	✓ Auditor: Must be a Chartered Accountant in practice.
5. Appointment of Auditor	A qualified auditor must be appointed for each financial year to audit the LLP's accounts.	✓ Non-compliance can result in penalties under the relevant provisions.



## 9. LEASE ACCOUNTING (AS - 19)

### 1. What is a Lease

Lease	An <b>agreement</b> where the <b>Lessor</b> (legal owner) conveys to the <b>Lessee</b> (user) the <b>right to use an asset</b> in exchange for <b>lease rent</b> (payment) for an <b>agreed period of time</b> . A lease includes <b>hire agreements</b> where the hirer has the option to acquire ownership upon meeting agreed conditions.
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### 2. Applicability of AS 19

The standard applies to all leases other than	
a.	<b>Natural Resources</b> Leases for <b>exploration or use of natural resources</b> such as oil, gas, timber, metals, and other minerals.
b.	<b>Licensing Agreements</b> Covers <b>motion picture films, video recordings, plays, manuscripts, patents, and copyrights</b> .
c.	<b>Land Use Leases</b> Agreements specifically for <b>using land</b> .

### 3. Definitions

1.	<b>Non-Cancellable Lease</b> A non-cancellable lease is a lease that is cancellable only: a. upon the occurrence of some <b>remote contingency</b> ; or b. with the <b>permission of the lessor</b> ; or c. if the lessee enters into a <b>new lease</b> for the <b>same or an equivalent asset</b> with the same lessor; or d. upon payment by the lessee of an <b>additional amount</b> such that, at inception, continuation of the lease is <b>reasonably certain</b> .
2.	<b>Lease Term</b> The lease term is the <b>non-cancellable period</b> for which the lessee has agreed to take on lease the asset together with any <b>further periods</b> for which the lessee has the <b>option to continue the lease</b> of the asset, with or without further payment, which option at the inception of the lease it is <b>reasonably certain</b> that the lessee will exercise.
3.	<b>Inception of Lease</b> The inception of the lease is the <b>earlier</b> of the date of the <b>lease agreement</b> and the <b>date of a commitment by the parties</b> to the principal provisions of the lease.
4.	<b>MLP</b> Minimum lease payments are the <b>payments over the lease term</b> that the lessee is, or can be required, to make <b>excluding contingent rent</b> , costs for services and taxes to be paid by and reimbursed to the lessor, together with:



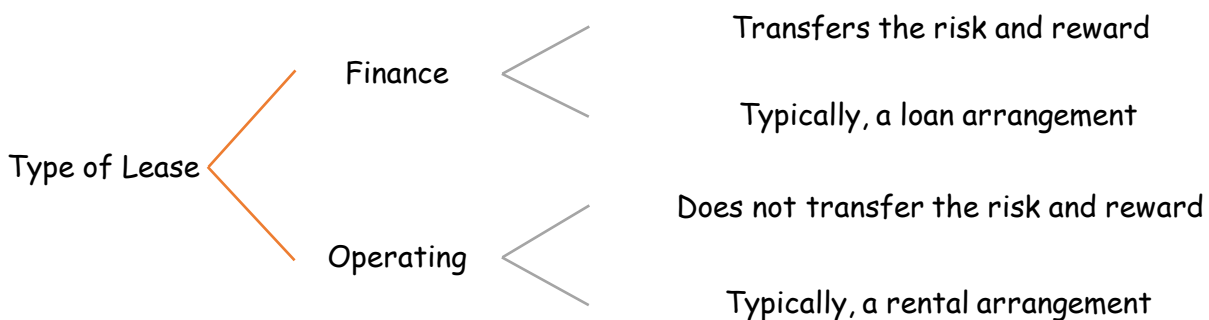
	<p>a. In the case of the <b>lessee</b>, any <b>residual value guaranteed</b> by or on behalf of the lessee; or</p> <p>b. In the case of the <b>lessor</b>, any <b>residual value guaranteed to the lessor</b>:</p> <ol style="list-style-type: none"> <li>by or on behalf of the <b>lessee</b>; or</li> <li>by an <b>independent third party</b> financially capable of meeting this guarantee.</li> </ol> <p>If the lessee has an <b>option to purchase</b> the asset at a price that is expected to be <b>significantly lower than the fair value</b> when the option becomes exercisable, and it is <b>reasonably certain</b> to be exercised at the <b>inception of the lease</b>, the minimum lease payments include:</p> <ul style="list-style-type: none"> <li>✓ The <b>payments due over the lease term</b>, plus</li> <li>✓ The payment required to <b>exercise the purchase option</b>.</li> </ul>
5.	<p><b>Economic Life</b> The <b>total usable period</b> of an asset across multiple users.</p>
6.	<p><b>Useful Life</b> The <b>depreciable life</b> of an asset <b>used by the lessee</b>. (Always shorter than economic life).</p>
7.	<p><b>Residual Value</b> Residual value of a leased asset is the <b>estimated fair value of the asset</b> at the end of the lease term.</p>
8. :	<p><b>Guaranteed residual value is:</b> Guaranteed residual value is:</p> <ol style="list-style-type: none"> <li>in the case of the lessee, that part of the residual value which is <b>guaranteed by the lessee or by a party on behalf of the lessee</b> and</li> <li>in the case of the lessor, that part of the residual value which is <b>guaranteed by or on behalf of the lessee, or by an independent third party</b> who is financially capable of discharging the obligations under the guarantee.</li> </ol>
9.	<p><b>Unguaranteed residual value</b> Unguaranteed residual value of a leased asset is the amount by which the <b>residual value of the asset exceeds its guaranteed residual value</b>.</p>
10.	<p><b>Gross investment</b> Gross investment in the lease is the <b>aggregate</b> of the <b>minimum lease payments</b> under a finance lease from the standpoint of the lessor and any <b>unguaranteed residual value</b> accruing to the lessor.</p>
11.	<p><b>Unearned finance income</b> Unearned finance income is the <b>difference</b> between:</p> <ol style="list-style-type: none"> <li>the <b>gross investment</b> in the lease; and</li> <li>the <b>present value</b> of <ol style="list-style-type: none"> <li>the <b>minimum lease payments</b> under a finance lease from the standpoint of the lessor; and</li> <li>any <b>unguaranteed residual value</b> accruing to the lessor, at the interest rate implicit in the lease.</li> </ol> </li> </ol>



12.	<p><b>Net investment</b></p> <p>Net investment in the lease is the <b>gross investment</b> in the lease <b>less unearned finance income</b>.</p>
13.	<p><b>Interest rate implicit in the lease</b></p> <p>The interest rate implicit in the lease is the <b>discount rate</b> that, at the <b>inception of the lease</b>, causes the <b>aggregate present value</b> of</p> <ol style="list-style-type: none"> <li>the <b>minimum lease payments</b> under a finance lease from the standpoint of the lessor; and</li> <li>any <b>unguaranteed residual value</b> accruing to the lessor, to be equal to the fair value of the leased asset.</li> </ol>
14.	<p><b>Lessee's incremental borrowing rate of interest</b></p> <p>The lessee's incremental borrowing rate of interest is the rate of interest the lessee would have to pay on a <b>similar lease</b> or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur <b>to borrow over a similar term</b>, and with a similar security, the funds necessary to purchase the asset.</p>
15.	<p><b>Contingent rent</b></p> <p>Contingent rent is that portion of the lease payments that is <b>not fixed</b> in amount but is based on a factor <b>other than</b> just the <b>passage of time</b> (e.g., percentage of sales, amount of usage, price indices, market rates of interest).</p>

#### 4. Types of Leases

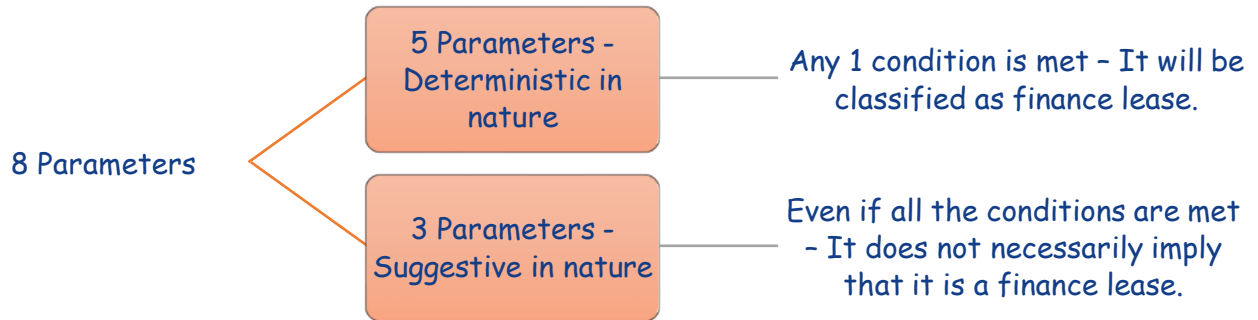
Lease Type	Definition
Finance Lease	A lease where <b>substantially all risks and rewards</b> of ownership are <b>transferred</b> .
Operating Lease	A lease where ownership <b>risks and rewards</b> are <b>NOT transferred</b> .
Classification Basis	Determined by the <b>substance of the transaction</b> , not just legal form.





## 5. Indicators of Finance Lease

AS 19 has given a total of 8 parameters to decide whether it is a finance lease or not. These 8 conditions can be divided into following categories:



### Finance Lease Classification: Deterministic & Suggestive Conditions

#### 1. Deterministic Conditions (Normally Lead to Finance Lease Classification)

a.	The lease <b>transfers ownership</b> of the asset to the lessee by the <b>end of the lease term</b> ;
b.	The lessee has the <b>option to purchase the asset</b> at a price which is expected to be sufficiently <b>lower than the fair value</b> at the date the option becomes exercisable such that, at the <b>inception of the lease</b> , it is <b>reasonably certain</b> that the option will be exercised; <b>Example</b> Mr. A has taken a car on lease for 5 years from XYZ. After 5 years of lease term Mr. A has the option to purchase this car for Rs.20,000, whereas it is assumed the car market value at the end of 5th year would be Rs.2,00,000. Considering the option to buy it at bargain price, it is reasonably certain that Mr. A would exercise that option.
c.	The lease term is for the <b>major part of the economic life of the asset</b> even if title is not transferred; <b>Example</b> XYZ has taken a property on lease for 32 years from ABC, expected economic life of the property is 40 years. Since XYZ is going to use the asset over major part of its economic life (80% in this case), it will meet the condition to be treated as finance lease.
d.	At the <b>inception of the lease</b> , <b>present value of the minimum lease payments</b> amounts to at least substantially all of the <b>fair value of the leased asset</b> ; and
e.	The leased asset is of a <b>specialized nature</b> such that only the lessee can use it without <b>major modifications</b> being made. <b>Example</b> PQR, a hospital ordered 10 ambulances, specially designed as per the requirement of PQR. These ambulances are taken on lease and it cannot be used by anyone else without major modifications. This would meet the condition of finance lease



## 2. Suggestive Conditions (Additional Indicators for Finance Lease Classification)

- |    |   |
|----|---|
| a. | If the lessee can <b>cancel the lease</b> and the lessor's losses associated with the cancellation are borne by the lessee;           |
| b. | If the lessee <b>benefits from fluctuations in the asset's residual value</b> (e.g., receiving rent rebates based on disposal value). |
| c. | If the lessee <b>continues the lease</b> for a secondary period at a <b>rent substantially lower than the market rate</b> .           |

## 3. Key Notes on Lease Classification

- |    |  |
|----|--|
| a. | Lease classification is determined <b>at inception</b> .   |
| b. | If <b>terms change</b> (except renewals), a <b>new lease</b> classification applies.   |
| c. | <b>Changes in Estimates</b> or Circumstances<br>Changes in economic life, residual value, or lessee default <b>do not lead to reclassification</b> . |

## 6. Accounting for Finance Leases (Books of Lessee)

### 1. Initial Recognition (At Inception of Lease)

Accounting Entry		Debit	Credit
Recognition of Asset & Liability		<b>Leased Asset</b>	<b>Lessor</b>
1.	<b>Measurement Basis</b> Lease recorded at <b>lower of</b> : ✓ <b>Fair Value of the asset</b> ✓ <b>Present Value of MLP</b> (Discounted at interest rate implicit in the lease or, if unavailable, <b>lessee's incremental borrowing rate</b> ).		

### 2. Subsequent Accounting Treatment

a.	<b>Lease Payments</b> <b>Apportioned</b> between: ➤ Finance Charge (Interest Expense) ➤ Reduction of Lease Liability.
b.	<b>Finance Charges</b> Allocated across periods to maintain a <b>constant interest rate</b> on the outstanding liability.
c.	<b>Depreciation</b> ➤ Finance lease results in <b>depreciation expense</b> for the asset. ➤ Depreciation policy must <b>align with AS 10</b> .

### 3. Depreciation Criteria

a.	<b>Lessee Retains Asset</b> Depreciated <b>over its useful life</b> .
b.	<b>Asset is Returned to Lessor</b> Depreciated over <b>lease term or useful life, whichever is shorter</b> .

### 4. Initial Direct Costs



- a. **Costs Related to Lease Negotiation**  
Included in asset cost as part of lease recognition.

### 5. Interest Rate Implicit in Lease (Computation)

- a. **Implicit Interest Rate**  
The discount rate that equates: Present Value of Minimum Lease Payments (MLP) + Unguaranteed Residual Value (UGRV) = Fair Value of the Leased Asset.

#### Example 1

Annual lease rents	= Rs.50,000 at the end of each year.
Lease period	= 5 years;
Guaranteed residual value	= Rs.25,000
Unguaranteed residual value (UGR)	= Rs.15,000
Fair Value at the inception (beginning) of lease	= Rs.2,00,000

Interest rate implicit on lease is computed below:

Interest rate implicit on lease is a discounting rate at which present value of minimum lease payments and unguaranteed residual value is Rs.2 lakhs.

PV of minimum lease payments and unguaranteed residual value at guessed rate 10%

Year	MLP + UGR Rs.	DF (10%)	PV Rs.
1	50,000	0.909	45,450
2	50,000	0.826	41,300
3	50,000	0.751	37,550
4	50,000	0.683	34,150
5	50,000	0.621	31,050
5	25,000	0.621	15,525
5	15,000	0.621	9,315
			2,14,340

PV of minimum lease payments and unguaranteed residual value at guessed rate 14%

Year	MLP + UGR Rs.	DF (10%)	PV Rs.
1	50,000	0.877	43,850
2	50,000	0.769	38,450
3	50,000	0.675	33,750
4	50,000	0.592	29,600
5	50,000	0.519	25,950
5	25,000	0.519	12,975
5	15,000	0.519	7,785
			1,92,360

Interest rate implicit on lease is computed below by interpolation:



$$\text{Interest rate implicit on lease} = 10\% + \frac{14\% - 10\%}{2,14,340 - 1,92,360} \times (2,14,340 - 2,00,000) = 12.6\%$$

### Example 2

Annual lease rents	=	Rs.50,000 at the end of each year.
Lease period	=	5 years;
Guaranteed residual value	=	Rs.25,000
Unguaranteed residual value (UGR)	=	Rs.15,000
Fair Value at the inception (beginning) of lease	=	Rs.2,00,000
Interest rate implicit on lease is	=	12.6%

Present value of minimum lease payment is computed below:

Year	MLP Rs.	DF (12.6%)	PV Rs.
1	50,000	0.890	44,500
2	50,000	0.790	39,500
3	50,000	0.700	35,000
4	50,000	0.622	31,100
5	50,000	0.552	27,600
5	25,000	0.552	13,800
			1,91,500

Present value of minimum lease payment = Rs.1,91,500

Fair value of leased asset = Rs.2,00,000

The accounting entry at the inception of lease to record the asset taken on finance lease in books of lessee is suggested below:

		Rs.	Rs.
Asset A/c	Dr.	1,91,500	
To Lessor (Lease Liability) A/c			1,91,500
(Being recognition of finance lease as asset and liability)			

### Example 3

Using data for example 2 and assuming zero residual value, allocation of finance charge over lease period is shown below:

Year	Minimum Lease Payments Rs.	Finance Charge (12.6%) Rs.	Principal Rs.	Principal due Rs.
0	--	--	--	1,91,500
1	50,000	24,129	25,871	1,65,629
2	50,000	20,869	29,131	1,36,498
3	50,000	17,199	32,801	1,03,697
4	50,000	13,066	36,934	66,763
5	75,000	8,237*	66,763	
	2,75,000	83,500	1,91,500	

Accounting entries in year 1 to recognise the finance charge in books of lessee are suggested below:



		Rs.	Rs.
Finance Charge A/c	Dr.	24,129	
To Lessor			24,129
(Being finance charge due for the year)			
Lessor	Dr.	50,000	
To Bank A/c			50,000
(Being payment of lease rent for the year)			
P & L A/c	Dr.	24,129	
To Finance Charge A/c			24,129
(Being recognition of finance charge as expense for the year)			

## 7. Disclosures made by the Lessee

### Lessee's Disclosure Requirements for Finance Leases

a.	Finance lease assets should be <b>separately disclosed</b> from owned assets.
b.	For each asset class, disclose the <b>net carrying amount</b> at the balance sheet date.
c.	Show a <b>reconciliation between total MLP and their present value</b> , including a breakdown for: <ul style="list-style-type: none"> <li>✓ Not later than one year</li> <li>✓ Later than one year and not later than five years</li> <li>✓ Later than five years.</li> </ul>
d.	Disclose <b>contingent rents</b> recognized as expense in the Profit & Loss Statement.
e.	Disclose total <b>future minimum sublease payments</b> under non-cancellable subleases at the balance sheet date.
f.	Provide key details of the lessee's leasing arrangements, including: <ul style="list-style-type: none"> <li>✓ Basis of <b>contingent rent payments</b></li> <li>✓ <b>Renewal, purchase options, and escalation clauses</b></li> <li>✓ <b>Lease restrictions</b> (e.g., dividends, additional debt, further leasing).</li> </ul>

## 8. Accounting for Finance Leases (Books of Lessor)

### 1. Initial Recognition (At Lease Inception)

Accounting Entry	Debit	Credit
Purchase of Asset by Lessor	Asset (Fair Value)	Bank (Fair Value)
Recognition of Lease Receivable	Lease Receivable (at NI)	Asset (at NI)

### 2. Recognition of Finance Income

a.	Unearned Finance Income (UFI) Recognized <b>systematically over the lease term</b> .
b.	Income Allocation Method Ensures a <b>constant periodic return on the net investment</b> .
c.	Interest Rate Basis Based on <b>Interest Rate Implicit in Lease</b> or <b>Commercial Interest Rate</b> .



### 3. Initial Direct Costs

a.	<p><b>Definition</b> Includes <b>commissions, legal fees, and other costs</b> incurred to arrange the lease.</p>
b.	<p><b>Accounting Treatment</b></p> <ul style="list-style-type: none"> <li>✓ <b>Recognized immediately</b> in Profit &amp; Loss, or</li> <li>✓ <b>Allocated over lease term</b> against finance income.</li> </ul>

### 4. Review of Unguaranteed Residual Value (UGRV)

a.	<p><b>Regular Review</b> Lessor must <b>regularly review</b> UGRV.</p>
b.	<p><b>Reduction in UGRV</b> <b>Revise income allocation</b> over remaining lease term; previously accrued income is <b>adjusted immediately</b>.</p>
c.	<p><b>Increase in UGRV</b> <b>Upward adjustments are NOT allowed</b>.</p>

### 5. Manufacturer or Dealer Lessor

a.	<p><b>Sales Recognition</b> Recognized in <b>Profit &amp; Loss</b> as per normal <b>sales policy</b>.</p>
b.	<p><b>Low Interest Rate Quotes</b> If an <b>artificially low interest rate</b> is used, profit should be restricted to a <b>commercial rate</b>.</p>
c.	<p><b>Initial Direct Costs</b> <b>Recognized as an expense</b> in Profit &amp; Loss at lease inception.</p>

## 9. Disclosures

### Lessor's Disclosure Requirements for Finance Leases

a.	<p>Show a <b>reconciliation between total Gross Investment (GI) and Present Value (PV) of Minimum Lease Payments (MLP) receivable</b>, with a breakdown for:</p> <ul style="list-style-type: none"> <li>✓ Not later than one year</li> <li>✓ Later than one year and not later than five years</li> <li>✓ Later than five years.</li> </ul>
b.	Disclose the <b>total unearned finance income</b> (interest income not yet recognized).
c.	Report the <b>unguaranteed residual value (UGRV)</b> that benefits the lessor.
d.	Disclose the <b>accumulated provision for uncollectible MLP receivables</b> .
e.	Report <b>contingent rents recognized as income</b> in the Profit & Loss Statement.
f.	Provide a <b>general description of the lessor's significant lease agreements</b> .
g.	Disclose the <b>accounting policy for initial direct costs</b> (whether expensed immediately or allocated over lease term).
h.	<b>Report Gross Investment Less Unearned Income</b> for <b>new leases</b> added, after deducting cancelled leases.



## 10. Accounting For Operating Leases (Lessee Books)

### Accounting Treatment in the Books of Lessee

a.	<p><b>Recognition of Lease Payments</b></p> <p>Lease payments are recognized as an <b>expense in the Profit &amp; Loss Statement on a straight-line basis</b> over the lease term, unless another method <b>better reflects the benefit pattern</b>.</p>
b.	<p><b>Requirement under AS 19</b></p> <p>To ensure a <b>better revenue-cost match</b>, AS 19 mandates that operating lease payments be recognized on a straight-line basis, unless another method better represents the benefit pattern.</p>

### Example

Suppose outputs from a machine taken on a 3 year operating lease are estimated as 10,000 units in year 1; 20,000 units in year 2 and 50,000 units in year 3. The agreed annual lease payments are Rs.25,000, Rs.45,000 and Rs.50,000 respectively.

The total lease payment Rs.1,20,000 in this example should be recognised in proportion of output as Rs.15,000 in year 1, Rs.30,000 in year 2 and Rs.75,000 in year 3. The difference between lease rent due and lease rent recognised can be debited / credited to Lease Equalisation A/c.

The accounting entries for year 1 in books of lessee are suggested below:

		Rs.	Rs.
Lease Rent A/c	Dr.	15,000	
Lease Equalization A/c	Dr.	10,000	
To Lessor			25,000
(Being lease rent for the year due)			
Lessor	Dr.	25,000	
To Bank A/c			25,000
(Being payment of lease rent for the year)			
P & L A/c	Dr.	15,000	
To Lease Rent A/c			15,000
(Being recognition of lease rent as expense for the year)			

Since total lease rent due and recognised must be same, the Lease Equalisation A/c will close in the terminal year. Till then, the balance of Lease Equalisation A/c can be shown in the balance sheet under "Current Assets" or "Current Liabilities" depending on the nature of balance.



## 11. Disclosures made by Lessee

### Disclosures for Operating Leases

a.	Disclose <b>payments due</b> in: <ul style="list-style-type: none"> <li>✓ Not later than one year</li> <li>✓ Later than one year and not later than five years</li> <li>✓ Later than five years</li> </ul>
b.	Disclose <b>total sublease payments</b> expected to be received at balance sheet date.
c.	Report <b>lease payments recognized</b> , with separate amounts for minimum lease payments and contingent rents.
d.	Report <b>sublease payments received</b> (or receivable).
e.	Disclose <b>key lease terms</b> , including: <ul style="list-style-type: none"> <li>✓ Basis of <b>contingent rent payments</b></li> <li>✓ <b>Renewal, purchase options, and escalation clauses</b></li> <li>✓ <b>Restrictions on dividends, debt, further leasing</b></li> </ul>

## 12. Accounting for operating leases (Lessor books)

### Accounting Treatment in the Books of Lessor

a.	<b>Recognition of Asset</b> Asset given on lease remains in the books of the lessor as Property, Plant & Equipment (PPE).
b.	<b>Lease Income Recognition</b> Recognized in Profit & Loss Statement on a straight-line basis (SLM) unless another method better reflects the time pattern of benefit.
c.	<b>Depreciation</b> Charged as per AS 10, following the lessor's normal depreciation policy.
d.	<b>Impairment Losses</b> Assessed and accounted for as per AS 28.

### Accounting Treatment in the Books of Lessee vs. Lessor

Particulars	Books of Lessor	Books of Lessee
Asset Recognition	Appears in books as PPE	Not recognized as an asset
Depreciation	Charged	Not applicable
Impairment	Applicable	Not applicable
Lease Rent Treatment	Income recognized on SLM	Expense recognized on SLM

### Example:

Suppose outputs from a machine of economic life of 6 years are estimated as 10,000 units in year 1, 20,000 units in year 2 and 30,000 units in year 3, 40,000 units in year 4, 20,000 units in year 5 and 5,000 units in year 6. The machine was given on 3-year operating lease by a dealer of the machine for equal annual lease rentals to yield 20% profit margin on cost Rs.5,00,000. Straight-line depreciation in proportion of output is considered appropriate.



$$\begin{aligned} \text{Total lease rent} &= 120\% \text{ of Rs.5 lakhs} \times \frac{\text{Output during lease period}}{\text{Total output}} \\ &= \text{Rs.6 lakhs} \times \frac{60,000 \text{ units}}{1,25,000 \text{ units}} = \text{Rs.2.88 lakhs} \end{aligned}$$

$$\text{Annual lease rent} = \text{Rs.2,88,000} / 3 = \text{Rs.96,000}$$

Total lease rent should be recognised as income in proportion of output during lease period, i.e. in the proportion of 10: 20 : 30. Hence income recognised in years 1, 2 and 3 are Rs.48,000, Rs.96,000 and Rs.1,44,000 respectively.

Since depreciation in proportion of output is considered appropriate, the depreciable amount Rs.5 lakh should be allocated over useful life 6 years in proportion of output, i.e. in proportion of 10: 20 : 30 : 40 : 20 : 5. Depreciation for year 1 is Rs.40,000.

The accounting entries for year 1 in books of lessor:

		Rs.	Rs.
Machine given on Operating Lease	Dr.	5,00,000	
To Purchase			5,00,000
(Being machine given on operating lease brought into books)			
Lessee	Dr.	96,000	
To Lease Equalization A/c			48,000
To Lease Rent (Being lease rent for the year due)			48,000
Bank	Dr.	96,000	
To Lessee			96,000
(Being receipt of lease rent for the year)			
Lease Rent	Dr.	48,000	
To P & L A/c			48,000
(Being recognition of lease rent as income for the year)			
Depreciation	Dr.	40,000	
To Machine given on Operating Lease			40,000
(Being depreciation for the year)			
P & L A/c	Dr.	40,000	
To Depreciation			40,000
(Being depreciation for the year transferred to P & L A/c)			

Since total lease rent due and recognised must be same, the Lease Equalisation A/c will close in the terminal year. Till then, the balance of Lease Equalisation A/c can be shown in the balance sheet under "Current Assets" or "Current Liabilities" depending on the nature of balance.



### 13. Disclosures by Lessors for Operating Leases (As per AS 19)

a.	For each class of assets, disclose: <ul style="list-style-type: none"> <li>✓ Gross carrying amount</li> <li>✓ Accumulated depreciation</li> <li>✓ Accumulated impairment losses <ul style="list-style-type: none"> <li>i. Depreciation in P&amp;L Depreciation expense recognized during the period.</li> <li>ii. Impairment Losses in P&amp;L Impairment losses recognized during the period.</li> <li>iii. Reversal of Impairment Losses in P&amp;L Impairment losses reversed during the period.</li> </ul> </li> </ul>
b.	Disclose lease amounts for: <ul style="list-style-type: none"> <li>✓ Not later than one year</li> <li>✓ Later than one year and not later than five years</li> <li>✓ Later than five years</li> </ul>
c.	Report contingent rent recognized as income in the Profit & Loss Statement.
d.	Provide a general description of the lessor's significant lease agreements.
e.	Disclose accounting policy for initial direct costs (whether expensed immediately or allocated over lease term).

### 14. Sale and Leaseback

#### Accounting of Sale and Leaseback

a.	A property owner sells an asset and leases it back from the buyer.
b.	The seller (lessee) receives cash upfront while retaining the asset's use.
c.	Lease payments and sale price are negotiated together.
d.	Accounting Treatment Depends on whether the lease is a Finance Lease or an Operating Lease.
I.	Where sale and leaseback results in finance lease The excess or deficiency of sales proceeds over the carrying amount should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.
II.	Where sale and leaseback results in operating lease Case 1: Sale price = Fair Value Profit or loss should be recognised immediately. Case 2: Sale Price < Fair Value Profit and loss should be recognised immediately. However, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used.



### Case 3: Sale Price > Fair Value

The excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.

### Sale and Leaseback Accounting Summary

Sale Price at Fair Value	Carrying Amount = Fair Value	Carrying Amount < Fair Value	Carrying Amount > Fair Value
Profit	No profit	Recognize profit immediately	Not applicable
Loss	No loss	Not applicable	Recognize loss immediately

Sale Price below Fair Value	Carrying Amount = Fair Value	Carrying Amount < Fair Value	Carrying Amount > Fair Value
Profit	No profit	Recognize profit immediately	No profit (Asset written down to fair value)
Loss (Not Compensated by Below-Market Lease Payments)	Recognize loss immediately	Recognize loss immediately	Write down asset to fair value
Loss (Compensated by Below - Market Lease Payments)	Defer & amortize loss	Defer & amortize loss	Write down asset to fair value

Sale Price above Fair Value	Carrying Amount = Fair Value	Carrying Amount < Fair Value	Carrying Amount > Fair Value
Profit	Defer & amortize profit	Recognize difference between carrying amount & fair value immediately + Defer & amortize excess over fair value	Defer & amortize profit (Profit = Sale Price - Fair Value, since asset is written down to fair value)
Loss	No loss recognized	No loss recognized	Write down asset to fair value + Defer & amortize difference between sale price & fair value



# 10. BRANCH (INCLUDING FOREIGN BRANCHES) ACCOUNTS

## 1. Introduction

1.	<b>Branch</b> An establishment that operates at a <b>different location from the Head Office</b> , carrying out the same or similar activities.
2.	<b>Head Office Requirement</b> A branch cannot exist without a Head Office, which is the <b>principal place of business</b> .
3.	<b>Difference Between Branch &amp; Department</b> a. <b>Branch</b> Operates at a <b>different location from the Head Office</b> but performs the same or similar activities. b. <b>Department</b> A <b>division</b> within the <b>same location</b> handling different activities in a large organization.

## 2. Classification of Branches from Accounting Point of View

1.	<b>Inland Branches</b> Branches which are <b>situated within the territories of a country</b> . Inland branches are also known as <b>home branches</b> . They are further classified into a. <b>Independent Branches</b> Maintain their <b>own</b> independent accounting records. b. <b>Dependent Branches</b> All accounting records are maintained <b>at the Head Office</b> .
2.	<b>Foreign Branches</b> Foreign branches are the branches which are <b>situated outside the country</b> .

## 3. Dependent Branches

1.	<b>Dependent Branch</b> A branch fully <b>controlled by the Head Office (H.O.)</b> , including business policies, administration, and accounts.
2.	<b>Accounting</b> All transactions related to the branch are <b>recorded in the H.O. books</b> , and the H.O. determines the branch's profit or loss.
3.	<b>Branches maintain memorandum records like:</b> - ➤ <b>Stock Register</b> ➤ <b>Debtors Ledger</b> ➤ <b>Petty Cash Book</b> ➤ <b>Customers' Ledger</b>



4.	Types of Dependent Branches
a.	<b>Order-Booking Branch</b> Takes customer orders, but H.O. fulfils them.
b.	<b>Sales Branch</b> Sells goods supplied by the H.O. and H.O. manages collections.
c.	<b>Retail Branch</b> Directly sells goods to customers, supplied by the H.O.

#### 4. Methods of Charging Goods to Branches

1.	<b>At Cost</b> Goods are sent to the branch at their <b>actual cost price</b> .
2.	<b>At Selling Price</b> Goods are invoiced at <b>pre-determined selling prices</b> .
3.	<b>At Wholesale Price</b> Goods are invoiced at the <b>wholesale price</b> , which is lower than the final selling price. Used primarily for retail branches.

#### 5. Accounting for Dependent Branches

##### Methods of Branch Accounting

1.	If goods are sent at cost or at selling price <ul style="list-style-type: none"> <li>➤ <b>Debtors Method</b></li> <li>➤ <b>Stock &amp; Debtors Method</b></li> <li>➤ <b>Final Accounts Method</b></li> </ul> If goods send at whole sale price <ul style="list-style-type: none"> <li>➤ <b>Wholesale Branch Method</b></li> </ul>
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##### A. Debtors Method

1.	<b>Suitable for Small Branches</b> <ul style="list-style-type: none"> <li>➤ This method is used for <b>small-sized branches</b>.</li> <li>➤ where the H.O. maintains a <b>separate Branch Account</b>. To determine the profit or loss of each branch.</li> </ul>
2.	<b>Nature of Branch Account</b> The Branch Account is a <b>nominal account</b> , recording all transactions related to the branch.

Transaction	Journal Entry (In H.O. Books)
1. <b>Opening Balances of Branch Assets</b>	Branch A/c <span style="float: right;">Dr.</span> To Branch Opening Stock A/c To Branch Petty Cash A/c To Other Assets at Branch A/c
2. <b>Opening Balances of Branch Liabilities</b>	Branch Liabilities A/c <span style="float: right;">Dr.</span>



	To Branch A/c	
3. Goods Sent to Branch	Branch A/c To Goods Sent to Branch A/c	Dr.
4. Cash/Draft Sent to Branch for Expenses	Branch A/c To Cash or Bank A/c	Dr.
5. Goods Returned by Branch to H.O.	Goods Sent to Branch A/c To Branch A/c	Dr.
6. Remittance from Branch (Cash Received from Branch)	Cash or Bank A/c Dr. To Branch A/c	
7. Goods Sold by Branch (Intimated to H.O.)	No Journal Entry	
8. Transfer of 'Goods Sent to Branch' to Trading/Purchases Account	Goods Sent to Branch A/c To Branch Trading (or Purchases) A/c	Dr.
9. Closing Balances of Branch Assets	Branch Stock A/c Branch Petty Cash A/c Branch Assets A/c (after depreciation) To Branch A/c	Dr. Dr. Dr.
10. Closing Liabilities of Branch	Branch A/c To Branch Creditors A/c To Branch Outstanding Expenses A/c	Dr.
11. Transfer of Branch Profit/Loss to H.O.	(A) For Profit: Branch A/c To Profit & Loss A/c (B) For Loss: Profit & Loss A/c To Branch A/c	Dr. Dr.

## Proforma Branch Account

Particulars	Amount	Particulars	Amount
To Balance b/d (Assets in the beginning): Stock Petty Cash Debtors Furniture Prepaid Expenses To Goods sent to Branch A/c To Cash or Bank A/c (For Expenses) Salaries Rent Wages etc.		By Balance b/d (Liabilities in the beginning) Creditors, Outstanding Expenses By Bank A/c (Remittances from the Branch) By Cash Sales By Cash received from debtors By Goods sent to Branch A/c (Goods returned by branch) By Balance c/d (Assets at the end)	



To Balance of Branch Liability (if any) To P & L A/c (if Profit)	Balancing figure	Stock Petty Cash Sundry Debtors Prepaid Expenses Furniture By P & L (if Loss)	Balancing figure
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### Accounting for Goods Sent to Branch at Invoice Price

Procedure	The accounting process is the same as when goods are sent at cost, except for adjustments related to goods.
Need for Adjustments	<ul style="list-style-type: none"> <li>➤ To accurately determine branch profit or loss, loading' adjustments must be made.</li> <li>➤ Loading refers to the difference between Invoice Price and Cost Price of goods.</li> </ul>

### Adjustment Entries in H.O. Books (When Goods Sent at Invoice Price)

Transaction	Journal Entry
Goods Sent to Branch at Invoice Price	Branch A/c Dr. To Goods Sent to Branch A/c
Adjustment for 'Loading' (Invoice Price - Cost Price)	Goods Sent to Branch A/c Dr. To Branch A/c
Goods Returned to H.O. at Invoice Price	Goods Sent to Branch A/c Dr. To Branch A/c
Adjustment for 'Loading' on Goods Returned	Branch A/c Dr. To Goods Sent to Branch A/c
Adjustment for 'Loading' in Opening Stock	Stock Reserve A/c Dr. To Branch A/c
Closing Stock at Invoice Price	Branch Stock A/c Dr. To Branch A/c
Adjustment for 'Loading' in Closing Stock	Branch A/c Dr. To Stock Reserve A/c

### B. Stock and Debtors Method

#### When Goods Are Sent at Cost

- This method is used to exercise detailed control over branch operations.
- The Head Office (H.O.) maintains separate accounts for different aspects of branch activities.
- Accounts Maintained by Head Office & Their Purpose

Account	Purpose
1. Branch Stock Account	Ascertainment of shortage or surplus



(or Branch Trading Account)	
2. Branch Debtors Account	Ascertainment of closing balance of debtors
3. Branch Expenses Account	Ascertainment of total expenses incurred
4. Goods sent to Branch Account	Ascertainment of cost of goods sent to branch
5. Branch Cash / Bank Account	Know about cash flow at branch
6. Branch Fixed Asset Account	Control over branch Fixed Assets
7. Branch Profit and Loss Account	Calculation of net profit or loss

### Journal Entries in HO books

	Transaction	Account debited	Account credited
a.	Cost of goods sent to the Branch	Branch Stock A/c	Goods sent to Branch A/c
b.	Remittances for expenses	Branch Cash A/c	Cash A/c
c.	Any asset (e.g. furniture) provided by H.O.	Branch Asset (Furniture) A/c	Asset A/c
d.	Cost of goods returned by the branch	Goods sent to Branch A/c	Branch Stock A/c
e.	Cash Sales at the Branch	Branch Cash A/c	Branch Stock A/c
f.	Credit Sales at the Branch	Branch Debtors A/c	Branch Stock A/c
g.	Return of goods by debtors to the Branch	Branch Stock A/c	Branch Debtors A/c
h.	Cash paid by debtors	Branch Cash A/c	Branch Debtors A/c
i.	Discount & allowance to debtors, bad debts	Branch Expenses A/c	Branch Debtors A/c
j.	Remittances to H.O.	Cash A/c	Branch Cash A/c
k.	Branch Expenses directly paid by H.O.	Branch Expenses A/c	Cash A/c
l.	Expenses met by Branch	Branch Expenses A/c	Branch Cash A/c

### Final Adjustments in Stock and Debtors Method

Transaction	Journal Entry	Explanation
Closing Stock	Branch Stock A/c Cr. (at cost)	Closing stock is credited to Branch Stock A/c and carried forward as opening stock for the next period.
Effect of Branch Stock A/c Balance	✓ Credit balance → Gross Profit ✓ Debit balance → Loss	The final balance in the Branch Stock Account helps determine gross profit or loss.
Transfer of Branch Stock A/c Balance to Branch P&L A/c	Branch Stock A/c Dr. To Branch Profit & Loss A/c	Any remaining balance in Branch Stock A/c is



		transferred to Branch P&L A/c.
Transfer of Branch Expenses to Branch P&L A/c	Branch Profit & Loss A/c Dr. To Branch Expenses A/c	All branch expenses are transferred to Branch P&L A/c to determine net profit or loss.
Transfer of Branch P&L A/c Balance to H.O. P&L A/c	Head Office P&L A/c Dr. To Branch P&L A/c	The final net profit/loss of the branch is transferred to the H.O. Profit & Loss A/c.
Transfer of Goods Sent to Branch A/c to H.O. Purchase/Trading A/c	Goods Sent to Branch A/c Dr. To H.O. Purchase A/c / Trading A/c	The credit balance in Goods Sent to Branch A/c is transferred to H.O. Trading/Purchase A/c for final accounting.

#### When Goods Are Sent at Invoice Price

- When goods are invoiced at selling price, an additional account called the **Branch Adjustment Account** is maintained.
- This helps adjust the **loading (difference between Invoice Price and Cost Price)** to reflect actual profit or loss.

#### Journal Entries

Transaction		Accounts debited		Accounts credited
a.	Sale price of the goods sent from H.O. to the Branch		Branch Stock A/c (at selling price)	i. Goods sent to Branches A/c with cost of the goods sent. ii. Branch Adjustment A/c (with the loading i.e., Difference between the selling and cost price).
b.	Return of goods By the Branch to H.O.	i.	Goods sent to Branch A/c (with the cost of goods returned).	Branch Stock A/c
		ii.	Branch Adjustment A/c (with the loading)	
c.	Cash sales at the Branch		Branch Cash/Bank A/c	Branch Stock A/c
d.	Credit Sales at the Branch		Branch Debtors A/c	Branch Stock A/c
e.	Goods returned to Branch by customer		Branch Stock A/c	Branch Debtors A/c (at selling price)
f.	Goods lost in Transit	i.	Goods Lost in Transit A/c	Branch Stock A/c



or stolen	ii.	or Goods Stolen A/c (with cost of the goods) Branch Adjustment A/c (with the loading)
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## Adjustments for Goods Sent at Invoice Price

Transaction	Journal Entry	Purpose
Goods Sent to Branch at Invoice Price	Branch A/c Dr. To Goods Sent to Branch A/c	Records goods sent to branch at invoice (selling) price.
Adjustment for 'Loading' on Goods Sent	Goods Sent to Branch A/c Dr. To Branch Adjustment A/c	Records excess price (loading) to ensure profit is not overstated.
Goods Returned to H.O. at Invoice Price	Goods Sent to Branch A/c Dr. To Branch A/c	Adjusts for goods returned to H.O. at invoice price.
Adjustment for 'Loading' on Goods Returned	Branch Adjustment A/c Dr. To Goods Sent to Branch A/c	Reverses excess price (loading) on returned goods.
Adjustment for 'Loading' on Opening Stock	Stock Reserve A/c Dr. To Branch Adjustment A/c	Removes loading from opening stock to reflect actual cost.
Closing Stock at Invoice Price	Branch Stock A/c Dr. To Branch A/c	Records closing stock at invoice price.
Adjustment for 'Loading' on Closing Stock	Branch Adjustment A/c Dr. To Stock Reserve A/c	Removes loading from closing stock to reflect cost price.

## Adjustments for Stock Discrepancies

Stock Loss (Due to Pilferage, Fire, or Other Reasons)	Dr. Goods Lost A/c (for cost value) Dr. Branch Adjustment A/c (for profit margin included in invoice price) Cr. Branch Stock A/c
Stock Surplus (Excess Stock Found During Physical Verification)	Dr. Branch Stock A/c Cr. Branch Adjustment A/c (for markup amount)
Stock Lost Due to Theft (Misappropriation of Sale Proceeds)	Dr. Loss by Theft A/c (instead of Goods Lost A/c) Dr. Branch Adjustment A/c (for profit margin) Cr. Branch Stock A/c

## Example (Stock Loss of Rs.100 with 25% Profit Margin)

Account	Dr. (Rs.)	Cr. (Rs.)
Goods Lost A/c	80	-



Branch Adjustment A/c	20	-
To Branch Stock A/c	-	100

### Elimination of Unrealized Profit in Closing Stock

To ensure the Branch Stock Account reflects stock at cost price, the profit margin (markup) needs to be removed.

Adjustment	Journal Entry
Removing Profit Element in Closing Stock	Dr. Branch Adjustment A/c Cr. Stock Reserve A/c (for markup amount)
Alternative Method (Direct Adjustment)	Dr. Branch Adjustment A/c Cr. Branch Stock A/c
Impact on Balance Sheet	The credit balance in Stock Reserve A/c is deducted from closing stock value, ensuring stock is shown at cost.

### C. Branch Trading and Profit and Loss Account (Final Accounts Method)

1.	<b>Profit &amp; Loss Calculation</b> The Branch Trading and Profit & Loss Account is prepared to determine branch profit or loss using standard accounting principles.
2.	<b>Basis for Calculation</b> The Trading & P&L Account is based on: ✓ Cost of opening and closing stock ✓ Cost of goods supplied to branch ✓ Goods transferred to and from the branch
3.	<b>Nature of Branch Trading &amp; P&amp;L Account</b> It is a memorandum account; it does not follow the double-entry system but is used for tracking branch profitability.
4.	<b>Adjustments for Invoice Price</b> If figures are at loaded price (invoice price), they must be converted to cost price by removing the loading (markup).
5.	<b>Branch Account Classification</b> Unlike the Branch Trading & P&L Account, the Branch Account is a personal account, tracking amounts owed to or by the branch instead of being a nominal account.

### D. Wholesale Branch Method (Goods Invoiced at Wholesale Price to Retail Branches)

1.	<b>Goods Supplied at Wholesale Price</b> The H.O supplies goods to its retail branches at wholesale price, which includes cost + wholesale profit.
2.	<b>Branch Profit Calculation</b> Profit = Sale Proceeds at Shop - Wholesale Price of Goods Sold.
3.	<b>Manufacturer's Assumption</b> It is assumed that the manufacturer could always sell at wholesale price,



Manufacturer's Profit = Wholesale Price - Cost.

#### 4. Why Use This Method?

Many businesses invoice goods at wholesale price to branches and determine branch profit or loss based on retail sales.

#### Entries in Branch Stock/Trading Account

Debits (Dr.)	Credits (Cr.)
Opening Stock at Wholesale Price	Sales at Shop
Price of Goods Sent to Branch at Wholesale Price	Closing Stock at Wholesale Price
	Goods Lost (Accident, Theft, etc.) at Wholesale Price

#### Result:

After these adjustments, the Branch Stock or Trading Account reveals the gross profit or loss, which is transferred to the Branch Profit & Loss Account.

#### Entries in Branch Profit & Loss Account

Debits (Dr.)	Credits (Cr.)
Shop Expenses	Gross Profit (Transferred from Branch Trading A/c)
Wholesale Price of Goods Lost	

**Result:** The final balance in Branch P&L A/c shows the net profit or loss at the branch.

## 6. Accounting for Independent Branches

### Independent Branch Accounting System

- Independent Branches**  
When a business is large, branches maintain complete records of their transactions and operate independently.
- Accounting System**  
Each independent branch maintains its own books of accounts and prepares a trial balance separately.
- Head Office Control**  
The Head Office (H.O.) maintains one ledger account per branch, recording all transactions between H.O. and the branch.

### Salient Features of Independent Branch Accounting

- Double-Entry System**  
The branch maintains its own books under the double-entry system for accurate financial tracking.
- Head Office & Branch Accounts**
  - ✓ The Branch opens a Head Office Account to record transactions with H.O.
  - ✓ The H.O. maintains a Branch Account to track transactions with the branch.
- Independent Financial Statements**



	The branch prepares its <b>Trial Balance, Trading, and Profit &amp; Loss Account</b> at the end of the period and sends them to the H.O.
4.	<b>Reconciliation Between H.O. &amp; Branch</b> The Head Office reconciles its <b>Branch Account with the Head Office Account</b> in the branch books.
5.	<b>Journal Entries in H.O. Books</b> After receiving the Branch Trial Balance, the <b>H.O. records journal entries to incorporate branch financials</b> into its books.

The Head Office Account in branch books and Branch Account in head office books is maintained respectively.

	Transactions	Head office books		Branch books	
i.	Dispatch of goods to branch by H.O.	Branch A/c To Good sent to Branch A/c	Dr.	Goods received from H.O. A/c To Head Office A/c	Dr.
ii.	When goods are returned by the Branch to H.O.	Goods sent to Branch A/c To Branch A/c	Dr.	Head Office A/c To Goods received from H.O. A/c	Dr.
iii.	Branch Expenses are paid by the Branch	No Entry		Expenses A/c To Bank or Cash A/c	Dr.
iv.	Branch Expenses paid by H.O.	Branch A/c To Bank or cash	Dr.	Expenses A/c To Head Office A/c	Dr.
v.	Outside purchases made by the Branch	No Entry		Purchases A/c To Bank (or) Creditors A/c	Dr.
vi.	Sales effected by the Branch	No Entry		Cash or Debtors A/c To Sales	Dr.
vii.	Collection from Debtors of the Branch recd. by H.O.	Cash or Bank A/c To Branch A/c	Dr.	Head office A/c To Sundry Debtors A/c	Dr.
viii.	Payment by H.O. for purchase made by Branch	Branch A/c To Bank	Dr.	Purchases (or) Sundry Creditors A/c To Head Office	Dr.
ix.	Purchase of Asset by Branch	No Entry		Sundry Assets To Bank (or) Liability	Dr.
x.	Asset purchased by the Branch but Asset A/c retained at H.O. books	Branch Asset A/c To Branch A/c	Dr.	Head office To Bank (or) Liability	Dr.
xi.	Depreciation on (x) above	Branch A/c To Branch Asset	Dr.	Depreciation A/c To Head Office A/c	Dr.



xii.	Remittance of funds by H.O. to Branch	Branch A/c To Bank	Dr.	Bank A/c To Head Office	Dr.
xiii.	Remittance of funds by Branch to H.O.	Reverse entry of (xii) above i.e.		Reverse entry of (xii) above	
xiv.	Transfer of goods from one Branch to another branch	(Recipient) Branch A/c To Supplying Branch A/c	Dr.	<u>Supplying Branch</u> H.O. A/c To Goods sent to H.O. A/c	Dr.
				<u>Recipient Branch</u> Goods Received from H.O. A/c To Head Office A/c	Dr.

### Adjustment and Reconciliation of Branch and Head Office Accounts

1.	<b>Need for Reconciliation</b> If the Branch Account (in H.O. books) and Head Office Account (in Branch books) do not tally, they must be reconciled before finalizing accounts.
2.	<b>Example - Goods in Transit</b> If the H.O. sent goods worth Rs. 50,000 but the branch received only Rs. 40,000, the branch should record Rs. 10,000 as Goods in Transit.
3.	<b>Journal Entry in Branch Books</b> Dr. Goods in Transit A/c - Rs. 10,000 Cr. Head Office A/c - Rs. 10,000
4.	<b>Journal Entry in Head Office Books</b> No entry, as the event has already been recorded in full.

### Reasons for Disagreement Between Branch and Head Office Accounts

1.	<b>Goods Sent by H.O. but Not Received by Branch</b> The goods are in transit or lost; the branch will record them once received.
2.	<b>Goods Returned by Branch but Not Received by H.O.</b> The returned goods might still be in transit or lost; the H.O. records them only upon receipt.
3.	<b>Money Transfer in Transit</b> If funds are sent but not yet received, they remain unrecorded until reflected in the recipient's books.
4.	<b>Income or Expenses Directly Handled by H.O. or Branch</b> If one entity directly handles an income/expense on behalf of the other, it may not be recorded until the adjustment is made.



## Important Points in Branch and Head Office Accounting

### 1. Reconciliation of Branch & Head Office Accounts

1. **Balance Agreement**  
The **Head Office A/c in Branch Books** and **Branch A/c in Head Office Books** should match after adjustments.
2. **Adjustments**  
Adjustments are only made when a transaction is **missing in either books**, not where it has already been recorded.

### 2. Inter-Branch Transactions

- ✓ Inter-branch transactions are routed through the Head Office to ensure smooth consolidation, especially when multiple branches exist.
- ✓ **Example: If Kolkata Branch spends Rs. 1,000 on advertisement for Delhi Branch, the entries will be:**

Books	Journal Entry
Kolkata Branch	Dr. Head Office A/c - Rs. 1,000 Cr. Cash A/c - Rs. 1,000
Delhi Branch	Dr. Advertisement A/c - Rs. 1,000 Cr. Head Office A/c - Rs. 1,000
Head Office	Dr. Delhi Branch A/c - Rs. 1,000 Cr. Kolkata Branch A/c - Rs. 1,000

### 3. Fixed Assets Accounting in Branch Books

- ✓ If the H.O. maintains fixed asset accounts, depreciation is charged by H.O. to the branch at year-end.

Books	Journal Entry
Head Office	Dr. Branch A/c Cr. Branch Fixed Asset A/c
Branch	Dr. Depreciation A/c Cr. Head Office A/c

### 4. Head Office Expenses Charged to Branch

- ✓ H.O. allocates expenses to branches for administrative support.
- ✓ The H.O. debits the Branch A/c and credits the respective expense account.
- ✓ The Branch debits its expense account and credits Head Office A/c.

Books	Journal Entry
Head Office	Dr. Branch A/c Cr. Salaries / General Expenses A/c
Branch	Dr. Expense A/c Cr. Head Office A/c

### 5. Incorporation of Branch Accounts into Head Office Books

The method that will be adopted for incorporating the trading result of the branch with that of the head office would depend on whether it is desired to prepare



- a. Standalone P&L & Balance Sheet for each Branch, or
- b. Consolidated statement of Branch & H.O.

#### Method I: Separate P&L & Balance Sheet for each Branch

- Amount of P&L is shown by Branch & is transfer to H.O. in Branch books & converse entry is passed in H.O. Books as:

Branch A/c Dr.  
To Profit & Loss A/c

- In such a case, not only P&L but also separate Balance Sheet for Branch & H.O. is to be prepared.
- The Branch Balance Sheet would show the amount advanced by H.O. to it as "Capital." In H.O. Books such amount would be shown as "Advance to Branch"

#### Method II: Prepare a consolidated Profit & Loss Account and Balance Sheet

- The individual balances of all revenue accounts (such as sales and income) are transferred to the Head Office Account in the branch books. The opposite entries are made in the Head Office books.
- This process reflects the transfer of the branch's net profit or loss.
- If a consolidated balance sheet for the Head Office and branch is required, the balances of the branch's assets and liabilities need to be transferred to the Head Office books. The adjusting entries that would be passed in this respect in the books of branch are shown below:

Head Office Account                      Dr.  
To Asset (individual) Account  
(Individual) Liability Account              Dr.  
To Head Office Account

Converse entries are passed in the head office books.

- It is obvious that after the above-mentioned entries have been passed, the Branch Account in the Head Office books and Head Office Account in the branch books will be closed, and it will be necessary to restart them at the beginning of next year.
- In consequence, at the beginning of the following year, the under-mentioned entry is recorded by the branch:

Asset Account (In Detail)                      Dr.  
To Liability Accounts (In Detail)  
To H.O. Account (The difference between assets and liabilities)

## 7. Foreign Branches

### Accounting for Foreign Branches

- Foreign branches maintain independent records in local currency, but for consolidation into Indian accounts, their balances must be converted to Indian Rupees.
- This conversion is influenced by exchange rate fluctuations.



### Classification of Foreign Branches (As per AS 11)

1.	<p><b>Integral Foreign Operation (IFO)</b> A foreign branch that is an <b>extension of the reporting enterprise's business</b>. It operates as if it were part of the main entity. Example: A branch that sells imported goods from the Indian enterprise and remits proceeds back.</p>
2.	<p><b>Non-Integral Foreign Operation (NFO)</b> A <b>foreign operation that functions independently</b>, managing its own cash, expenses, income, and financing in local currency. Example: A production unit that operates using local resources, separate from the parent company.</p>

### Indicators of a Non-Integral Foreign Operation (NFO)

Indicator	Description
Control by Reporting Enterprise	Controlled by the reporting enterprise but operates independently without significant reliance on it.
Transactions with Reporting Enterprise	Limited transactions with the reporting enterprise, indicating operational independence.
Financing	Primarily self-financed through its operations or local borrowings, with no dependency on the reporting enterprise for funds.
Sales Currency	Predominantly conducts sales in currencies other than the reporting currency.
Expense Payments	Expenses are mainly paid in the local currency rather than the reporting currency.
Cash Flow Independence	Cash flows of the foreign operation are separate from the reporting enterprise's cash flows.
Pricing and Exchange Rate Impact	Sales prices are unaffected by daily exchange rate fluctuations of the reporting currency.
Active Sales Market	Has an active local market for its products, supporting its independent operation.

**Note:** These indicators help classify a foreign operation as NFO but are not conclusive factors. Each case must be analyzed individually.

### Foreign Currency Translation Techniques

Items	Integral Foreign Operation (IFO)	Non-Integral Foreign Operation (NFO)
Monetary Items (Cash, Debtors, Creditors, Loans, etc.)	Closing rate	Closing rate
Non-Monetary Items (Fixed Assets, Inventory, etc.)	Rate on purchase date	Closing rate



Inventory	Generally, closing rate (or purchase rate if available)	Closing rate
Profit & Loss Items (Revenue & Expenses)	Average rate (or transaction date rate if available)	Average rate (or transaction date rate if available)
Exchange Difference	Charge to P&L Account	Accumulated in Foreign Currency Translation Reserve

### Change in Classification of Foreign Operations

#### 1. Change from Integral to Non-Integral

Exchange gain or loss from the date of reclassification should be transferred to **FCTR a/c**.

#### 2. Change from Non-Integral to Integral

- Exchange gain or loss from the date of reclassification should be transferred to **P&L a/c** and
- Balance in **FCTR A/c** will continue in bs till the date of sale of foreign operation.
- If investment in non-IFO's is sold in part then **FCTR a/c** is also proportionately transferred to **P&L a/c**.



# 11. DEPARTMENTAL ACCOUNTS

## 1. Introduction to Departmental Accounts

### Need for Departmental Accounting in Multi-Activity Organisations

#### Content

1.	<b>Purpose</b> Used by large organizations with <b>diverse products/services</b> .
2.	<b>Goals</b> <ul style="list-style-type: none"> <li>➤ <b>Efficient management</b></li> <li>➤ <b>Effective operations</b></li> <li>➤ <b>Better control</b></li> </ul>
3.	<b>Function</b> Each department works as a <b>separate unit</b> for <b>accounting and performance evaluation</b> .

#### Industry Examples of Departments

Bank	Forex, Underwriting, Credit Cards
Hospital	Rooms, Medical Store, Cafeteria
Hotel	Rooms, Restaurants, Confectionery, Gym & Spa
Departmental Store	Stationery, Electronics, Grocery
Two-Wheelers	Motorcycles, Scooters
Automobile	Hatchback, Sedan, SUV, EVs

### Responsibility Accounting

1.	<b>Definition</b> For better performance and control, responsibility and authority are <b>decentralized to each department</b> .
2.	<b>In-Charge</b> A <b>manager or supervisor</b> is assigned to each department to whom the <b>targets and budgets are provided</b> for carrying out the operations.
3.	<b>Cost Centre</b> Although all departments are " <b>Cost Centres</b> ", all may not be " <b>Revenue Centres</b> ". At the end of certain period, the performance of the Department/Centre is assessed and suitable measures are taken for betterment.

### Department vs. Branch

Point of Difference	Department	Branch
1. Concept	A <b>segment/unit</b> of the business	A <b>geographically separate</b> part of the business
2. Purpose	Better <b>control, operations, and management</b>	Increase <b>market reach</b> and boost sales revenue



3. Location	Located within the same premises	Located in different cities / regions / countries
4. Interrelation	A department cannot have its own branch	A branch may contain several departments

### 2. Concept of Departmental Accounting

Meaning	
1.	Traditional accounting shows overall profit/loss of the entity.
2.	It does not show performance of each department.
3.	For managerial control and decision-making, individual department results are needed.
4.	Departmental Accounting is the branch of accounting that focuses on financial performance of each department.
5.	It is used in large organisations with multiple departments.

Features of Departmental Accounting	
1.	Transactions are recorded department-wise in the books of accounts.
2.	Expenses and incomes are recognised separately for each department.
3.	It is an application of Responsibility Accounting.
4.	Each department acts as a Responsibility Centre.
5.	Both internal and external transactions are recorded.
6.	Provides useful information to internal stakeholders (like management).
7.	Involves preparation of Departmental Trading & Profit and Loss Account.

Objectives of Departmental Accounting	
1.	To get an analytical view of the affairs of each department.
2.	To find out the true operating result (profit/loss) and efficiency of each department.
3.	To compare financial performance between different departments.
4.	To provide data for managerial decisions and policy formulation.

### 3. Methods of Maintaining Departmental Accounts

Content	
Two methods are used to record department-wise expenses and incomes	
1.	<b>Maintenance of Same Set of Books (Also called Columnar / Tabular Method)</b> <ul style="list-style-type: none"> <li>➤ A single set of books is maintained for all departments.</li> <li>➤ Records are kept in a tabular or columnar format.</li> <li>➤ Accounts are maintained by a centralized accounting department.</li> <li>➤ It is less expensive and widely used.</li> </ul>
2.	<b>Maintenance of Separate Set of Books (Also called Unitary Method)</b> <ul style="list-style-type: none"> <li>➤ Each department maintains separate books of accounts.</li> <li>➤ Figures for expenses and incomes are recorded independently.</li> </ul>



- Suitable for large organisations.
- This method is costly but gives better control and independence.

#### 4. Components of Departmental Final Accounts

Content	
1.	<p><b>Departmental Trading Account</b></p> <ul style="list-style-type: none"> <li>➤ Prepared in columnar format (each column = one department).</li> <li>➤ Shows Gross Profit / Gross Loss of each department.</li> <li>➤ Direct expenses are debited.</li> <li>➤ Direct incomes are credited.</li> </ul>
2.	<p><b>Departmental Profit &amp; Loss Account</b></p> <ul style="list-style-type: none"> <li>➤ Columnar format (one column per department).</li> <li>➤ Shows Net Profit / Net Loss of each department.</li> <li>➤ Indirect expenses are debited (allocated between departments).</li> <li>➤ Indirect incomes are credited (allocated), after including Gross Profit / Loss.</li> </ul>
3.	<p><b>General Profit &amp; Loss Account</b></p> <ul style="list-style-type: none"> <li>➤ Shows Overall Net Profit / Net Loss of the entity.</li> <li>➤ Used for common indirect incomes/expenses that cannot be allocated to departments.</li> <li>➤ Prepared in normal format (no departmental columns).</li> <li>➤ Includes Departmental Net Profit / Net Loss.</li> </ul>

#### Format: Departmental Trading & Profit & Loss Account (Columnar Format)

Particulars	Dept. I	Dept. II	Particulars	Dept. I	Dept. II
To Opening Stock	xx	xx	By Sales	xx	xx
To Purchases	xx	xx	By Transfers	xx	xx
To Wages	xx	xx	By Closing Stock	xx	xx
To Other Direct Expenses	xx	xx			
To Transfer	xx	xx			
To Gross Profit c/d	xxx	xxx			
	xxx	xxx		xxx	xxx
To Rent, Salaries, Depreciation, Other Indirect Expenses	xx	xx	By Gross Profit b/d	xx	xx
To General P&L A/c (Dept. Net Profit transferred)	xxx	xxx	By Indirect Income	xx	xx
	xxx	xxx		xxx	xxx

#### General Profit & Loss Account for the year ended

Particulars	₹	Particulars	₹
To General Expenses	xx	By Departmental P&L A/c (Net Profit)	xx



To Stock Reserve (Provision on stock)	xx		
To Capital A/c (Net Profit Transferred)	xx		
Total	xxx	Total	xxx

### 5. Steps for Preparation

#### Step 1: Departmental Gross Profit/Loss

Item	Treatment
Direct Allocable Direct Expenses	Debit to Dept. Trading A/c
Direct Expenses that cannot be directly allocated	Apportioned on suitable basis & Debited to Dept. Trading A/c
Direct Allocable Direct Incomes	Credited to Dept. Trading A/c
Inter-departmental Transfers	Dr. Receiving Dept, Cr. Sending Dept

After determining Departmental Gross Profit/Loss, it is transferred to Departmental Profit & Loss A/c.

#### Step 2: Departmental Net Profit/Loss

Item	Treatment
Direct Allocable Indirect Expenses	Debit to Dept. P&L A/c
Indirect Expenses that cannot be directly allocated	Apportioned & Debited to Dept. P&L A/c
Directly Allocable Indirect Incomes	Credited to Dept. P&L A/c
Indirect Incomes that cannot be directly allocated	Apportioned & Credited to Dept. P&L A/c

After determining Departmental Net Profit/Loss, it is transferred to General Profit & Loss A/c.

#### Step 3: General Profit/Loss

Item	Treatment
Indirect Expenses that could not be allocated to departments	Debit to General P&L A/c
Indirect Incomes that could not be allocated to departments	Credit to General P&L A/c
Provision for Unrealised Profit (if any)	<ul style="list-style-type: none"> <li>➤ Unrealised Profit on Closing Stock → Debit</li> <li>➤ Unrealised Profit on Opening Stock → Credit</li> </ul>

By, Balancing General Profit & Loss A/c, Consolidated or Overall Net Profit / Loss is ascertained.

### 6. Treatment of Specific Transactions in Departmental Accounting

Items of Income			
Type	Treatment	Example	Basis of Apportionment
1. <b>Directly Allocable Income</b>	Credited to the specific department	Sales of Dept A, Service income from Dept B	Direct Allocation



2. Common Income (among departments)	Apportioned over all concerned departments	Discount Received, Sales Commission	Discount Received: Net Purchases = Purchases - Returns Outward Sales Commission: Net Sales = Sales - Returns Inward
3. Other Indirect Incomes which are of financial in nature	Credited to General P&L A/c (Not departmental)	Dividend Received, Interest on Deposits, Profit on sale of assets	Not Apportioned

Items of Expenses			
Type	Treatment	Example	Basis of Apportionment
1. Directly Allocable Expenses	Debited to the specific department	Dept A Wages, Dept B Raw Materials	Direct Allocation
2. Common Expenses (among departments)	Apportioned over all concerned departments	Rent, Power, Carriage Inwards	See basis below
3. Other indirect expenses which are of general nature as well as expenses which are of financial in nature	Debited to General P&L A/c (Not departmental)	General charges, Sundry charges, MD's Remuneration, Miscellaneous expenses, Bank Charges, Interest on loan/debentures	Not Apportioned

Common Expense - Basis of Apportionment	
Expense Item	Basis
Commission to Purchase Manager, Carriage Inwards	Purchases
Selling Expenses, Salesman Commission, Bad Debts, Discount Allowed	Sales
Depreciation, Insurance, R&M	Value of Fixed Assets
Rent, Rates, Insurance (building), Heating	Floor Area Occupied
Power	HP × Hours Worked

Inter-Departmental Transfer
Concept
Goods/services transferred from one department to another:
➤ Transferor Department: Treats as Sales



➤ Transferee Department: Treats as Purchases

Valuation Methods of Inter-Departmental Transfers				
Method	Transfer Value	Used By	Treatment of Unrealised Profit in Closing Stock	Purpose
At Cost	Cost to Transferor Department	Any department	✗ Not required	No internal profit booking; purely cost pass-through
At Cost plus Profit	Cost + Pre-determined Margin	Intermediate Goods/Service Departments	☑ Required	Reflects internal performance and ensures profit recognition
At Normal Selling Price	Prevailing Market Price	Marketable Goods/Service Departments	☑ Required	Reflects external market comparability; profit booking is maxed

Provision for Unrealised Profit	
1.	<b>Concept</b> Profit included in goods transferred between departments (at cost + profit/selling price), but not yet sold externally by transferee dept.
2.	<b>Reason for Adjustment</b> To comply with the prudence concept - profits not yet realized from external parties should not be recognized at the entity level.
3.	<b>Impact</b> Overstates entity's profit if not adjusted.
4.	<b>Where applicable?</b> On closing stock of Transferee Dept, if it includes inter-departmental transfers at price > cost. Applies to all predecessor departments, not just immediate one.

Steps to Calculate Provision for Unrealised Profit	
Step	Description
Step 1	Identify value of transferred stock included in closing inventory of Transferee Dept.
Step 2	Ascertain Gross Profit Rate (GP%) of Transferor Department.
Step 3	Apply the GP rate: Provision = Value of Transferred Stock × GP% (of Transferor Dept.)

Accounting of Transfer-Entries	
1.	On Transfer of Goods/Services: Transferee Department A/c Dr.



	<p>To Transferor Department A/c</p> <p>Explanation: This entry records the transfer of goods or services from the transferor department to the transferee department.</p>
2.	<p>Creation of Provision for Unrealized Profit on Closing Stock:</p> <p>General Profit &amp; Loss A/c Dr.</p> <p>To Provision for Unrealised Profit A/c</p> <p>Explanation: This entry is made to create a provision for any unrealized profit on the closing stock, reflecting the internal transfer.</p>
3.	<p>On Opening Stock (in the subsequent period):</p> <p>Provision for Unrealised Profit A/c Dr.</p> <p>To General Profit &amp; Loss A/c</p> <p>Explanation: In the subsequent period, the provision for unrealized profit on the opening stock is reversed and adjusted in the general profit and loss account.</p>



## 12. INSURANCE CLAIM FOR LOSS OF STOCK AND LOSS OF PROFIT

### 1. Insurance Claim for Loss of Stock

Accidental Loss & Insurance Coverage	
1.	<p><b>Accidental Loss</b></p> <ul style="list-style-type: none"> <li>➤ Accidents may occur during operations at business premises (e.g., factory, godown, shop).</li> <li>➤ Such accidents can damage assets, mainly:           <ul style="list-style-type: none"> <li>• Fixed Assets: buildings, machineries, furniture, etc.</li> <li>• Stock: raw materials, WIP, finished goods, etc.</li> </ul> </li> </ul>
2.	<p><b>Need for Funds</b></p> <p>To replenish the damaged/mutilated assets, immediate funds are required.</p>
3.	<p><b>Insurance Coverage</b></p> <ul style="list-style-type: none"> <li>➤ To cover such risks, the business takes an insurance policy.</li> <li>➤ Insurance premium is paid yearly, quarterly, or as per agreement.</li> </ul>
4.	<p><b>Loss Assessment</b></p> <ul style="list-style-type: none"> <li>➤ On occurrence of loss, the business must:           <ul style="list-style-type: none"> <li>• Compute the amount of loss, and</li> <li>• File a claim with the insurance company.</li> </ul> </li> <li>➤ The insurer appoints a loss assessor to:           <ul style="list-style-type: none"> <li>• Verify the cause and</li> <li>• Assess the extent of loss.</li> </ul> </li> <li>➤ Based on the assessor's report, the insurance claim is settled—either fully or partly.</li> </ul>

Loss of Stock	
1.	<p><b>Common Accident</b></p> <p>Among accidental losses, loss by fire is the most common.</p>
2.	<p><b>Covered by Policy</b></p> <p>Businesses usually take a fire insurance policy to cover:</p> <ul style="list-style-type: none"> <li>(i) Loss of Stock</li> <li>(ii) Loss of Profits</li> </ul>
3.	<p><b>Significance</b></p> <ul style="list-style-type: none"> <li>➤ Stock forms a major part of working capital, especially in trading concerns.</li> <li>➤ Any loss of stock can adversely affect the solvency of the business.</li> <li>➤ Hence, it is essential to adequately insure stock against such risks.</li> </ul>



## Steps in Determination of Insurance Claim

Step 1

Value of Stock on the date of fire

- If **stock records** and **physical stock** are **destroyed**, it becomes difficult to determine the stock lost.
- Since the accident occurs suddenly, the up-to-date stock value is often **not available**.
- In such cases, the stock value is **estimated** using available data by preparing a Memorandum Trading Account.
- A Memorandum Trading Account is:
  - A statement, **not a ledger** account
  - Prepared in the **format of a Trading Account**
- It is prepared for the period:
  - **From the beginning of the accounting year**
  - **To the date of accident**

Memorandum Trading A/c for the period April 1 of year of accident - Date of accident

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Opening Stock	***	By Sales	***
To Purchases	***	By Closing Stock (Balancing Figure)	***
To Gross Profit ( <i>Sales × GP Rate</i> )	***		

Note"

- The **GP Rate** may be:
  - Known to the entity, or
  - Estimated based on previous year's data
- Usually, the **Trading Account** of the preceding accounting year is prepared to ascertain the **GP Rate**.
- **Adjustments** may be required in past/current data for:
  - **Slow-moving or obsolete items**
  - **Abnormal/defective goods**
  - **Free samples distributed**
  - **Goods withdrawn by proprietor**
  - **Over/under valuation of stock**
  - **Omissions in stock recording**

Step 2

Salvaged Stock

Salvaged Stock refers to the **portion of stock saved from the accident**.

Step 3

Value of Stock Lost

= **Value of Stock on the date of fire - Salvaged Stock**

Step 4

Calculation of Insurance Claim

- To determine amount of insurance claim we need to see whether insurance is Full or over insurance or under insurance.



- Policy Value  $\geq$  Value of Stock (Full/over Insurance): Full claim allowed. Average Clause not applicable.  
Insurance claim = total value of stock lost
- Policy Value  $<$  Value of Stock (Under Insurance): Average Clause applies.  
Insurance Claim = Value of stock Lost  $\times$  Policy Value / Value of Stock on accident date

### Special Situations in Stock Valuation & Insurance Claims

	Situation
1.	<p><b>Goods-in-Transit / Sent to Branch or Consignee</b></p> <ul style="list-style-type: none"> <li>➤ Cost of such goods is <b>not part of current stock</b>.</li> <li>➤ It should be: <ul style="list-style-type: none"> <li>• <b>Deducted</b> from Purchases,</li> <li>or</li> <li>• <b>Credited</b> separately in Trading A/c or Memorandum Trading A/c.</li> </ul> </li> </ul>
2.	<p><b>Goods Sold but Not Yet Delivered</b></p> <ul style="list-style-type: none"> <li>➤ These goods are <b>not yet out of stock</b>.</li> <li>➤ Hence, their sale value must be <b>deducted from Sales</b> in Trading A/c or Memorandum Trading A/c.</li> </ul>
3.	<p><b>Goods Sent on Approval Basis</b></p> <ul style="list-style-type: none"> <li>➤ These goods are <b>not yet confirmed as sales</b>.</li> <li>➤ Adjustments required: <ul style="list-style-type: none"> <li>• <b>Cost to be deducted</b> from Purchases</li> <li>• <b>Sale Value to be deducted</b> from Sales</li> </ul> </li> </ul>
4.	<p><b>Change in Price Level</b></p> <p>If <b>Prices have changed</b> during the period:</p> <ul style="list-style-type: none"> <li>➤ Adjustments are needed to <b>nullify the effect</b>.</li> <li>➤ Use <b>consistent stock pricing method</b> (e.g., FIFO, LIFO) for proper GP rate application.</li> </ul>
5.	<p><b>Under-Valued / Over-Valued Stock</b></p> <ul style="list-style-type: none"> <li>➤ <b>Incorrect stock</b> valuation affects GP rate. <ul style="list-style-type: none"> <li>• <b>If under-valued:</b> Add the under-valued amount back to stock to get actual cost.</li> <li>• <b>If over-valued:</b> Deduct the excess amount to arrive at cost.</li> </ul> </li> <li>➤ While computing Gross Claim, consider <b>only the unsold portion of such stock</b>.</li> </ul>
6.	<p><b>Abnormal/ Defective/ Usual Selling line Items</b></p> <ul style="list-style-type: none"> <li>➤ Items that <b>do not fetch</b> the usual Gross Profit rate are considered <b>abnormal or defective items</b>.</li> <li>➤ Treatment in Memorandum Trading Account: <ol style="list-style-type: none"> <li>a. <b>Opening Stock:</b> <ul style="list-style-type: none"> <li>• Deduct unwritten-off value of such items from Opening Stock.</li> </ul> </li> </ol> </li> </ul>



b. **Purchases:**

- Deduct the cost of such items (if purchased during the current period) from Purchases.

c. **Sales:**

- Deduct the actual selling price of such abnormal items (if sold) from Sales.

d. **Closing Stock (on date of fire):**

- If any such items remain unsold, their agreed value is added to the estimated value of normal stock.

**Additional Note:**

- Similar adjustments may be made in the Trading Account of the previous year, if such items existed.
- Alternatively, a **Columnar Trading Account** may be prepared:
  - **One column for normal items**
  - **Another column for abnormal/defective items**

## 2. Insurance Claim for Loss of Profit

Loss of Profit / Consequential Loss Policy	
1.	<p><b>Purpose</b></p> <ul style="list-style-type: none"> <li>➤ When fire occurs, there is:           <ul style="list-style-type: none"> <li>• <b>Direct loss of stock</b> or other assets, and</li> <li>• <b>Consequential loss</b> due to business disruption.</li> </ul> </li> <li>➤ After the fire, the business may:           <ul style="list-style-type: none"> <li>• Be <b>disorganized</b> or</li> <li>• Temporarily shut down operations.</li> </ul> </li> <li>➤ During this period, standing expenses continue, such as:           <ul style="list-style-type: none"> <li>• Rent</li> <li>• Salaries</li> <li>• Other fixed overheads</li> </ul> </li> <li>➤ The business also suffers <b>loss of profit</b> it would have earned in the normal course. Such losses can be covered through a: "<b>Loss of Profit</b>" or "<b>Consequential Loss</b>" Policy</li> <li>➤ This is a <b>separate insurance policy</b> taken in addition to fire insurance.</li> <li>➤ Claim under this policy is admitted only if the fire insurance claim is also accepted.</li> </ul>
2.	<p><b>Coverage</b></p> <p>The Loss of Profit Policy normally covers the following items:</p> <ol style="list-style-type: none"> <li><b>Loss of net profit</b></li> <li><b>Standing charges</b></li> <li><b>Any increased cost of working</b></li> </ol>



Key Terms	
1.	<p><b>Indemnity Period</b> The period beginning with the occurrence of the damage and ending not later than twelve months. Thus, it is a period during which business is disturbed due to fire and it is not greater than 12 months.</p>
2.	<p><b>Standard Turnover</b> The turnover of the period in corresponding previous year from the year in which damage occurred, that corresponds with the Indemnity Period after adjustment of trend in turnover.</p>
3.	<p><b>Annual Turnover</b> The turnover during the twelve months immediately preceding to the date of damage.</p>
4.	<p><b>Adjusted Annual Turnover</b> Annual Turnover adjusted with (+/-) Trend</p>
5.	<p><b>Standing Charges</b></p> <ul style="list-style-type: none"> <li>➤ Unavoidable fixed expenses which have to be paid even if there is reduction in sale.</li> <li>➤ Interest on Debentures, Mortgage Loans and Bank Overdrafts, Rent, Rates and Taxes (other than taxes which form part of net profit) Salaries of Permanent Staff and Wages to Skilled Employees, Boarding and Lodging of resident Directors and/or Manager, Directors' Fees, Unspecified Standing Charges.</li> </ul>
6.	<p><b>Trend</b> It is an indication of Sales pattern of an organization over a specific time period. It will help in estimation of future expected sales.</p>

Steps to Calculate Net Claim													
Step	Calculation												
Step 1	<p><b>Determine Gross Profit Rate</b>  <math>GP\ Rate = GP / Sales \times 100</math>            If Net Profit exists:  <math>GP = Net\ Profit + Insured\ Standing\ Charges</math>            If Net Loss exists:  <math>GP = Insured\ Standing\ Charges - (Net\ Loss \times Insured\ Standing\ Charges / All\ Standing\ Charges)</math></p>												
Step 2	<p><b>Calculation of Short Sales</b></p> <table border="1"> <thead> <tr> <th>Particulars</th> <th>Amount</th> </tr> </thead> <tbody> <tr> <td>Standard turnover</td> <td>XXXX</td> </tr> <tr> <td>+/-Increase/decrease in trend</td> <td>XXXX</td> </tr> <tr> <td>Adjusted standard turnover</td> <td>XXXX</td> </tr> <tr> <td>- Actual turnover</td> <td>XXXX</td> </tr> <tr> <td>Short Sales</td> <td>XXXX</td> </tr> </tbody> </table>	Particulars	Amount	Standard turnover	XXXX	+/-Increase/decrease in trend	XXXX	Adjusted standard turnover	XXXX	- Actual turnover	XXXX	Short Sales	XXXX
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Step 3	<p>Calculation of GP on Short Sales</p> <p><math>GP \text{ on Short Sales} = \text{Short Sales} \times GP \text{ Rate}</math></p>										
Step 4	<p>Calculation of Claim for additional working expenses</p> <p>Least of the following:</p> <ol style="list-style-type: none"> <li>Actual additional expenses</li> <li>Additional Sales <math>\times</math> GP rate</li> <li><math>\text{Actual expenses} \times (\text{Net Profit} + \text{Insured Standing Charges}) / (\text{Net Profit} + \text{All Standing Charges})</math></li> </ol>										
Step 5	<p>Calculation of G.P on Adjusted Annual Turnover (G.P on AAT)</p> <table border="1"> <thead> <tr> <th>Particulars</th> <th>Amount</th> </tr> </thead> <tbody> <tr> <td>Annual turnover</td> <td>XXXX</td> </tr> <tr> <td>+/- Increase/decrease in trend</td> <td>XXXX</td> </tr> <tr> <td>Adjusted annual turnover</td> <td>XXXX</td> </tr> <tr> <td>G.P ON AAT=</td> <td>AAT <math>\times</math> G.P %</td> </tr> </tbody> </table>	Particulars	Amount	Annual turnover	XXXX	+/- Increase/decrease in trend	XXXX	Adjusted annual turnover	XXXX	G.P ON AAT=	AAT $\times$ G.P %
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Step 6	<p>Calculation of Gross Claim</p> <table border="1"> <thead> <tr> <th>Particulars</th> <th>Amount</th> </tr> </thead> <tbody> <tr> <td>G.P on short sales as per step 3</td> <td>XXXX</td> </tr> <tr> <td>+ Claim on increased cost of working</td> <td>XXXX</td> </tr> <tr> <td>- Savings in Insured standing charges</td> <td>(XXXX)</td> </tr> <tr> <td>Gross claim</td> <td>XXXX</td> </tr> </tbody> </table>	Particulars	Amount	G.P on short sales as per step 3	XXXX	+ Claim on increased cost of working	XXXX	- Savings in Insured standing charges	(XXXX)	Gross claim	XXXX
Particulars	Amount										
G.P on short sales as per step 3	XXXX										
+ Claim on increased cost of working	XXXX										
- Savings in Insured standing charges	(XXXX)										
Gross claim	XXXX										
Step 7	<p>Calculation of Net Claim</p> <ul style="list-style-type: none"> <li>✓ If Average Clause applies (Insurable Value <math>&gt;</math> Policy Value):  <math>\text{Net Claim} = (\text{Policy Value} / \text{Insurable Value}) \times \text{Gross Claim}</math></li> <li>✓ If Average Clause does not apply:  <math>\text{Net Claim} = \text{Gross Claim}</math></li> </ul>										

#### Important Notes

- If additional Sales due to additional expenses is not given, assume that entire sale has been attained due to additional expenses.
- All standing charges = insured standing charges + uninsured standing charges.
- In absence of specific information assume that all standing charges are insured.
- If sales for past years is given we need to determine the trend of sales.



# 13. HIRE PURCHASE AND INSTALLMENT SALE TRANSACTIONS

## 1. Hire Purchase

	Meaning
1.	<b>Agreement</b> between Hire Vendor and Hire Purchaser.
2.	<b>Possession</b> is given to the purchaser at the start.
3.	<b>Ownership</b> remains with the vendor until full instalment payment.
4.	Payment is made in <b>instalments over time</b> .
5.	If any instalment is <b>unpaid</b> (even the last), vendor can <b>repossess goods</b> .
6.	Amounts already paid are treated as <b>hire charges</b> - no refund on repossession.

	Special Features of Hire Purchase agreement
1.	<b>Possession:</b> Transferred to hire purchaser <b>at the time of agreement</b> .
2.	<b>Instalments:</b> Payment made in <b>periodic instalments</b> .
3.	<b>Down Payment:</b> Initial amount paid at the <b>time of agreement</b> .
4.	<b>Instalment Components:</b> Each instalment includes <b>interest and principal</b> .
5.	<b>Ownership:</b> Passes <b>only after payment of final instalment</b> and exercising purchase option.
6.	<b>Repossession Right:</b> On <b>default</b> (even last instalment), vendor can <b>repossess goods without refund</b> .

	Key terms
1.	Hire Vendor: The <b>seller who delivers goods and possession</b> under the agreement.
2.	Hire Purchaser: The <b>buyer who receives goods and uses them</b> while paying in instalments.
3.	Cash Price: Price payable for <b>immediate outright purchase in cash</b> .
4.	Down Payment: <b>Initial amount</b> paid by the purchaser <b>at the time of agreement</b> .
5.	Hire Purchase Instalment: Periodic payment including <b>principal + interest on unpaid balance</b> .
6.	Hire Purchase Price: <b>Total amount payable</b> (i.e., Cash Price + Interest) to gain ownership.



## 2. Hire Purchase vs Installment Sale

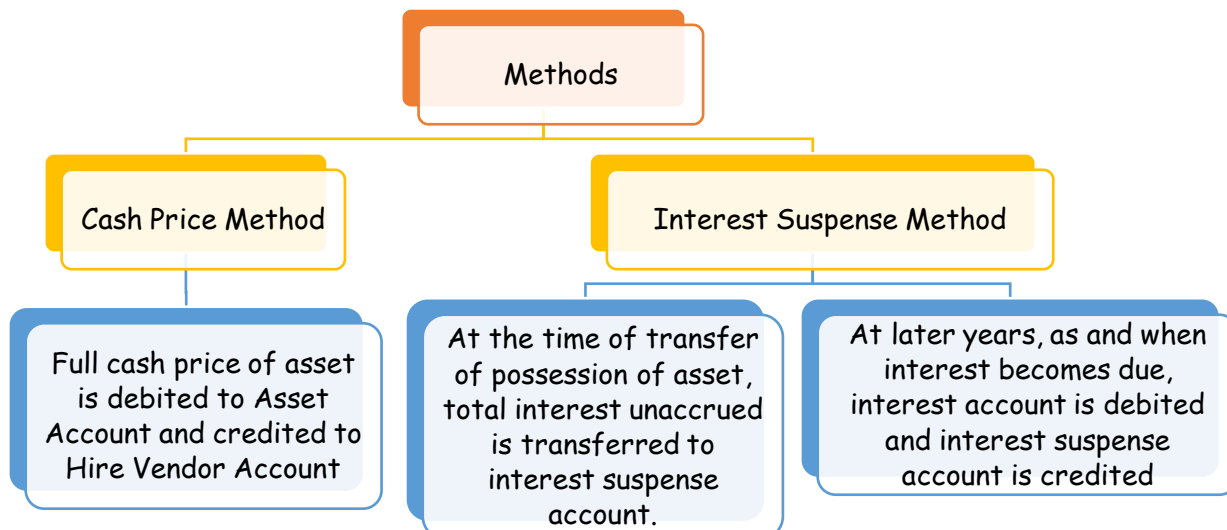
Particulars	Hire Purchase	Installment Sale
1. Ownership	Ownership transfers only <b>after the last installment is paid.</b>	Ownership passes <b>immediately</b> at the time of sale.
2. Default in Payment	Seller can <b>repossess the goods</b> ; paid installments are treated as hire charges.	Seller <b>cannot repossess</b> ; can only sue for non-payment of price.
3. Right of Sale / Transfer	Hirer <b>cannot sell or transfer</b> ; legal status is that of a bailee.	Buyer has <b>full right to sell or transfer</b> the goods.
4. Loss or Damage to Goods	<b>Seller bears loss</b> if the hirer has taken reasonable care.	<b>Buyer bears the loss</b> once goods are sold.

## 3. Different Situations - Calculation of Interest & Cash Price

Situation	Given	Missing	Approach / Method
Situation - I	Rate of Interest, Total Cash Price, Installments	<b>Nothing</b>	Use the <b>interest rate</b> to compute <b>interest component in each installment</b> . Subtract from installment to find principal.
Situation - II	Rate of Interest, Installments	<b>Cash Price</b>	Use <b>reverse calculation</b> by subtracting interest from installments over time. Apply the interest rate on outstanding balance to compute interest portion.
Situation - III	Installments only	<b>Cash Price, Rate of Interest</b>	Treat this as a simple allocation problem: <b>divide installments equally assuming no interest</b> (implied 0% rate). Used when no data on interest is given.
Situation - IV	Rate of Interest, Installments, Reference to Annuity Table	<b>Cash Price</b>	Use <b>annuity table</b> to find the <b>Present Value of installments</b> at the given interest rate and duration. This Present Value = Total Cash Price. Then solve as in Situation I.



#### 4. Accounting Treatment in the Books of the Hire-Purchaser



Cash Price Method	Interest Suspense Method
<b>1. On Purchase of Asset</b>	<b>1. On Purchase of Asset</b>
Hire Purchase Asset A/c Dr. To Hire Vendor A/c (for Cash Price)	Hire Purchase Asset A/c Dr. (cash price) Interest Suspense A/c Dr. (Total Interest) To Hire Vendor A/c (for HP Price incl. interest)
<b>2. On Down Payment</b>	<b>2. On Down Payment</b>
Hire Vendor A/c Dr. To Bank A/c	Hire Vendor A/c Dr. To Bank A/c
<b>3. On Interest Due (each year)</b>	<b>3. On Interest Due (each year)</b>
Interest A/c Dr. To Hire Vendor A/c	Interest A/c Dr. To Interest Suspense A/c
<b>4. On Installment Paid</b>	<b>4. On Installment Paid</b>
Hire Vendor A/c Dr. To Bank A/c	Hire Vendor A/c Dr. To Bank A/c
<b>5. Year-End Transfers to P&amp;L</b>	<b>5. Year-End Transfers to P&amp;L</b>
P&L A/c Dr. To Interest A/c To Depreciation A/c	P&L A/c Dr. To Interest A/c To Depreciation A/c



## 5. Accounting Treatment in the Books of the Hire-Vendor

### Methods of recording hire purchase transactions

**Sales Method**  
(hire purchase sale is treated as a credit sale).

**Interest Suspense Method** (hire purchaser is debited with full cash price and interest included in the selling price)

#### Sales Method

Transaction	Entry
1. When goods are sold and delivered under hire purchase	Hire Purchaser A/c Dr. [Full cash price] To Hire Purchase Sales A/c
2. When the down payment is received	Bank A/c Dr. [Down payment] To Hire Purchaser A/c
3. When an instalment becomes due	Hire Purchaser A/c Dr. [Amount of instalment] To Interest A/c
4. When the amount of instalment is received	Bank A/c Dr. [Amount of instalment] To Hire Purchaser A/c
5. For closing interest Account	Interest A/c Dr. To Profit & Loss A/c
6. For closing Hire Purchase Sales Account	Hire Purchase Sales A/c Dr To Trading Account

#### Interest Suspense Method

Transaction	Entry
1. When goods are sold and delivered under hire purchase	Hire Purchaser A/c Dr. [Full cash price + Total Interest] To Hire Purchase Sales A/c [Full cash Price] To Interest Suspense A/c [Total Interest]
2. When the down payment is received	Bank A/c Dr. [Down payment] To Hire Purchaser A/c
3. For Interest of the relevant accounting Period	Interest Suspense A/c Dr To Interest A/c
4. For closing interest Account	Interest A/c Dr. To Profit & Loss A/c
5. For closing Hire Purchase Sales Account	Hire Purchase Sales A/c Dr To Trading Account



## Disclosure in Balance Sheet

Balance Sheet of Hire Purchaser				Balance Sheet of Hire Vendor			
Liabilities	(Rs.)	Assets	(Rs.)	Liabilities	(Rs.)	Assets	(Rs.)
Balance in Hire Vendor's Account (outstanding Balance)	xxxx	Fixed Assets:				Current Assets:	
		Asset (at full cash price)	xxx			Hire Purchase Debtors	xxx
		Less: Depreciation till date	xxx				
			xxx				xxx

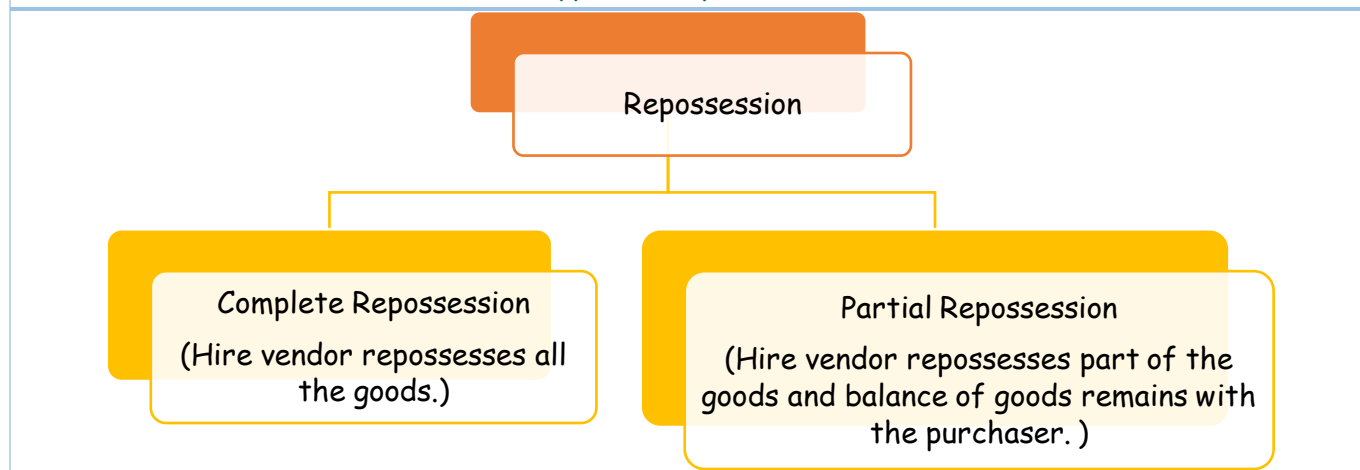
## 6. Default &amp; Repossession

## Repossession

## Meaning

- In a hire purchase agreement, the hire purchaser has to pay up to the last instalment to obtain the ownership of goods.
- If the hire purchaser fails to pay any one or more of the instalments, the hire vendor has the right to take the asset back in its actual form without any refund of the earlier payments to the hire purchaser.
- This act of recovery of possession of the asset is termed as repossession.

## Types of Repossession



## Complete or Full Repossession

## Journal Entries

Books of Hire Purchaser	Books of Hire Vendor
1. Closing Hire Vendor's A/c	1. On Repossession of goods



<p>Hire Vendor A/c Dr.     To Asset A/c</p> <p>Note: This entry is passed with the amount due to the hire-vendor.</p>	<p>Goods Repossessed A/c Dr. P/L A/c Dr.     To Hire Purchaser's A/c</p> <p>Note: This entry is passed with the revalued amount of goods repossessed.</p>
<p>2. Closing Asset A/c</p> <p>i. If Book Value &gt; Amount Due to Hire Vendor     Profit &amp; Loss A/c Dr.         To Asset A/c</p> <p>ii. If Amount Due &gt; Book Value     Asset A/c Dr.         To Profit &amp; Loss A/c</p>	<p>3. For amount spent on reconditioning of     Goods Repossessed     Goods Repossessed A/c Dr.         To Cash A/c/Bank A/c</p> <p>4. For sale of Goods Repossessed     Cash A/c/Bank A/c /Debtors A/c Dr.         To Goods Repossessed A/c</p> <p>5. For loss on sale of Goods Repossessed     Profit &amp; Loss A/c Dr.         To Goods Repossessed A/c</p> <p>Note: In case of profit, a reverse entry will be passed</p>

### Partial Repossession

#### Journal Entries

Books of Hire Purchaser	Books of Hire Vendor
<p>1. For transfer of the agreed value of Goods Repossessed     Hire Vendor's A/c Dr.         To Asset A/c</p>	<p>1. On Repossession of Goods at agreed value H.P. Goods Repossessed A/c Dr.         To Hire Purchaser's A/c</p>
<p>2. For Transfer of Loss on default     Profit &amp; Loss A/c Dr.         To Asset A/c</p> <p>Note: In case of profit on default, the reverse entry will be passed</p>	<p>2,3,4—Same entries as in case of complete repossession</p>

### Practical Steps under Partial Repossession

Step1: Calculate Book value of Goods Repossessed

A. Cost	xxxx
B. Less: Depreciation upto date of repossession	(xxxx)
C. Book value of Goods Repossessed	xxxx

Step 2: Calculate Agreed Value of Goods Repossessed

Step 3: Loss on default = Book Value - Agreed Value



# 14. INTRODUCTION TO ACCOUNTING STANDARDS

## 1. Overview of Accounting Framework

1.	<p><b>Introduction</b></p> <p>Accountancy is the art of <b>recording, classifying, and summarizing</b> financial information using creative skills. However, complete freedom can lead to non-uniformity and manipulation. Hence, there's a need for a <b>standard accounting framework</b>.</p>
2.	<p><b>Need for GAAP</b></p> <p>To ensure that financial transactions are recorded <b>uniformly</b> and financial statements are <b>comparable</b>, the concept of <b>Generally Accepted Accounting Principles (GAAP)</b> emerged.</p>

## 2. Generally Accepted Accounting Principles (GAAP)

1.	<p><b>Definition</b></p> <p>GAAP is a collection of <b>commonly followed accounting rules and standards</b> used for recording and reporting transactions.</p>
2.	<p><b>Purpose</b></p> <p>Provides <b>financial information</b> to stakeholders for <b>decision-making</b> via financial statements.</p>
3.	<p><b>Components</b></p> <p>Includes <b>accounting standards, principles, and procedures</b>.</p>
4.	<p><b>Nature</b></p> <p>It is a framework for more detailed <b>rules and industry-specific practices</b>.</p>

## 3. Accounting Standards (AS)

1.	<p><b>Definition</b></p> <p><b>Written policy documents</b> covering <b>recognition, measurement, treatment, presentation, and disclosure</b> of transactions.</p>
2.	<p><b>Issuing Authority</b></p> <p>Issued by <b>professional accounting bodies, government, or regulators</b>.</p>
3.	<p><b>Purpose</b></p> <p>Standardise <b>treatment of business transactions</b> and ensure proper <b>disclosure</b> in financial statements.</p>
4.	<p><b>India-specific</b></p> <ul style="list-style-type: none"> <li>➤ <b>For non-corporate entities:</b> Standards issued by <b>ASB of ICAI</b></li> <li>➤ <b>For corporate entities:</b> Standards notified by <b>MCA</b> through <b>Companies (Accounting Standards) Rules</b></li> </ul>



#### 4. Convergence to Indian Accounting Standards (Ind AS)

1.	<p><b>Convergence</b> The process of <b>harmonising accounting standards</b> globally to create a single set of high-quality standards.</p>
2.	<p><b>IFRS</b> Set of global standards developed by <b>IASB</b>.</p>
3.	<p><b>Objective</b> Create common high-quality standards to ensure:</p> <ul style="list-style-type: none"> <li>➤ <b>Comparability</b></li> <li>➤ <b>Lower cost of capital</b></li> <li>➤ <b>Mobility of professionals</b></li> </ul>
4.	<p><b>Types</b></p> <ul style="list-style-type: none"> <li>➤ <b>International-level convergence:</b> Between IASB and National Standard-Setters (NSS)</li> <li>➤ <b>National-level convergence:</b> Local GAAP aligned with IFRS</li> </ul>
5.	<p><b>India's Role</b> <b>ICAI works with IASB</b> to converge Indian GAAP with IFRS.</p>
6.	<p><b>Ind AS vs. IFRS</b></p> <ul style="list-style-type: none"> <li>➤ <b>Convergence ≠ Adoption</b></li> <li>➤ <b>Convergence means aligning standards, not full adoption.</b></li> </ul>
7.	<p><b>Notification</b> MCA notified <b>Companies (Ind AS) Rules, 2015</b> for phased implementation from 2016-17 onwards.</p>

#### 5. Ind AS Applicability Timeline

##### A. Companies (Other than Banks, NBFCs, and Insurance Companies)

Phase	Effective From	Applicable To
Voluntary Adoption	1 <sup>st</sup> April 2015	All companies (with comparatives)
Phase-I (Mandatory)	1 <sup>st</sup> April 2016	<ul style="list-style-type: none"> <li>➤ Listed or listing in process (India/abroad) with net worth <math>\geq</math> ₹500 Cr</li> <li>➤ Unlisted companies with net worth <math>\geq</math> ₹500 Cr</li> <li>➤ Their holding, subsidiary, JV, and associate companies</li> </ul>
Phase-II (Mandatory)	1 <sup>st</sup> April 2017	<ul style="list-style-type: none"> <li>➤ Remaining listed/listing in process companies not in Phase-I</li> <li>➤ Unlisted companies with net worth <math>\geq</math> ₹250 Cr but <math>&lt;</math> ₹500 Cr</li> <li>➤ Their holding, subsidiary, JV, and associate companies</li> </ul>
Important Notes	-	<ul style="list-style-type: none"> <li>➤ Companies listed on SME exchange               <ul style="list-style-type: none"> <li>▪ Not required to follow Ind AS</li> </ul> </li> <li>➤ Once adopted (voluntarily or mandatorily)               <ul style="list-style-type: none"> <li>▪ Irrevocable</li> </ul> </li> </ul>



- Criteria met in a year
  - Apply Ind AS from next year with comparatives
- Applicable on both standalone & consolidated financials

### B. NBFCs, Banks, and Insurers

	Phase	Effective From	Applicable To	Key Notes
1. NBFCs	Phase-I	1st April 2018	<ul style="list-style-type: none"> <li>➤ Listed/Unlisted NBFCs with net worth <math>\geq</math> ₹500 Cr</li> <li>➤ Their holding, subsidiary, JV, associate, excluding those under corporate roadmap</li> </ul>	➤ For large NBFCs
	Phase-II	1st April 2019	<ul style="list-style-type: none"> <li>➤ Listed/Listing NBFCs with net worth <math>&lt;</math> ₹500 Cr</li> <li>➤ Unlisted NBFCs with net worth <math>\geq</math> ₹250 Cr but <math>&lt;</math> ₹500 Cr</li> <li>➤ Their holding, subsidiary, JV, associate, excluding those under corporate roadmap</li> </ul>	➤ For medium NBFCs
	Notes	—	<ul style="list-style-type: none"> <li>➤ Ind AS to be applied to standalone &amp; consolidated statements</li> <li>➤ NBFCs with net worth <math>&lt;</math> ₹250 Cr               <ul style="list-style-type: none"> <li>▪ Cannot adopt voluntarily</li> </ul> </li> </ul>	➤ No voluntary adoption if $<$ ₹250 Cr
2. Scheduled Commercial Banks	—	Initially from 1st April 2018	All (excluding Regional Rural Banks)	➤ Implementation deferred until further notice
3. Insurance Companies / Insurers		FY 2018-19 (with FY 2017-18 comparatives)	All insurance companies	Mandated under Section 34, Insurance Act, 1938 by IRDA based on MCA roadmap

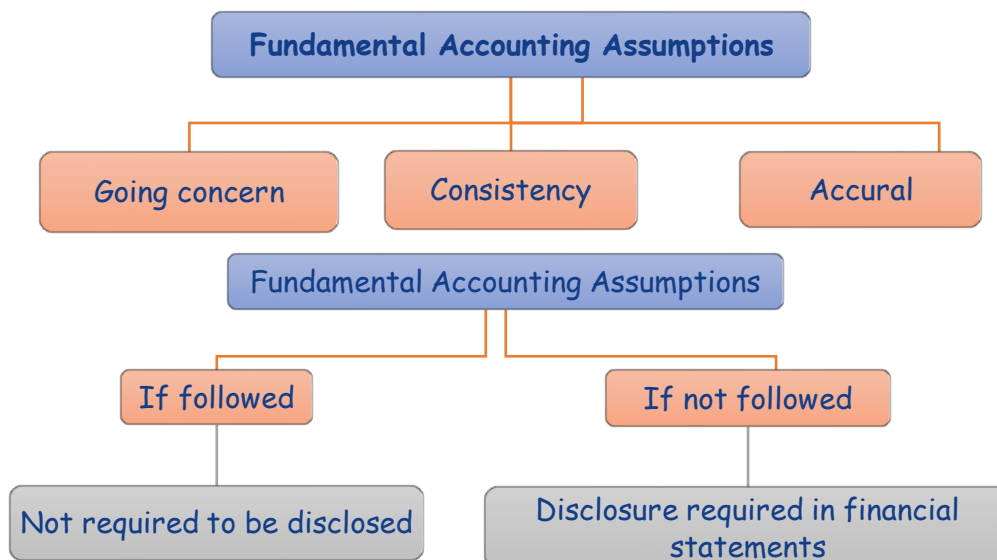


# 15. AS - 1: DISCLOSURE OF ACCOUNTING POLICIES

## 1. Objective/Need

1.	<p><b>Objective</b> Prescribes the principles for selecting and disclosing <b>significant accounting policies</b> in financial statements there by</p> <ul style="list-style-type: none"> <li>✓ Enhances <b>understanding of financial statements</b>.</li> <li>✓ Facilitates <b>comparison between different enterprises</b> for the same period.</li> </ul>
2.	<p><b>Need for Disclosure of Accounting Policies</b></p> <ul style="list-style-type: none"> <li>➤ Diversity in Accounting Policies are <b>unavoidable</b> due to:           <ol style="list-style-type: none"> <li>a. <b>Limited coverage of standards</b> - AS do not cover all areas, allowing enterprises to adopt reasonable policies where no standard exists.</li> <li>b. <b>Diverse business situations</b> - A single set of policies cannot apply to all enterprises at all times.</li> </ol> </li> <li>➤ AS allow <b>multiple policies</b>, even in covered areas.</li> <li>➤ <b>Different policies</b> lead to <b>different financial results</b>, even for the same transactions.</li> <li>➤ <b>Comparability suffers</b> due to variations in policies.</li> <li>➤ <b>Compliance</b> with standards alone is <b>not enough</b>; disclosure is <b>necessary</b>.</li> <li>➤ AS-1 requires <b>disclosure of significant accounting policies</b> used.</li> <li>➤ Users can understand <b>differences</b> and <b>adjust</b> their analysis accordingly.</li> </ul>
3.	<p><b>Changes in Accounting Policies</b> This also mandates <b>disclosing changes in accounting policies</b> to facilitate period-to-period comparison.</p>
4.	AS 1 is <b>applicable to all enterprises</b> .

## 2. Fundamental Accounting Assumptions





Principle	
1.	<p><b>Going Concern</b></p> <ul style="list-style-type: none"> <li>✓ FSs are prepared on the <b>assumption</b> that an enterprise will <b>continue its operations in the foreseeable future</b>.</li> <li>✓ <b>No intention or need to materially curtail the scale operations</b>.</li> <li>✓ Recognizes the need to:               <ol style="list-style-type: none"> <li>a. Retain profits to <b>replace used assets</b>.</li> <li>b. Provide for <b>adequate provision</b> for liabilities.</li> </ol> </li> </ul>
2.	<p><b>Consistency</b></p> <ul style="list-style-type: none"> <li>✓ <b>Same accounting policies</b> should be used for similar transactions across all periods.</li> <li>✓ Improves <b>comparability</b> over time.</li> <li>✓ Changes in accounting policies are allowed if:               <ol style="list-style-type: none"> <li>a. <b>Required by law (statute)</b>.</li> <li>b. <b>Mandated by an accounting standard</b>.</li> <li>c. <b>Leads to better financial statement presentation</b>.</li> </ol> </li> </ul>
3.	<p><b>Accrual Basis of Accounting</b></p> <ul style="list-style-type: none"> <li>➤ <b>Transactions</b> are recorded when they <b>occur</b>, irrespective of cash flow.</li> <li>➤ Provides a better <b>revenue-cost matching</b>, ensuring accurate performance measurement.</li> <li>➤ More <b>logical than cash basis</b> but risks recognizing income before actual receipt.</li> <li>➤ Can <b>overstate profits</b>, leading to <b>capital erosion</b> if dividends are paid on unrealized income.</li> <li>➤ Despite risks, <b>accrual basis is widely used</b> due to its logical approach.</li> <li>➤ Revenue is recognized only when realization is <b>reasonably certain</b>.</li> <li>➤ <b>Mandated</b> for companies under Section 128 of the Companies Act, 2013.</li> </ul>

### 3. Accounting Policies

1.	<p><b>Accounting Policies</b></p> <ul style="list-style-type: none"> <li>➤ Specific <b>accounting principles and methods</b> used by the enterprise in preparing and presenting financial statements.</li> <li>➤ Accountants <b>choose from various options</b> for recording and disclosing items in books of accounts. This list is <b>not exhaustive</b> i.e. endless. Example</li> </ul> <table border="1" data-bbox="252 1615 1441 1760"> <thead> <tr> <th>Items to be disclosed</th> <th>Method of disclosure or valuation</th> </tr> </thead> <tbody> <tr> <td>Inventories</td> <td>FIFO, Weighted Average etc.</td> </tr> <tr> <td>PPE</td> <td>Historical cost, market value, revaluation method etc</td> </tr> </tbody> </table> <ul style="list-style-type: none"> <li>➤ Policies cover <b>valuation of assets/liabilities, revenue recognition</b>, and expected losses etc.,</li> <li>➤ Policies <b>impact financial results</b>, making comparison between financial statements difficult</li> </ul>	Items to be disclosed	Method of disclosure or valuation	Inventories	FIFO, Weighted Average etc.	PPE	Historical cost, market value, revaluation method etc
Items to be disclosed	Method of disclosure or valuation						
Inventories	FIFO, Weighted Average etc.						
PPE	Historical cost, market value, revaluation method etc						



#### 4. Selection of Accounting Policy

##### Major Considerations for Selecting Accounting Policies

<p>I.</p>	<p><b>Prudence</b></p> <ul style="list-style-type: none"> <li>✓ Profits should <b>not be anticipated</b>, but potential losses must be accounted for.</li> <li>✓ Requires provisions for <b>all known liabilities and losses</b>, even if amounts are <b>uncertain</b>.</li> <li>✓ Ensures:             <ul style="list-style-type: none"> <li>➤ <b>No overstatement of profits</b></li> <li>➤ <b>No understatement of losses</b></li> <li>➤ <b>No overstatement of assets</b></li> <li>➤ <b>No understatement of liabilities</b></li> </ul> </li> </ul> <p><b>Example 1</b></p> <p>Inventory Valuation: At lower of cost or net realizable value (NRV).</p> <ul style="list-style-type: none"> <li>✓ If <math>NRV &gt; Cost</math>, ignore future profit.</li> <li>✓ If <math>NRV &lt; Cost</math>, recognize potential loss immediately.</li> </ul> <p>A company facing a damage lawsuit should recognize a provision only if the probability of losing is higher than winning.</p> <p><b>Scenario 1: NRV is ₹15 per unit</b></p> <p>Purchase Cost: <math>500 \text{ units} \times ₹10 = ₹5,000</math></p> <p>Sold: <math>400 \text{ units} \times ₹15 = ₹6,000</math></p> <p>Unsold Stock (100 units): Valued at ₹10 per unit (cost, since NRV is higher).</p> <p>Profit Calculation: <math>(400 \times 15) - (500 \times 10 - 100 \times 10) = 6,000 - 4,000 = ₹2,000</math></p> <p>Future profit (₹500) is ignored, as it is not yet realized.</p> <p><b>Scenario 2: NRV is ₹8 per unit</b></p> <p>Unsold Stock (100 units): Valued at ₹8 per unit (NRV, since it is lower than cost).</p> <p>Profit Calculation: <math>(400 \times 15) - (500 \times 10 - 100 \times 8) = 6,000 - 4,200 = ₹1,800</math></p> <p>Possible loss (₹200) is recognized immediately, following conservatism.</p> <p><b>Example 2</b></p> <p>Exercise of prudence does not permit creation of hidden reserve by understating profits and assets or by overstating liabilities and losses. Suppose a company is facing a damage suit. No provision for damages should be recognised by a charge against profit, unless the probability of losing the suit is more than the probability of not losing it.</p>
<p>II.</p>	<p><b>Substance Over Form</b></p> <p>Transactions should be recorded based on <b>their true economic impact</b>, not just their <b>legal form</b>.</p> <p>Example: A company sells an asset to a bank and immediately leases it back. Legally, it appears as a sale, but economically, the company still controls the asset. So, instead of recording it as a sale, it should be treated as a finance lease in the books.</p>
<p>III.</p>	<p><b>Materiality</b></p>



- ✓ Financial statements must disclose all material items that could influence user decisions.
- ✓ Materiality is not always based on size but based on nature of items for example, a small fraud could indicate major internal control weaknesses.

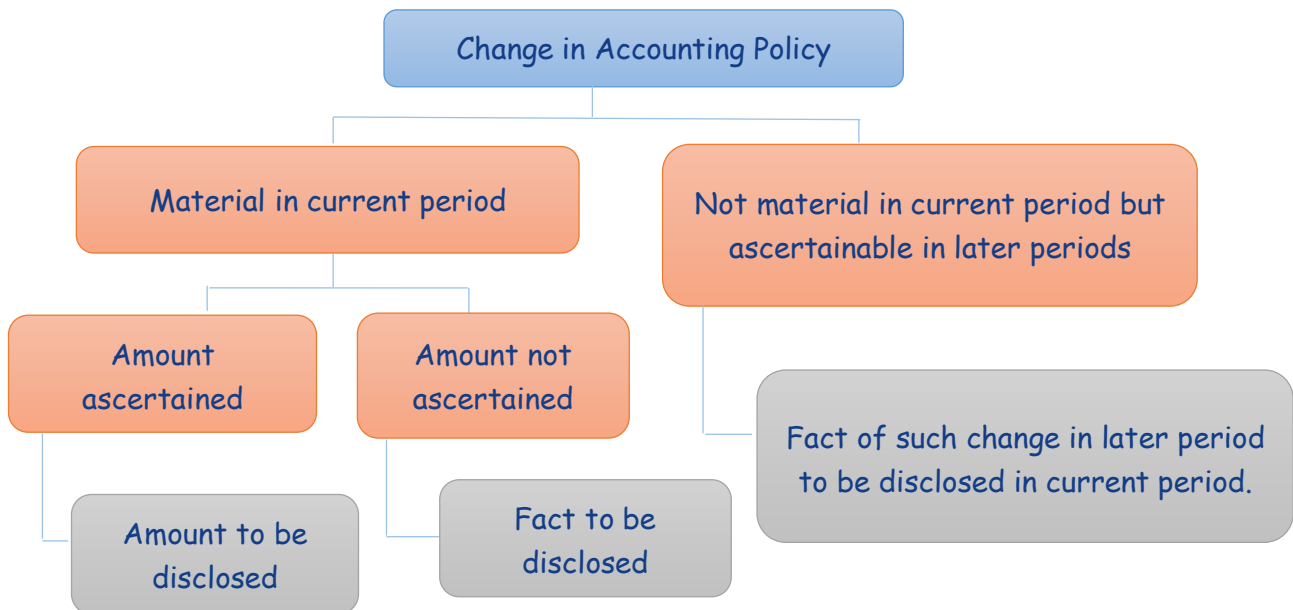
**Materiality Limits (as per Schedule III of the Companies Act, 2013)**

- a) Any income/expenditure item exceeding 1% of revenue from operations or ₹1,00,000, whichever is higher, must be disclosed.
- b) **Shareholding disclosure:** Companies must disclose in Notes to Accounts the shares held by shareholders owning more than 5% of the company's shares.

### 5. Manner of Disclosure

1.
  - ✓ All significant accounting policies used in preparing and presenting financial statements must be disclosed.
  - ✓ The disclosure should form part of the financial statements.
  - ✓ All policies should be disclosed in one place for clarity.
  - ✓ Disclosure is not a remedy for wrong accounting.

### 6. Disclosure of Changes in Accounting Policies



#### Example of Disclosure

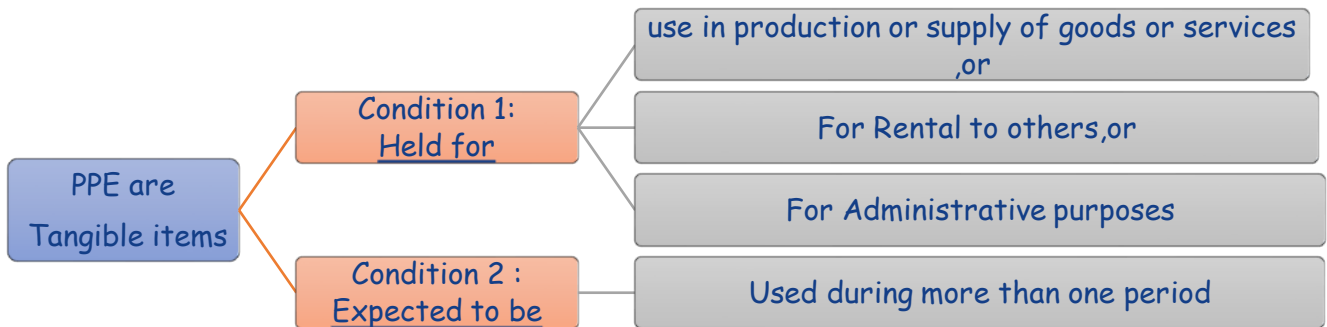
A company switches from FIFO to weighted average method for inventory valuation, reducing profit and inventory value by Rs. 20,000.

Disclosure: "The company changed its policy to the weighted average method, which better reflects consumption. This change reduced profit and inventory value by Rs. 20,000."



# 16. AS - 10: PROPERTY, PLANT AND EQUIPMENT

## 1. Definition Of PPE



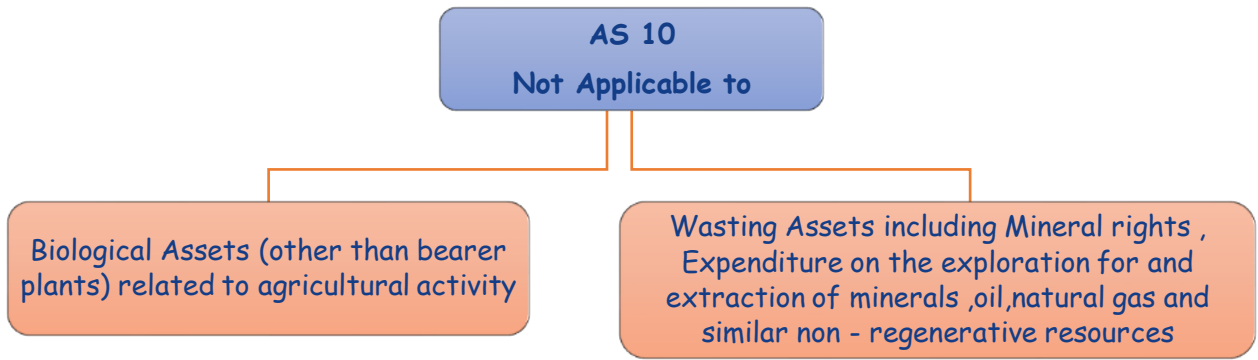
1.	<b>Administrative Purposes</b> includes all <b>business purposes</b> can be used for: <ul style="list-style-type: none"> <li>✓ Selling and distribution</li> <li>✓ Finance and accounting</li> <li>✓ Personnel and other functions of an enterprise.</li> </ul>
2.	If spare parts or standby equipment <b>meet the definition of PPE</b> , apply <b>AS 10</b> .

## 2. Objective

1.	<b>Objective</b> To prescribe the <b>accounting treatment for PPE</b> .
2.	<b>Principal Issues</b> The main issues in accounting for PPE are: <ul style="list-style-type: none"> <li>➤ <b>Recognition of assets</b></li> <li>➤ <b>Carrying amounts</b> determination</li> <li>➤ <b>Depreciation charges</b> and impairment losses to be recognised.</li> </ul>

## 3. Scope of the Standard

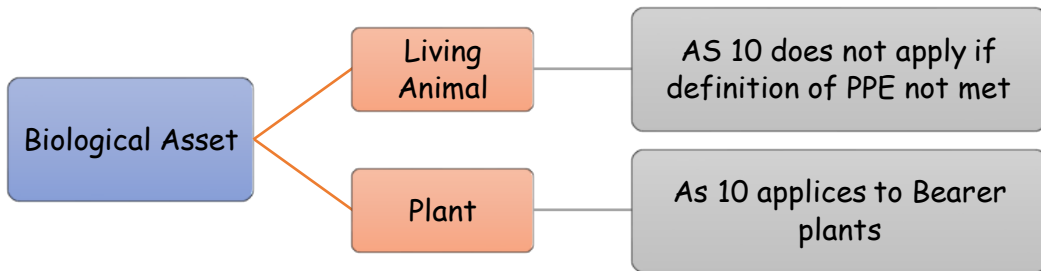
1.	<b>Application of the Standard</b> This Standard applies to <b>PPE accounting</b> unless another Standard requires a different treatment.
2.	<b>Example</b> AS 19 assesses leased PPE based on risk transfer, while depreciation follows PPE accounting standards.



Note: AS 10 applies to Bearer Plants but it does not apply to the produce on Bearer Plants.

**4. Other Definitions**

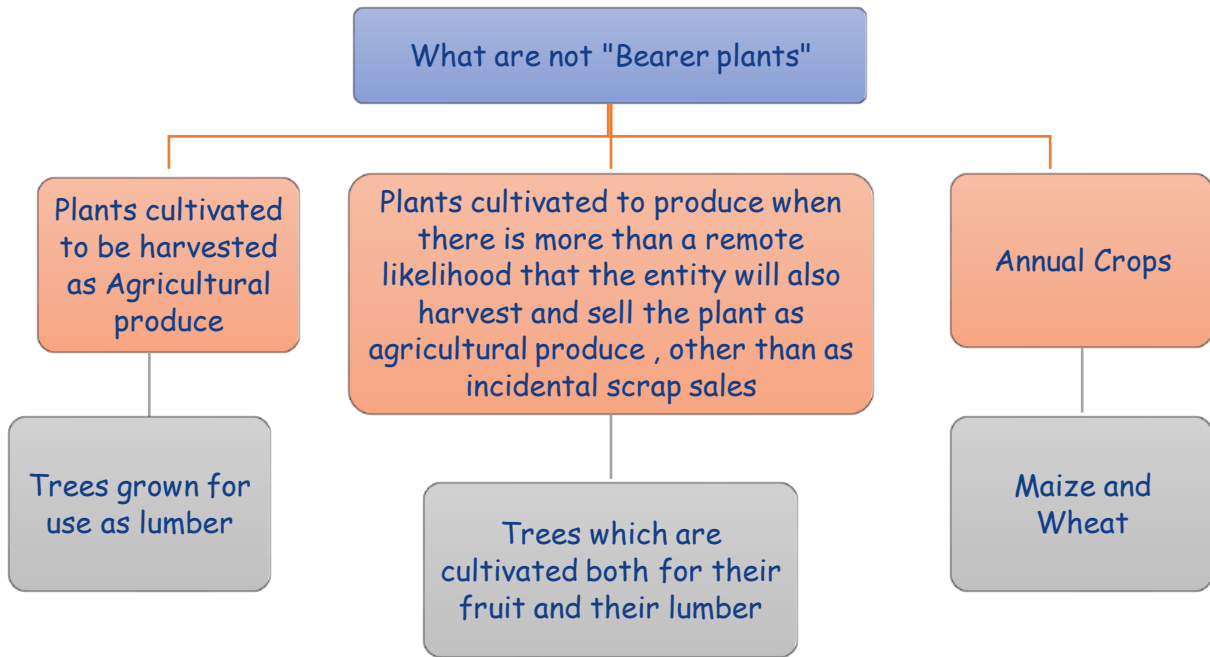
1. Biological Asset:



2. Bearer Plant: Is a plant that (satisfies all 3 conditions):



Note: When bearer plants are no longer used to bear produce, they might be cut down and sold as scrap.  
 For example - use as firewood. Such incidental scrap sales would not prevent the plant from satisfying the definition of a Bearer Plant.



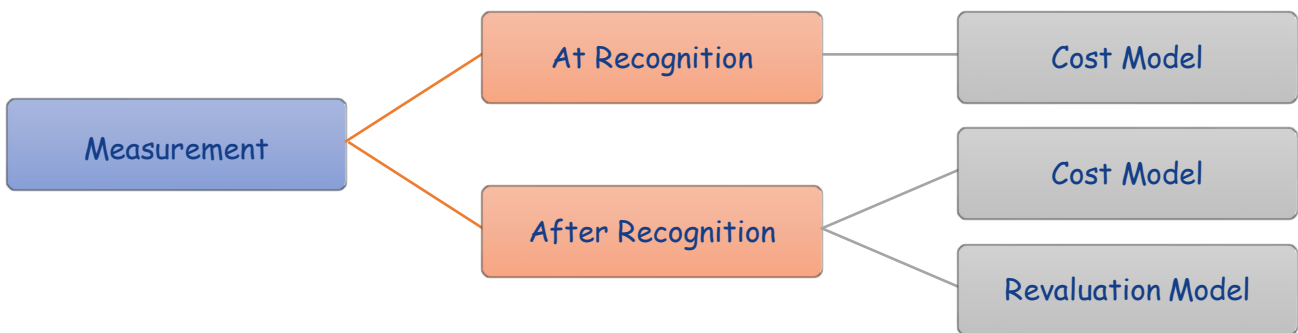
5. Recognition criteria for PPE

- Probable future economic benefits will flow to the enterprise from the asset.
- The cost of the asset must be measurable reliably.

Note:

- ✓ Small items like moulds, tools, and dies can be grouped, applying recognition criteria to the total.
- ✓ If the cost is immaterial, an enterprise may expense it instead of capitalizing as PPE.

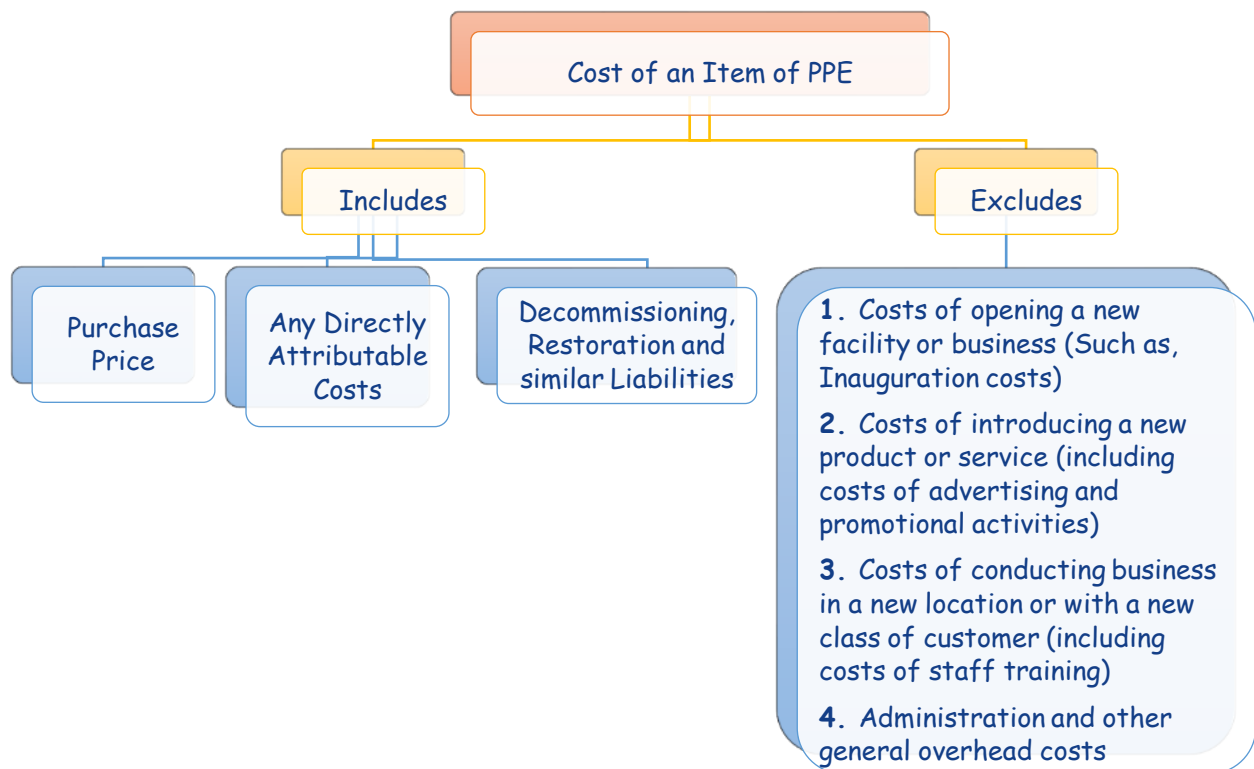
6. Measurement of PPE





## 7. Initial Recognition

An item of PPE that qualifies for recognition as an asset should be **measured at its cost**.  
Cost of an item of PPE comprises:



A.	<p><b>Purchase Price</b></p> <ul style="list-style-type: none"> <li>➤ Includes import duties and non-refundable purchase taxes.</li> <li>➤ Trade discounts and rebates must be deducted.</li> </ul>
B.	<p><b>Directly Attributable Costs</b></p> <p>Costs directly related to bringing the <b>asset to the location and condition</b> necessary for it to <b>operate as intended by management</b>. Recognition stops once the item is ready for use.</p> <p><b>Costs Not Included</b></p> <ol style="list-style-type: none"> <li>a. Costs incurred before the asset is fully operational or running at full capacity.</li> <li>b. Initial operating losses.</li> <li>c. Relocation or reorganization costs of operations.</li> </ol> <p><b>Examples of Directly Attributable Costs</b></p> <ol style="list-style-type: none"> <li>a. Employee benefits (as per AS 15) directly linked to the construction or acquisition.</li> <li>b. Site preparation costs.</li> <li>c. Delivery and handling costs.</li> <li>d. Installation and assembly costs.</li> <li>e. Testing costs (after deducting proceeds from selling items produced during testing).</li> <li>f. Professional fees.</li> </ol>

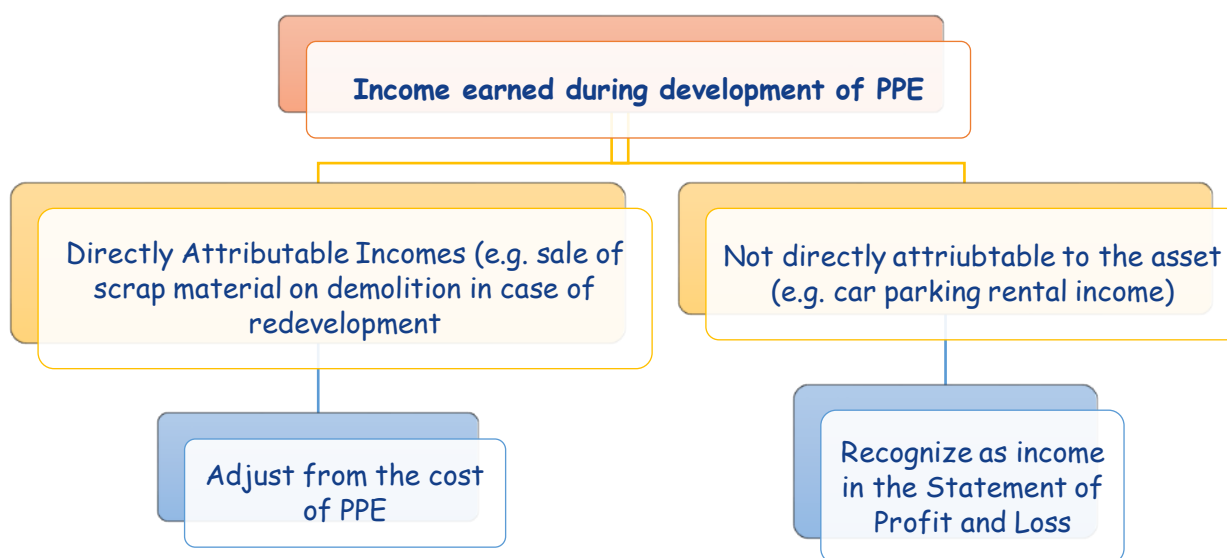


### Examples of Costs Not Included

- Opening costs (e.g., inauguration cost).
- Costs for introducing new products/services (e.g., advertising).
- Costs for conducting business in a new location or with new customers (e.g., staff training).
- Administration and general overhead costs

### Example:

Income from incidental operations, like using a site as a car park before construction, is recognized in the Statement of Profit and Loss, as it is not necessary to prepare the asset for its intended use.



### C. Decommissioning, Restoration, and Similar Liabilities

**Initial estimate** of costs related to dismantling, removing the item, and restoring the site referred to as decommissioning, restoration, and similar liabilities.

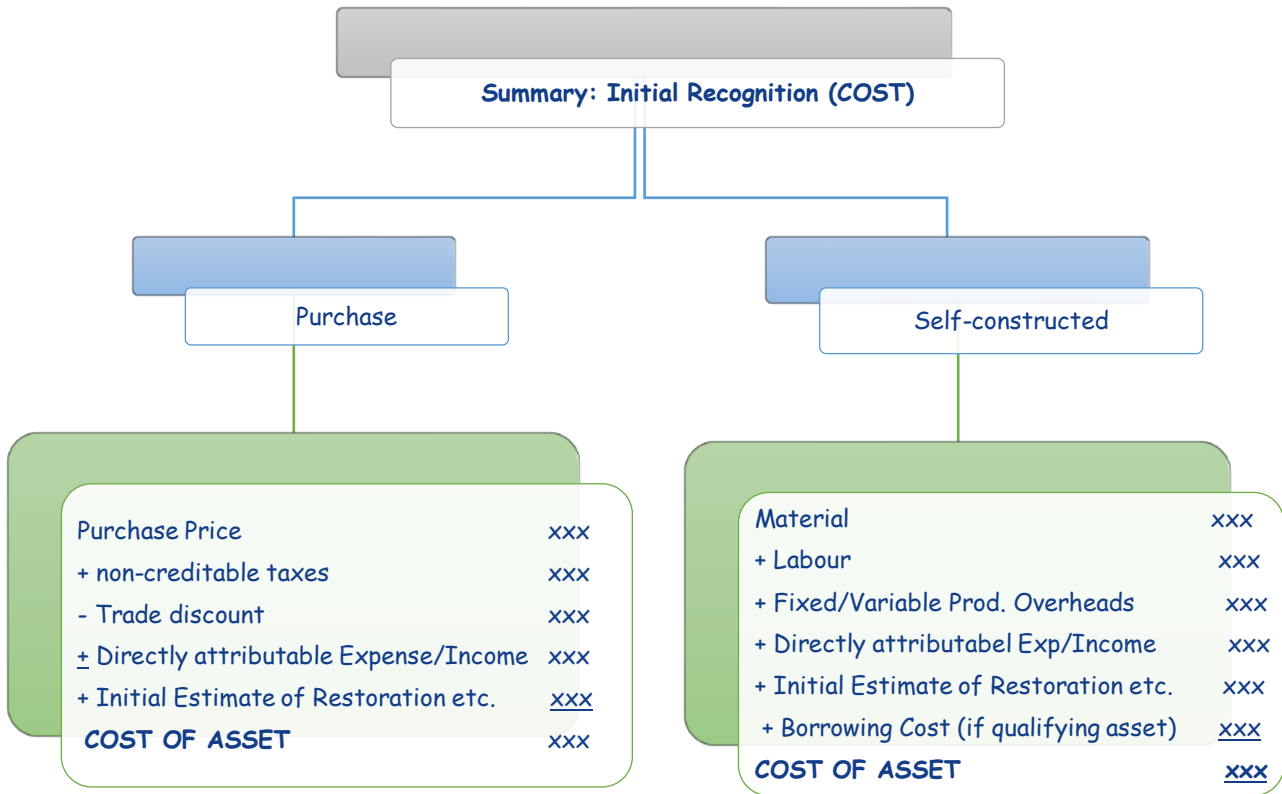
#### Exception

Costs for dismantling and site restoration, when **related to inventory production**, are accounted for under AS 2 - Valuation of Inventories instead of capitalizing as PPE.

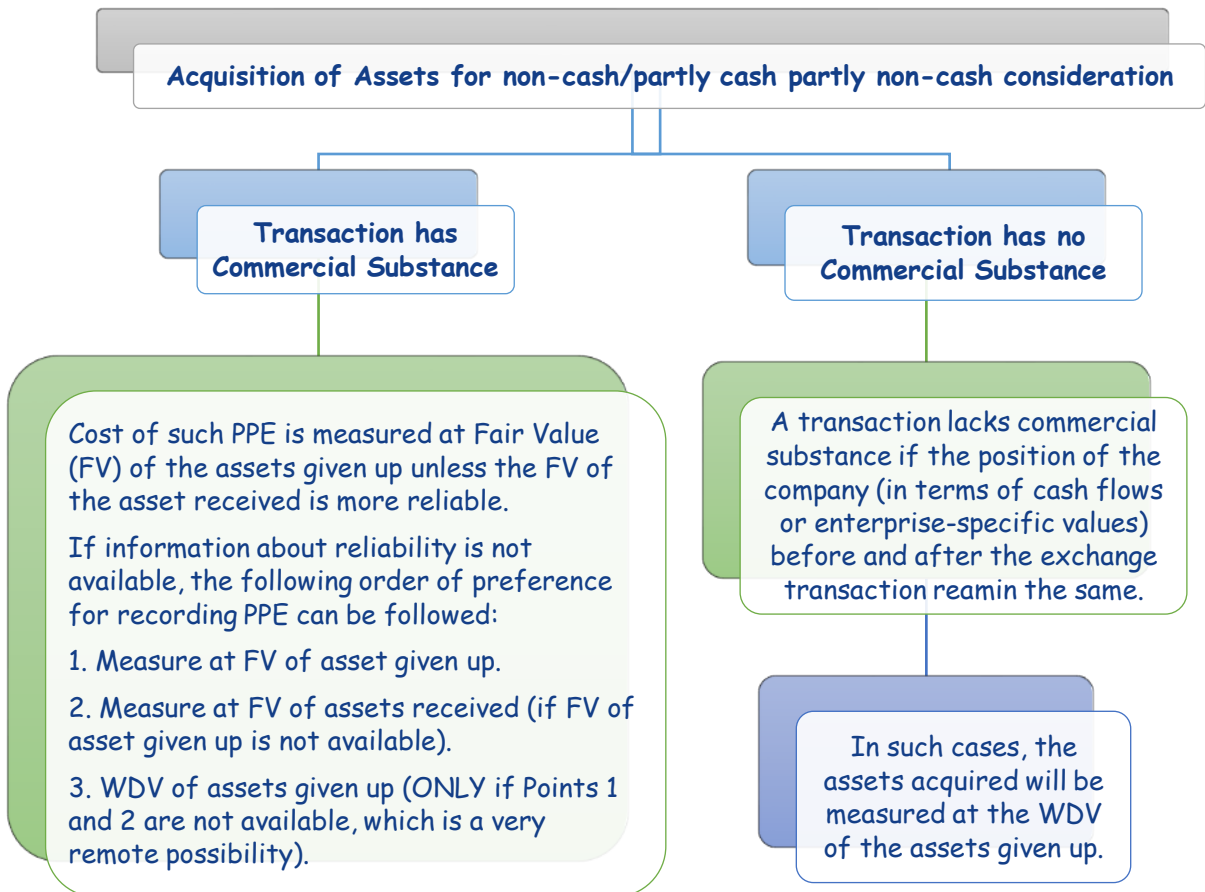
Note: These obligations are recognized and measured in accordance with AS 29.

## 8. Cost of a Self-Constructed Asset

1.	<b>Self-constructed Asset Cost</b> The cost of a self-constructed asset is determined using <b>the same principles</b> as for an <b>acquired asset</b> .
2.	<b>Special Points</b> <ul style="list-style-type: none"> <li>➤ <b>Internal profits</b> are <b>eliminated</b> in calculating the cost.</li> <li>➤ The cost of <b>abnormal amounts of wasted material, labour, or other resources</b> is <b>not included</b> in the cost of the asset.</li> <li>➤ <b>Borrowing costs</b> should be <b>included in PPE</b>, following AS 16</li> </ul>
3.	<b>Bearer Plants</b> Bearer plants are treated the same way as <b>self-constructed items of PPE</b> .



**9. PPE Acquired in Exchange of Assets**





### Commercial Substance in Exchange Transaction

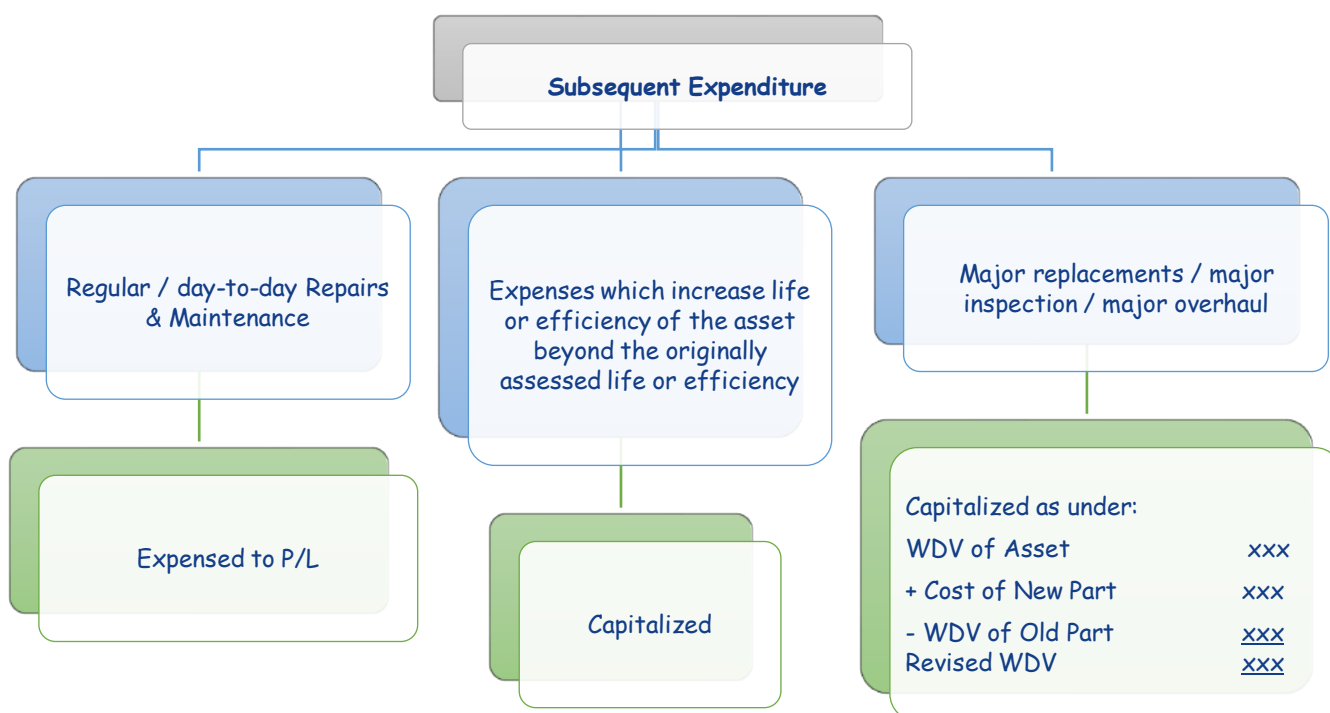
An exchange transaction has commercial substance if:

- Cash Flow Configuration**  
The configuration (risk, timing, and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred.
- Enterprise-Specific Value**  
The enterprise-specific value of the portion of the operations of the enterprise affected by the transaction changes as a result of the exchange.

### 10. Determination of Cost in Special Cases

- Deferred Payment Beyond Normal Credit Terms**  
**Recognition of Interest**  
Total payment minus cash price equivalent is recognised as interest expense over the period of credit, unless the interest is capitalised in accordance with AS 16.
- PPE Purchased for a Consolidated Price**  
When several items of PPE are purchased for a consolidated price, the consideration is apportioned to the items based on their respective fair values at the acquisition date.
- PPE Held Under Finance Lease**  
The cost of an item of PPE held by a lessee under a finance lease is determined in accordance with AS 19.
- Government Grant Related to PPE**  
The carrying amount of PPE may be reduced by government grants in accordance with AS 12.

### 11. Treatment of Subsequent Costs



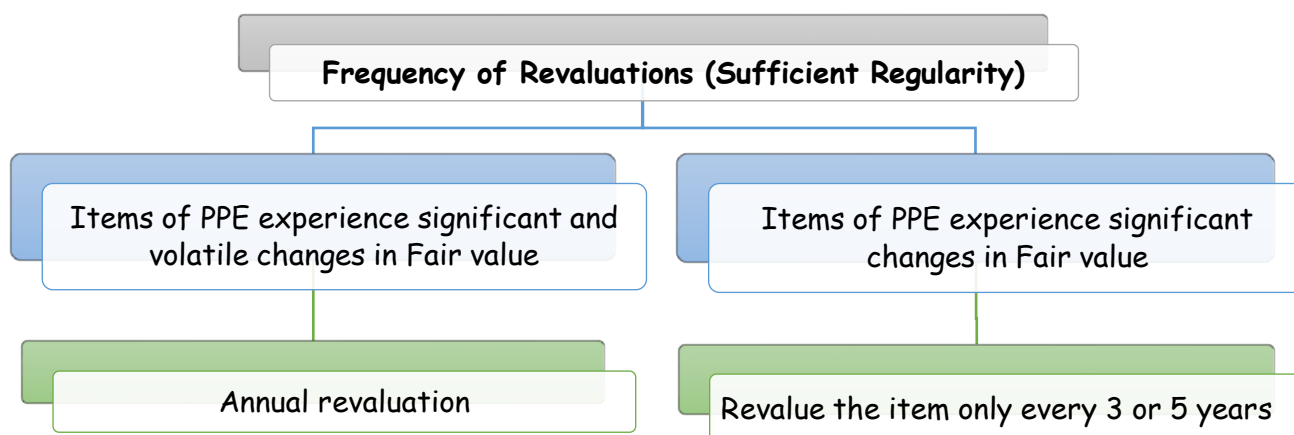


## 12. Measurement After Recognition

1.	<p><b>Choice of Model</b></p> <p>An enterprise should choose either the Cost model or the Revaluation model as its accounting policy and apply it to an entire class of PPE.</p>
2.	<p><b>Class of PPE</b></p> <p>A class of PPE is a grouping of assets of similar nature and use in the operations of the enterprise.</p> <p><b>Examples:</b></p> <ul style="list-style-type: none"> <li>➤ Land</li> <li>➤ Land and Buildings</li> <li>➤ Machinery</li> <li>➤ Ships</li> <li>➤ Aircraft</li> <li>➤ Motor Vehicles</li> <li>➤ Furniture and Fixtures</li> <li>➤ Office Equipment</li> <li>➤ Bearer plants</li> </ul>
3.	<p><b>Cost Model</b></p> <p>After recognition, an item of PPE should be carried at:</p> $\begin{array}{r} \text{Cost} \\ (-) \\ \text{Accumulated Depreciation} \\ (-) \\ \text{Accumulated Impairment Losses.} \end{array}$
4.	<p><b>Revaluation Model</b></p> <p>After recognition, an item of PPE whose fair value can be measured reliably should be carried at:</p> <p>Carrying Value =</p> $\begin{array}{r} \text{Fair value at the revaluation date} \\ - \\ \text{Subsequent Accumulated Depreciation} \\ - \\ \text{Subsequent Accumulated Impairment Losses.} \end{array}$ <p><b>Revaluation for Entire Class of PPE</b></p> <p>If one item of PPE in a class is revalued, the entire class must be revalued.</p>



## Frequency of Revaluations



1.	<p><b>Fair Value Determination</b> Fair value is usually determined through market-based evidence by a professional appraiser. If there is no market-based evidence, fair value is estimated using:</p> <ul style="list-style-type: none"> <li>➤ Income Approach (Discounted Cash Flow projections)</li> <li>➤ Depreciated Replacement Cost Approach.</li> </ul>																																					
2.	<p><b>Accounting Treatment of Revaluations</b> When revalued, the carrying amount of the asset is adjusted to the revalued amount.</p> <p><u>Technique 1: Adjust Gross Carrying Amount</u> PPE is revalued to Rs.1,500 consisting of Rs.2,500 Gross cost and Rs.1,000 Depreciation based on observable market data. Details of the PPE before and after revaluation are as follows:</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 40%;">Particulars</th> <th style="width: 15%;">Cost/ Revalued Cost</th> <th style="width: 20%;">Accumulated depreciation</th> <th style="width: 25%;">Net book value</th> </tr> </thead> <tbody> <tr> <td>PPE before revaluation (assumed)</td> <td style="text-align: right;">1,000</td> <td style="text-align: right;">400</td> <td style="text-align: right;">600</td> </tr> <tr> <td>Fair Value</td> <td></td> <td></td> <td style="text-align: right;">1,500</td> </tr> <tr> <td>Revaluation Gain</td> <td></td> <td></td> <td style="text-align: right;">900</td> </tr> <tr> <td>Gain allocated proportionately to cost and depreciation</td> <td style="text-align: right;">1,500</td> <td style="text-align: right;">600</td> <td style="text-align: right;">900</td> </tr> <tr> <td></td> <td style="text-align: right;">(900 × 1,000/600)</td> <td style="text-align: right;">(900 × 400/600)</td> <td></td> </tr> <tr> <td>PPE after revaluation</td> <td style="text-align: right;">2,500</td> <td style="text-align: right;">1,000</td> <td style="text-align: right;">1,500</td> </tr> </tbody> </table> <p>The increase on revaluation is Rs.900 (i.e., Rs.1,500 - Rs.600). The following journal entry will be passed:</p> <table style="width: 100%; border: none;"> <tr> <td style="width: 60%;">PPE</td> <td style="width: 10%; text-align: center;">Dr.</td> <td style="width: 30%; text-align: right;">1,500</td> </tr> <tr> <td style="padding-left: 20px;">To Accumulated Depreciation</td> <td></td> <td style="text-align: right;">600</td> </tr> <tr> <td style="padding-left: 20px;">To Gain on Revaluation*</td> <td></td> <td style="text-align: right;">900</td> </tr> </table>	Particulars	Cost/ Revalued Cost	Accumulated depreciation	Net book value	PPE before revaluation (assumed)	1,000	400	600	Fair Value			1,500	Revaluation Gain			900	Gain allocated proportionately to cost and depreciation	1,500	600	900		(900 × 1,000/600)	(900 × 400/600)		PPE after revaluation	2,500	1,000	1,500	PPE	Dr.	1,500	To Accumulated Depreciation		600	To Gain on Revaluation*		900
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	<p><b>Technique 2: Eliminate Accumulated Depreciation</b> Accumulated depreciation is eliminated against the gross carrying amount. Details of the PPE before and after revaluation are as follows:</p>																																					





	➤ Disposed of.
3.	<p><b>Case II: Partial Surplus Transfer</b></p> <p>Some of the surplus may be transferred as the asset is used by the enterprise. The amount transferred is the <b>difference between:</b></p> <ul style="list-style-type: none"> <li>➤ Depreciation (based on revalued carrying amount)</li> <li>➤ Depreciation (based on original cost).</li> </ul>
	<p><b>Note</b></p> <p>Transfers from revaluation surplus to revenue reserves are <b>not made through the Statement of Profit and Loss.</b></p>

### 13. Depreciation of PPE

1.	<p><b>Depreciation</b></p> <p>Systematic allocation of the depreciable amount of an asset over its useful life.</p>
2.	<p><b>Depreciable Asset</b></p> <p>Depreciable amount = Cost of asset - Residual value</p>
3.	<p><b>Residual Value</b></p> <p>The estimated amount an entity would obtain from disposing of the asset, after deducting the estimated disposal costs.</p>
4.	<p><b>Useful Life</b></p> <p>The period over which an asset is expected to be used by the entity or the number of production units expected to be obtained.</p>
5.	<p><b>Commencement of Depreciation</b></p> <p>Depreciation begins when the asset is available for use, i.e., when it is in the location and condition needed for operation.</p>
6.	<p><b>Cessation of Depreciation</b></p> <p>Depreciation stops at the earlier of:</p> <ul style="list-style-type: none"> <li>✓ The asset is classified as held for sale</li> <li>✓ The asset is derecognized.</li> </ul>

### 14. Depreciation Method

1.	<p><b>Depreciation Method</b></p> <p>The method used should reflect the pattern in which the asset's future economic benefits are consumed by the entity.</p>
2.	<p><b>Types of Depreciation Methods</b></p> <ul style="list-style-type: none"> <li>➤ <b>Straight Line Method (SLM):</b> Constant charge over the useful life if residual value remains unchanged.</li> <li>➤ <b>Reducing Balance Method (WDV):</b> Decreasing charge over the useful life.</li> <li>➤ <b>Units of Production Method:</b> Charge based on expected use or output.</li> </ul>
3.	<p><b>Review of Depreciation Method</b></p> <p>The depreciation method is reviewed at least at each financial year-end.</p>
4.	<p><b>Change in Depreciation Method</b></p>



	A change in depreciation method is treated as a <b>change in accounting estimate</b> as per <b>AS 5</b> (Prospective accounting).
5.	<b>Revenue-based Depreciation</b> A depreciation method based on revenue generated by an activity involving the use of an asset is <b>not appropriate</b> because inflation can affect revenue but not asset consumption.

### 15. Retirements

1.	<b>Retired PPE Held for Disposal</b> Items of PPE retired from active use and held for disposal should be <b>stated at the lower of:</b> <ul style="list-style-type: none"> <li>✓ <b>Carrying Amount</b></li> <li>✓ <b>Net Realisable Value</b></li> </ul>
2.	<b>Write-down</b> Any write-down (reduction in value) should be <b>recognized immediately</b> in the <b>Statement of Profit and Loss</b> .

### 16. De-Recognition

1.	<b>Derecognition of PPE</b> The carrying amount of an item of PPE should be derecognised when: <ul style="list-style-type: none"> <li>➤ <b>On disposal</b> <ul style="list-style-type: none"> <li>By sale</li> <li>By entering into a finance lease</li> <li>By donation</li> </ul> </li> <li>➤ <b>When no future economic benefits are expected from its use or disposal.</b></li> </ul>
2.	<b>Gain or Loss from Derecognition</b> Gain or loss should be <b>included in the Statement of Profit and Loss</b> when the item is <b>derecognised</b> . <b>Gain or Loss = Net disposal proceeds - Carrying amount of the item.</b>

#### Comparison of Ind AS 16 and AS 10

Aspect	Ind AS 16	AS 10
1. Scope	Does not exclude real estate developers from the scope.	Excludes real estate developers from the scope.
2. Recognition of Fixed Assets	Specific recognition criteria for fixed assets.	No specific recognition criteria for fixed assets.
3. Components Approach	Components approach is mandatory for asset recognition and depreciation.	No requirement for components approach.
4. Model Selection	Requires an organization to choose between <b>Cost Model</b> or	Recognizes the <b>revaluation of fixed assets</b> but doesn't



	Revaluation Model for	specifically require choosing a model.
5. Change in Depreciation Method	A change in depreciation method is considered as a change in accounting estimate.	No specific guidance provided for change in depreciation method.
6. Jointly Owned Assets	Does not deal with jointly owned assets.	Provides guidance for fixed assets owned jointly.
7. Assets Held for Sale	Does not deal with assets held for sale.	Deals with assets held for sale or those retired from active use.
8. Self-Generated Asset Construction Costs	Additional costs in the construction of self-generated assets should not be capitalized.	No specific guidance provided.
9. Revaluation Surplus	Revaluation surplus may be transferred to retained earnings on derecognition of the asset.	Provides recycling to the income statement in the ratio of additional depreciation.
10. Gain on Derecognition	Gain on derecognition should be considered as revenue.	No specific guidance provided for gain on derecognition.
11. Non-Monetary Exchange	PPE acquired in exchange of a non-monetary asset should be recognized at fair value.	PPE acquired in exchange is recorded at the net book value of the asset given up.



# 17. AS - 11: THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

## 1. Objective

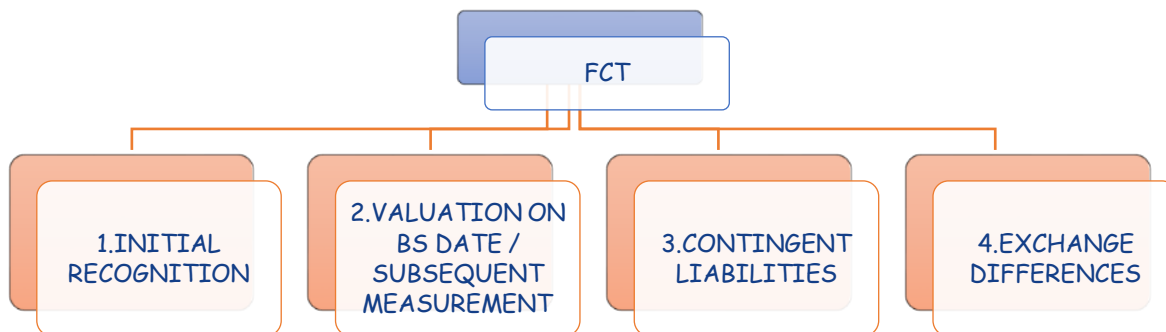
- A business can deal with foreign exchange in two ways.
  - a. It may have transactions in a foreign currency.
  - b. It may have operations in a foreign country.
- All foreign currency transactions & financial statements of foreign operations must be converted into the business's reporting currency.
- The principal issues here addressed by this AS are
  - ✓ to decide which exchange rate to use &
  - ✓ how to recognise in the FS's the financial effect of changes in exchange rates.

## 2. Scope

1.	<p><b>Application of the Standard</b></p> <p>This standard should be applied:</p> <ol style="list-style-type: none"> <li>a) In accounting for transactions in foreign currencies.</li> <li>b) In translating the financial statements of foreign operations.</li> <li>c) In accounting for foreign currency transactions related to forward exchange contracts.</li> </ol>
2.	<p><b>Exclusions from the Standard</b></p> <p>This standard does not:</p> <ol style="list-style-type: none"> <li>a. Specify the currency in which an enterprise presents its financial statements.           <ul style="list-style-type: none"> <li>✓ Usually, the currency of the country where the company is based is used.</li> <li>✓ a different currency is used, the reason must be disclosed.</li> <li>✓ Indian companies are required to present financial statements in INR.</li> <li>✓ If an Indian company is a subsidiary of a U.S. company, it may report in USD U.S. Dollars with a disclosed reason.</li> </ul> </li> <li>b. Showing cash flows from foreign currency transactions in the cash flow statement.</li> <li>c. Exchange differences on foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.</li> <li>d. Restatement of an enterprise's financial statements from its reporting currency into another currency just for user convenience.</li> </ol>



### 3. Accounting of FCT



1.	<p><b>A foreign currency transaction</b> is a transaction which is <b>denominated in or requires settlement in a foreign currency, including</b> transactions arising when an enterprise either</p> <ol style="list-style-type: none"> <li>Involves buying or selling goods or services priced in a foreign currency.</li> <li>Involves borrowing or lending funds in a foreign currency.</li> <li>Involves entering into a forward exchange contract.</li> <li>Acquiring or disposing of assets or incurring liabilities in a foreign currency.</li> </ol>
2.	<p><b>Initial Recognition</b> FCTs are initially recognized by applying:</p> <ul style="list-style-type: none"> <li>➤ <b>Exchange rate on the date of the transaction.</b></li> <li>➤ <b>Alternatively, the average rate of a week or month</b> can be used if there is <b>no significant fluctuation</b> in the exchange rate.</li> </ul>
3.	<p><b>Valuation on BS/Subsequent Measurement</b> For valuation on the balance sheet date, <b>items arising from FCT</b> are <b>classified</b> into:</p> <ol style="list-style-type: none"> <li><b>Monetary items</b></li> <li><b>Non-monetary items</b></li> </ol> <p><b>Monetary Items</b> <b>Monetary items include:</b></p> <ul style="list-style-type: none"> <li>➤ <b>Money held</b></li> <li>➤ <b>Assets and liabilities to be received or paid in fixed or determinable amounts of money.</b></li> </ul> <p>For example, cash, receivables and payables.</p> <p><b>Non-Monetary Items</b> Non-monetary items are <b>assets and liabilities other than monetary items.</b> For example, fixed assets, advances for purchase of goods / fixed assets, inventories and investments in equity shares.</p> <div style="text-align: center; margin-top: 20px;"> <pre>             graph LR               A[ASSETS/LIABILITIES] --&gt; B[MONETARY ITEMS]               A --&gt; C[NON MONETARY ITEMS]               B --&gt; D[CLOSING RATE]               C --&gt; E[CARRIED AT HISTORICAL COST]               C --&gt; F[CARRIED AT FMV/NRV]               E --&gt; G[ACTUAL RATE(NO REMEASUREMENT)]               F --&gt; H[CLOSING RATE]           </pre> </div>



4.	If the closing rate is <b>unrealistic</b> or <b>remittance restrictions exist</b> , the monetary item should be reported at the amount <b>likely to be realized</b> or <b>required to settle</b> at the balance sheet date.
5.	<b>Contingent Liabilities</b> Contingent liabilities are reported <b>at the exchange rate</b> on the balance sheet date.
6.	<b>Exchange Differences</b> Exchange differences are <b>transferred to the Profit &amp; Loss Account</b> .

#### 4. Special Option Available to Companies-Amendment to Para 46A

1.	<b>Irrevocable Option</b> <ul style="list-style-type: none"> <li>➤ Paragraph 46A of AS 11, introduced in December 2011, allows enterprises to follow this treatment for periods starting <b>April 1, 2011, onwards</b>.</li> <li>➤ Once exercised, the option is <b>irrevocable</b> and must be applied <b>consistently</b> to all such items.</li> </ul>
2.	<b>Long-Term Foreign Currency Monetary Items</b> <b>An asset or liability</b> is designated as a long-term foreign currency monetary item if it has a <b>term of 12 months or more</b> from the date of origination.
3.	<div style="text-align: center;"> <pre> graph LR     A[EXCHANGE DIFFERENCE ON LTFCMI] --&gt; B[RELATED TO ACQUISITION OF A DEPRECIABLE ASSET]     A --&gt; C[OTHERS]     B --&gt; D[ADD/DEDUCT FROM COST OF THE ASSET AND DEPRECIATED OVER THE BALANCE LIFE OF THE ASSET]     C --&gt; E[TRANSFER TO FCMTD A/C AND AMORTISE OVER THE BALANCE PERIOD OF SUCH LONG TERM ITEM.]           </pre> </div> <p>The debit or credit balance in FCMITDA shown under the head 'Reserves and Surplus' as a separate line item.</p>

#### 5. Foreign Operations

1.	<b>Foreign Operations</b> <ul style="list-style-type: none"> <li>➤ Foreign operation is a <b>subsidiary, associate, joint venture</b> or branch of the reporting enterprise, the activities of which are based or conducted in a country other than the country of the reporting enterprise.</li> <li>➤ These are classified as either <b>integral foreign operations (IFO's)</b> or <b>non-integral foreign operations (Non-IFO's)</b>.</li> </ul>
2.	<b>Integral Foreign Operations (IFO's)</b> <ul style="list-style-type: none"> <li>➤ IFO is an operation whose activities are an <b>essential part of the reporting enterprise's activities</b>.</li> <li>➤ An IFO operates as an <b>extension of the reporting enterprise</b>.</li> </ul>
3.	<b>Non-Integral Foreign Operations (Non-IFO's)</b> <b>A non-integral foreign operation (Non-IFO)</b> is <b>not an integral part of the reporting enterprise</b> .



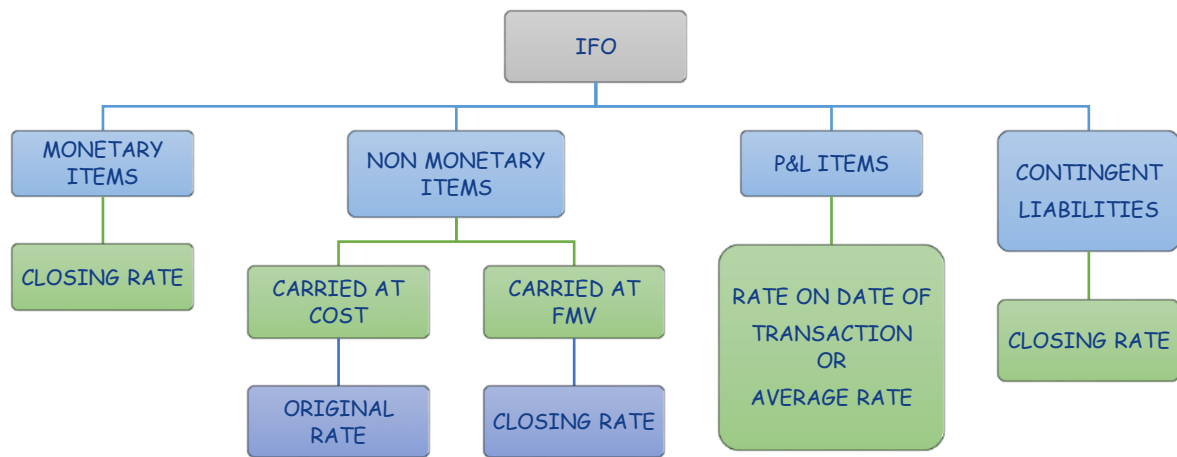
4. Indications of Non-IFO

The following indicate a foreign operation is a Non-IFO:

- It operates **independently** from the main enterprise.
- Transactions with the main enterprise are **minimal**.
- It is **self-financed** or uses **local borrowings**.
- Costs (labour, materials) are **paid in local currency**.
- **Sales** are mainly in **other currencies**, not the reporting currency.
- The main enterprise's **cash flows are not affected by daily activities** of foreign operation.
- Prices depend on **local factors**, not exchange rates.
- It has a **strong local market**, even if it exports.

6. Translation of Fs's of IFO's

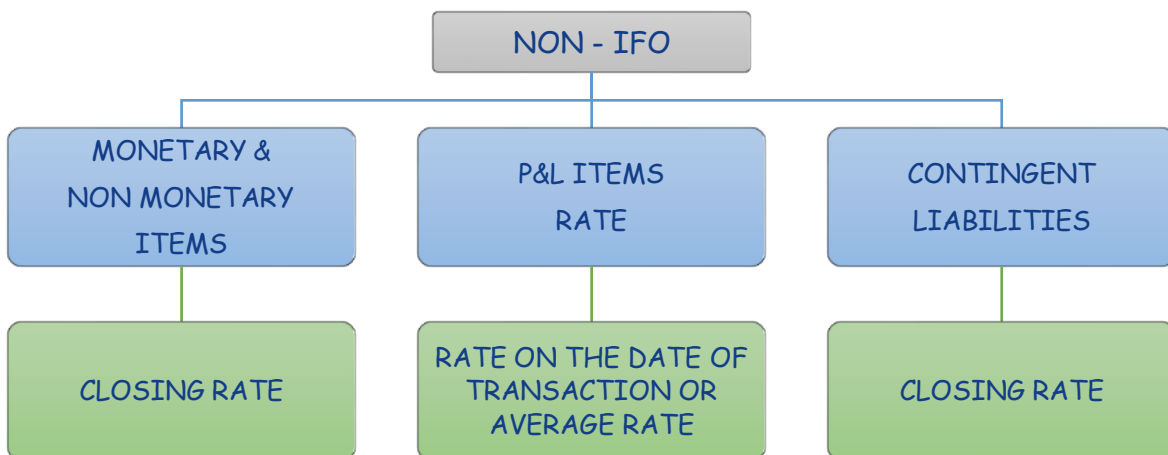
1. Translation of Financial Statements of Integral Foreign Operation (IFO)



2. Exchange Differences

Any exchange differences arising from translating the financial statements of IFO are **transferred to the P&L account**.

7. Translation of Fs's of NON-IFO'S





1.	<b>Exchange Difference on Conversion</b> Exchange differences arising from the conversion of financial statements should be transferred to the FCTR.
2.	<b>FCTR in Reserves &amp; Surplus</b> The FCTR account should be shown under reserves & surplus until the sale of the foreign operation.

### 8. Re-classification of Foreign operations

#### Integral to Non-Integral:

Exchange gain/loss after reclassification goes to FCTR.

#### Non-Integral to Integral:

- Exchange gain/loss after reclassification goes to Profit & Loss (P&L) account.
- Existing FCTR balance stays in the Balance Sheet until the foreign operation is sold.
- Partial Sale of Non-IFO  
A proportionate amount from FCTR is transferred to P&L.

### 9. Forward Exchange Contracts

1.	<b>Forward Exchange Contracts</b> A forward exchange contract is a contract where one party agrees to buy from or sell to the other party an asset (in this case, foreign currency) at a future date for an agreed price.
2.	<b>FC Types</b> FC is entered into for: <ol style="list-style-type: none"> <li>a. Managing or minimizing foreign exchange fluctuation risks (Hedging).</li> <li>b. Trading or speculation purposes.</li> </ol>
3.	<b>FC for Hedging</b> <ul style="list-style-type: none"> <li>➤ Premium or discount at the inception FEC should be amortized over the contract period.</li> <li>➤ Exchange differences are recognized in the P&amp;L account.</li> <li>➤ Profit or loss from cancellation or renewal of FEC is recognized in the P&amp;L account.</li> </ul>
4.	<b>FC for Trading or Speculation</b> <ul style="list-style-type: none"> <li>➤ The premium or discount on the FEC is ignored and not recognized separately.</li> <li>➤ At each balance sheet date, the contract value is marked to its current market value, and the gain or loss on the contract is recognized.</li> <li>➤ Gain/Loss on reporting date = foreign currency amount × (forward rate at reporting date for remaining maturity less contracted forward rate)</li> </ul>

### 10. Disclosure

1.	<b>Disclosure of Exchange Differences</b> An enterprise should disclose: <ul style="list-style-type: none"> <li>➤ Disclose exchange differences included in net profit or loss.</li> </ul>
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	➤ Show net exchange differences in the Foreign Currency Translation Reserve (FCTR) with a reconciliation of opening and closing balances.
2.	Reason for Using a Different Reporting Currency If the reporting currency differs from the country's currency, disclose the reason. If the reporting currency changes, disclose the reason for the change.
3.	Change in Classification of Foreign Operation: a) The nature of the change. b) The reason for the change. c) The impact of the change on shareholders' funds. d) Effect on net profit/loss in prior periods if applied earlier.

#### Comparative Provisions Between AS 11 and Ind AS 21

Aspect	Ind AS 21	AS 11
1. Forward Exchange Contracts	Not covered by Ind AS 21.	Included within the scope of AS 11.
2. Accounting for Foreign Operations	Based on the functional currency approach.	Based on integral and non-integral approach.
3. Exchange Difference Recognition on Long-Term Monetary Items	No specific guidance provided.	Option to recognize exchange difference arising on the translation of certain long-term monetary items over the period.
4. Presentation Currency	The presentation currency could be different from the local currency.	No such specification provided.



# 18. AS - 12: ACCOUNTING FOR GOVERNMENT GRANT

## 1. Objective/scope

1.	<p><b>Objective</b> This standard deals with <b>accounting for government grants</b>. GG can be in the form of subsidies, cash incentives, duty drawbacks, etc.</p>
2.	<p><b>Scope of the Standard</b></p> <ul style="list-style-type: none"> <li>➤ Does <b>not address/deals</b> with           <ol style="list-style-type: none"> <li>a. accounting for government grants in financial statements reflecting the <b>effects of changing prices or similar supplementary information</b>.</li> <li>b. government assistance <b>other than government grants</b>.</li> <li>c. government <b>participation in the ownership</b> of the enterprise.</li> </ol> </li> <li>➤ <b>Proper accounting</b> is required when a government grant is received.</li> <li>➤ FS should indicate how much the enterprise has <b>benefited</b> from the grant during the reporting period.</li> <li>➤ Clear reporting helps in <b>comparing financial statements</b> across different periods and with other enterprises.</li> </ul>

## 2. Definitions

1.	<p><b>Government</b> Government refers to government, government agencies and similar bodies whether <b>local, national or international</b>.</p>
2.	<p><b>Government Grants</b> Government grants are <b>assistance</b> provided by the government, in <b>cash or kind</b>, to an enterprise for <b>past or future compliance</b> with certain conditions.</p> <ul style="list-style-type: none"> <li>➤ They <b>exclude</b> those forms of government assistance which <b>cannot reasonably have a value</b> placed upon them &amp;</li> <li>➤ transactions with government which <b>cannot be distinguished</b> from the <b>normal trading transactions</b> of the enterprise.</li> </ul>

## 3. Accounting treatment of Government Grants

1.	<p><b>Two broad approaches</b> may be followed for the accounting treatment of government grants:</p>
2.	<p><b>Capital Approach</b> The 'capital approach', under which a grant is treated as part of <b>shareholders' funds</b>, and, suitable for grants similar to promoters' contributions.</p>
3.	<p><b>Income Approach</b> The grant is recognized as <b>income over one or more periods</b>, typically used for other types of grants.</p>



### Choice of Approach

The choice of approach depends on the **nature of the grant**.

## 4. Recognition of Government Grants

### 1. Grant Recognition Conditions

A government grant is **not recognised** until there is **reasonable assurance** that:

- the enterprise will **comply with the conditions** attaching to it &
- the grant will be **received**.

Receipt of a grant is not of itself **conclusive evidence** that the conditions attaching to the grant have been or will be fulfilled.

#### Example

X Ltd applies for a grant from the local authority for a social cause. To receive the grant, X Ltd must meet certain conditions. There is reasonable assurance that the grant will be received on time. However, there is a possibility that X Ltd may not fulfill all the conditions. In such a case, X Ltd should not recognize the grant until it is reasonably assured that all conditions will be met.

## 5. Non-Monetary Government Grants

### 1. Government Grants in Non-Monetary Assets (e.g., land or other resources) non-monetary assets given

- at concessional rates - recorded at their **acquisition cost**.
- At free of cost - recorded at **a nominal value**.

#### Example

X Convent applies for a land grant to the State authority for building a school. The market value of the land is Rs. 20 crores, but the authority provides it at a nominal cost of Rs. 50 lakhs. X Convent should recognize the land at its acquisition cost of Rs. 50 lakhs.

## 6. Presentation of Grants Related to Specific Fixed Assets

### 1. Grants Related to Specific Fixed Assets

These grants are given to enterprises to **purchase, construct, or acquire fixed assets**.

#### Example

The Central Government aims to boost employment in rural and backward areas by providing grants to eligible entities. F Ltd applies for such a grant, which requires the company to construct a factory and employ at least 500 workers for the next five years. The estimated cost of construction is ₹50 crore, while the grant amount is ₹30 crore. F Ltd can recognize the grant in its books only if there is reasonable assurance that it will meet the condition of employing 500 workers for the required period.

### 2. Methods of Accounting for Grants

**Two methods** for presenting grants related to specific fixed assets in the financial statements:

**Method I: Deduction method**



- The grant is **deducted from the gross value** of the asset and balance asset value is **depreciated over the remaining useful life** of the asset.
- If the **grant equals the entire cost** of the asset, show the asset in the balance sheet at a **nominal value**.

#### Method II: Income Method

- For depreciable assets, treat the grant as **deferred income**, which is recognised in the **profit and loss statement** on a systematic and rational basis over the useful life of the asset.
- For non-depreciable assets, credit the grant to **capital reserve**.
- If a non-depreciable asset grant requires fulfilling obligations, the grant is credited to **income over the same period** as the cost of fulfilling the obligations.

### 7. Presentation of Grants Related to Revenue

1.
  - These are the grants given to meet any **specific expenditure** (e.g salary, R&D etc) or as **reimbursement** to the previously incurred expenditure.
  - These grants can be shown either as **other income separately** or **deducted from the related expenses** in the P&L account.
  - If the grant is given as a **reimbursement** of previously incurred expenditure transfer it to **capital reserve a/c**.

### 8. Presentation of Grants of the Nature of Promoters' Contribution

1.
  - Where the government grants are of the nature of **promoters' contribution**, i.e., they are given with reference to the **total investment** in an undertaking or by way of contribution towards its **total capital outlay** (for example, central investment subsidy scheme) and
  - **no repayment** is ordinarily expected in respect thereof,
  - the grants are treated as **capital reserve** which can be **neither distributed as dividend** nor considered as deferred income.

### 9. Refund of Government Grants

1. **Refundable Government Grants**  
Treated as **extraordinary items (AS 5)**.
  1. For grants related to revenue:
    - Refunds are first applied against any **unamortised deferred credit**.
    - If refundable amount **exceeds deferred credit**, it is charged directly to **profit and loss**.
  2. For grants related to a specific fixed asset:
    - Refund is applied by **increasing the asset's book value** or **reducing deferred income**.
    - If book value is increased, **depreciation is adjusted** over the remaining useful life of the asset.
  3. For promoters' contribution grants, if refundable:



- The refundable amount is deducted from the capital reserve.

### 10. Disclosure

- The accounting policy adopted for government grants should be disclosed, including methods of presentation in the financial statements.
- Disclose the nature and extent of government grants recognised in the financial statements, including non-monetary assets given at a concessional rate or free of cost.

#### Comparative Provisions under Ind AS 20 and AS 12

Aspect	Ind AS 20	AS 12
1. Disclosure Requirement	Requires disclosure in financial statements about other forms of government assistance received.	No specific guidance on other forms of government assistance.
2. Capital Contribution Grants	Capital contribution grants are not recognized.	Capital contribution grants are specifically recognized.
3. Recognition of Grants in Shareholders' Funds	Prohibits recognition of grants directly in shareholders' funds.	Grants for non-depreciable assets are shown as capital reserve under shareholders' funds.
4. Recognition of Non-Monetary Grants	Non-monetary grants are recognized at fair value.	Non-monetary grants are recognized at acquisition cost or nominal value.
5. Deduction of Grant from Asset Book Value	No option to deduct the grant from the book value of the asset.	Optional to deduct the amount of grant from the book value of the asset.



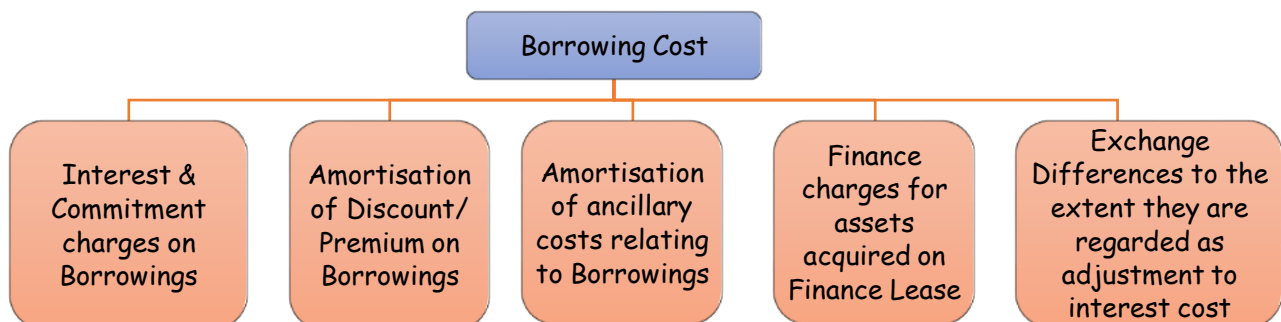
## 19. AS - 16: BORROWING COSTS

### 1. Objective & Scope

1.	<b>Objective</b> This AS provides <b>accounting for borrowing costs</b> .										
2.	<b>Scope</b> The Standard does <b>not deal with the actual or imputed cost of owners' equity, including preference share capital not classified as a liability</b> . Clarification Chart:										
	<table border="1"> <thead> <tr> <th>Particulars</th> <th>Remarks - Is the fund covered by AS 16?</th> </tr> </thead> <tbody> <tr> <td>Equity share capital</td> <td>No</td> </tr> <tr> <td>Retained earnings</td> <td>No</td> </tr> <tr> <td>Preference Share Capital classified as a liability</td> <td>Yes</td> </tr> <tr> <td>Preference Share Capital classified as equity</td> <td>No</td> </tr> </tbody> </table>	Particulars	Remarks - Is the fund covered by AS 16?	Equity share capital	No	Retained earnings	No	Preference Share Capital classified as a liability	Yes	Preference Share Capital classified as equity	No
Particulars	Remarks - Is the fund covered by AS 16?										
Equity share capital	No										
Retained earnings	No										
Preference Share Capital classified as a liability	Yes										
Preference Share Capital classified as equity	No										

### 2. Definitions

**Borrowing costs** are **interest and other costs** incurred by an enterprise in **connection with the borrowing of funds**. Borrowing cost may include



1.	<b>Qualifying Asset</b> An asset that takes a <b>substantial period of time</b> to be ready for its intended use or sale <b>Examples of Qualifying Assets</b> <ul style="list-style-type: none"> <li>➤ <b>Manufacturing plants, power generation facilities, and investment properties.</b></li> <li>➤ <b>Inventories that require substantial time to bring them to a saleable condition</b></li> </ul> <b>Non-qualifying assets include:</b> <ul style="list-style-type: none"> <li>➤ <b>Investments.</b></li> <li>➤ <b>Inventories produced quickly in large quantities.</b></li> <li>➤ <b>Assets that are ready for use or sale when acquired.</b></li> </ul>
2.	<b>Substantial Period of Time</b> <ul style="list-style-type: none"> <li>➤ <b>Substantial period of time depends on facts and circumstances of each case.</b></li> <li>➤ <b>Ordinarily, 12 months</b> is considered substantial, unless a shorter or longer period can be justified.</li> </ul>



- a **rebuttable presumption** of a period of twelve months is considered "substantial" period of time.
- The estimated period should consider the time needed for an asset to be **technologically and commercially ready** for use or sale.

## 3. Clarification Chart:

Particulars	Remarks - Is the fund covered by AS 16?
PPE (Property, plant and equipment)	Yes
Intangible assets	Yes
Investment Properties (Building meant for capital appreciation and earning rental income)	Yes
Inventory	Yes - If they require a substantial period of time to bring them to a saleable condition.
Investments (Financial assets)	No

## 3. Exchange Differences on Foreign Currency Borrowings

Particulars	Accounting Treatment
Exchange Gain	Credited to P&L
Exchange Loss	Lower of the following treated as borrowing cost:
	1. Actual exchange loss
	2. Difference between interest on local and foreign currency borrowings
Excess Exchange Loss	Charged to P&L

Understand this concept with example:

## Loan Details

XYZ Ltd. took a loan of USD 10,000 on April 1, 20X1, at an interest rate of 5% p.a., payable annually.

## Exchange Rates

On April 1, 20X1, the exchange rate was Rs. 45/USD.

On March 31, 20X2, the exchange rate was Rs. 48/USD.

## Local Currency Interest Rate

The corresponding local currency loan interest rate was 11% p.a. as of April 1, 20X1.

## Computation for Borrowing Costs (AS 16)

- i. Interest for the Period  
 $\text{USD } 10,000 \times 5\% \times \text{Rs. } 48/\text{USD} = \text{Rs. } 24,000$
- ii. Increase in Liability for Principal  
 $\text{USD } 10,000 \times (48-45) = \text{Rs. } 30,000$



iii. Interest if Loan was in Local Currency

$$\text{USD } 10,000 \times 45 \times 11\% = \text{Rs. } 49,500$$

iv. Difference in Interest (Local vs. Foreign Loan)

$$\text{Rs. } 49,500 - \text{Rs. } 24,000 = \text{Rs. } 25,500$$

#### Final Calculation of Borrowing Costs

Out of Rs. 30,000 increases in liability, only Rs. 25,500 is considered as borrowing costs.

Total borrowing cost = Rs. 24,000 (interest on foreign currency loan) + Rs. 25,500 (exchange difference).

Rs. 49,500 is considered as borrowing cost as per AS 16, and Rs. 4,500 is exchange difference under AS 11.

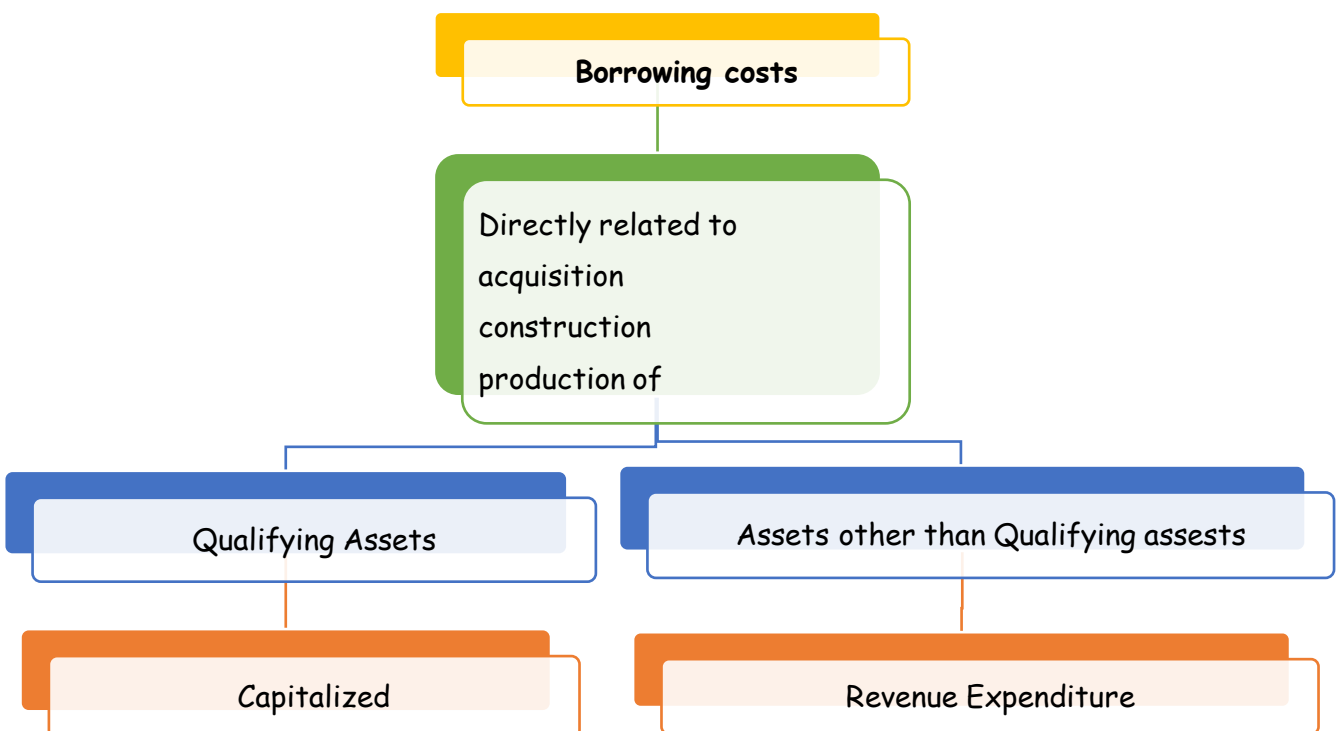
#### Alternative Scenario (13% Interest on Local Loan)

If the interest rate on the local currency loan is 13% instead of 11%, the entire exchange difference of Rs. 30,000 will be considered as borrowing costs.

Total borrowing cost = Rs. 24,000 + Rs. 30,000 = Rs. 54,000 under AS 16.

No exchange difference is recorded under AS 11.

### 4. Borrowing Costs Eligible for Capitalisation



### 5. Commencement of Capitalization

#### 1. Conditions for Capitalisation

Capitalisation of borrowing costs should begin when all the following conditions are met:

- Expenditures for the asset are incurred.
- Borrowing costs (loan taken) are incurred.
- Activities necessary to prepare the asset for its intended use or sale are in progress.



2.	<p><b>Expenditures on a Qualifying Asset</b></p> <p>Expenditures include:</p> <ul style="list-style-type: none"> <li>➤ Cash payments, transfers of other assets, and assumption of interest-bearing liabilities.</li> <li>➤ Expenditures are reduced by progress payments received and grants related to the asset.</li> </ul>
3.	<p><b>Activities to Prepare Asset for Use/Sale</b></p> <ul style="list-style-type: none"> <li>➤ Activities to prepare an asset for intended use or sale include more than just physical construction.</li> <li>➤ They also cover technical and administrative work before construction begins.</li> <li>➤ Excludes periods when the asset is held without any development or production activity.</li> <li>➤ Example: <ul style="list-style-type: none"> <li>• Borrowing costs incurred during land development → Capitalized.</li> <li>• Borrowing costs incurred while holding land without development → Not capitalized.</li> </ul> </li> </ul>
4.	<p><b>Example of Borrowing Cost Capitalisation</b></p> <p>X Ltd. is starting a construction project, financed by borrowing. The key dates are:</p> <ol style="list-style-type: none"> <li>i. 15th May, 20X1: Loan interest related to the project starts incurring.</li> <li>ii. 2nd June, 20X1: Technical site planning begins.</li> <li>iii. 19th June, 20X1: Expenditure on the project starts incurring.</li> <li>iv. 18th July, 20X1: Construction work begins.</li> </ol> <p><b>Commencement Date for Capitalisation</b></p> <p>The three conditions are:</p> <ol style="list-style-type: none"> <li>a. Borrowing cost incurred: 15th May, 20X1</li> <li>b. Expenditure incurred: 19th June, 20X1</li> <li>c. Activities necessary to prepare the asset: 2nd June, 20X1</li> </ol> <p>The commencement date for capitalisation of borrowing cost is the date when all three conditions are met: 19th June, 20X1.</p>

## 6. Suspension of Capitalization

1.	<p><b>Suspension of Capitalisation</b></p> <ul style="list-style-type: none"> <li>➤ Capitalization of borrowing costs is suspended during extended periods when active development is interrupted.</li> <li>➤ Costs incurred during such interruptions are considered holding costs and do not qualify for capitalization.</li> <li>➤ Exceptions (Capitalization continues): <ul style="list-style-type: none"> <li>• When technical or administrative work is ongoing.</li> <li>• When the delay is a normal or necessary part of development (e.g., inventories maturing, seasonal delays like high water levels affecting bridge construction).</li> </ul> </li> </ul>
2.	<p><b>Example 1 (Suspension of Development)</b></p>



Construction suspended from October 20X1 to January 20X2 due to heavy equipment being moved to another site.

In this case, capitalisation of borrowing costs must be suspended since the active development was interrupted.

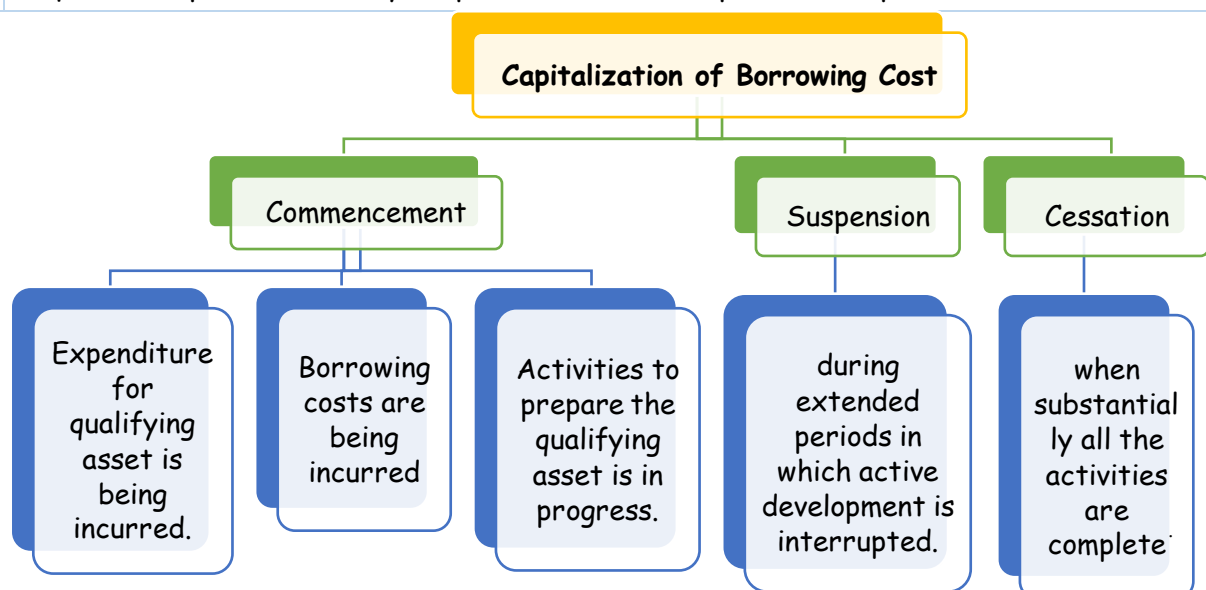
#### Example 2 (Temporary Delay)

Temporary delay of 20 days during the completion of construction due to technical reasons.

Capitalisation of borrowing costs shall continue during this temporary delay.

## 7. Cessation of Capitalization

- Cease Capitalisation of Borrowing Costs**  
Capitalisation of borrowing costs should cease when **substantially all activities necessary to prepare the qualifying asset for its intended use or sale are complete**.  
Note: Even if some routine administrative work is pending in respect of an asset like decoration of the property still it is treated as substantially completed.
- Construction in Parts (Usable Separately)**  
If an asset is completed in parts and each part is capable of being used while construction continues on other parts, capitalisation ceases once **substantially all activities are completed for that part**.  
**Example 1 (Business Park)**  
A business park with several buildings, each usable individually, is a qualifying asset. Capitalisation ceases when each part is ready for use.
- Construction in Parts (Not Usable Separately)**  
If part of the asset cannot be used separately (e.g., industrial plant), capitalisation continues until the **entire asset is complete**.  
**Example 2 (Industrial Plant)**  
For an industrial plant (e.g., a steel mill) involving several processes carried out in sequence, capitalisation only stops when the entire plant is complete.





## 8. Amount of capitalization

1.	<p><b>Conditions for Capitalisation</b> Borrowing costs are capitalised when <b>both conditions</b> are met:</p> <ol style="list-style-type: none"> <li>1. It is <b>probable</b> that the borrowing costs will result in <b>future economic benefits</b> to the entity.</li> <li>2. The borrowing costs can be <b>measured reliably</b>.</li> </ol>
2.	<p><b>Other Borrowing Costs</b> Other borrowing costs are recognised as <b>an expense</b> in the period in which they are incurred.</p>
3.	<p><b>Classification of Borrowings</b> Borrowings are classified as:</p> <ol style="list-style-type: none"> <li>1. <b>Specific borrowings:</b> Amount borrowed specifically for the <b>acquisition or construction</b> of a qualifying asset.</li> <li>2. <b>General borrowings:</b> All other borrowings that are not specific, which <b>can be used for any purpose</b>.</li> </ol>
4.	<p><b>Calculation of specific Borrowing Costs</b> <b>Actual borrowing costs</b> incurred during the period Less <b>Investment income on temporary investments</b> made using those borrowings.</p>
5.	<p><b>Capitalisation of General Borrowing Costs</b> When general borrowings are used for a qualifying asset (QA), the entity must determine the borrowing costs eligible for capitalisation by applying the <b>capitalisation rate</b>. <b>Compute Capitalisation Rate</b> Capitalisation rate = <math display="block">\frac{\text{Borrowing cost on general borrowings}}{\text{weighted average of general borrowings outstanding during the period}} \times 100</math> <b>Amount eligible for capitalisation =</b> <math display="block">\text{Expenditure on QA} \times \text{Capitalisation rate}</math></p>
6.	<p><b>Maximum Capitalisation</b> The amount of borrowing costs capitalised during a period must <b>not exceed</b> the actual borrowing costs incurred during that period.</p>
7.	<p><b>Total Borrowing Costs to Capitalise on QA</b> Total borrowing costs capitalised on QA = <b>Specific borrowing costs + General borrowing costs</b></p>

## 9. Excess of the Carrying Amount Over Recoverable Amount

1.	<p><b>After capitalization of borrowing cost</b></p> <ul style="list-style-type: none"> <li>➤ If the carrying amount or expected cost of a qualifying asset exceeds its recoverable amount or net realizable value, it must be <b>written down or written off</b> as per relevant accounting standards.</li> </ul>
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- In some cases, this write-down or write-off can be reversed if allowed by those accounting standards.

### 10. Disclosure

- a. Amount of borrowing costs capitalised during the period
- b. accounting policy adopted for borrowing costs.

#### Comparative Provisions: Ind AS 23 vs AS 16

Aspect	Ind AS 23	AS 16
1. Qualifying Assets	Biological assets will never be included as qualifying assets.	Biological assets may be included as qualifying assets.
2. Definition of Substantial Period of Time	No specific definition provided; it is a matter of judgement.	Specific definition and explanation on the substantial period of time is provided.
3. Inventories as Qualifying Assets	Inventories produced in large quantities should not be considered as qualifying assets.	Inventories can be considered as qualifying assets if they meet the condition of substantial period.
4. Disclosure of Interest Expense	Interest expense, whether capitalised or not, should be disclosed separately during the period.	Disclosure is required only if capitalisation of borrowing costs has occurred during the period.
5. Borrowing Costs in Hyper-inflation	Hyper-inflationary situations addressed. Increases in interest costs due to hyperinflation must be written off in the income statement.	No specific guidance on hyperinflation and its impact on interest costs.
6. Capitalisation Rate Disclosure	Weighted average capitalisation rate on borrowings should be disclosed in Notes to accounts.	No specific guidance on capitalisation rate disclosure.
7. Consolidated Financial Statements	In consolidated financial statements, the weighted average capitalisation rate on borrowings of the holding and subsidiaries should be considered.	No specific guidance on capitalisation rate for consolidated statements.



## 20. AS - 22: ACCOUNTING FOR TAXES ON INCOME

### 1. Objective

1.	This standard prescribes the <b>accounting treatment for taxes on income</b> .
2.	<b>Matching Concept</b> In accordance with the matching concept, <b>taxes on income are accrued in the same period as the revenue and expenses to which they relate</b> .
3.	Taxable income may be <b>significantly different</b> from the accounting income.

### 2. Scope

1.	This Standard applies to <b>accounting for taxes on income</b> .
2.	Covers <b>determining tax expense</b> for an accounting period and its disclosure in financial statements.
3.	Taxes on income <b>includes all domestic &amp; foreign taxes</b> based on taxable income.

### 3. Key Terms

1.	<b>AI (Accounting Income)</b> <b>Net profit or loss before tax.</b>
2.	<b>TI (Taxable Income)</b> <b>Income computed under tax laws, on which tax is payable.</b>
3.	<b>Tax Expense</b> <b>Current Tax + Deferred Tax.</b>
4.	<b>CT (Current Tax)</b> <b>Tax payable on taxable income for the period.</b>
5.	<b>DT (Deferred Tax)</b> <b>Tax effect of timing differences.</b>
6.	<b>Timing Differences</b> <b>Differences between taxable &amp; accounting income that originate in one period and reverse in future periods.</b> <b>Example</b> Machinery purchased for scientific research - fully deductible for tax in Year 1, but depreciated over years in accounting books. Creates a temporary difference, leading to a deferred tax asset or liability.
7.	<b>Permanent Differences</b> <b>Differences that originate in one period and do not reverse later.</b> <b>Example</b> Fine for late tax payment - considered an expense in profit & loss, but not allowed for tax computation. Since it never reverses, it is a permanent difference.



#### 4. Recognition

1.	<p><b>Tax on Income as an Expense</b> Tax on income is considered as an <b>expense for the period</b>, (current tax and deferred tax), should be <b>included in the determination of the net profit or loss</b> for the period.</p>
2.	<p><b>Tax Effects of Timing Differences</b> Shown in Statement of <b>Profit &amp; Loss</b> as <b>tax expenses</b> &amp; as <b>DTA or DTL</b> in the <b>Balance Sheet</b>.</p>
3.	<p><b>Recognition of Deferred Tax Assets (DTA)</b> DTA should be recognised and carried forward only to the extent that there is a <b>reasonable certainty that sufficient future taxable income</b> will be available against which such deferred tax assets can be realised.</p>
4.	<p><b>DTA for Unabsorbed Depreciation or Losses</b> If an enterprise has unabsorbed depreciation or carry-forward losses, DTA can be recognized only when there is <b>virtual certainty, backed by convincing evidence</b>, that <b>sufficient future taxable income</b> will be available to utilize these assets.</p>
5.	<p><b>Criteria for Certainty in Recognizing Deferred Tax Assets</b></p> <p>a. This reasonable level of certainty would normally be achieved by</p> <ul style="list-style-type: none"> <li>➤ Examining <b>the past record of the enterprise</b> and</li> <li>➤ by making <b>realistic estimates of profits</b> for the future.</li> </ul> <p>b. Virtual certainty cannot be based only on performance forecasts.</p> <ul style="list-style-type: none"> <li>➤ It must be backed by <b>strong evidence</b>, such as: <ul style="list-style-type: none"> <li>• A binding export order that ensures profits.</li> <li>• A contract where cancellation leads to heavy penalties for the defaulting party</li> </ul> </li> </ul>

#### 5. Measurement

1.	<p><b>Current Tax</b> Measured at the amount expected to be paid to tax authorities using <b>applicable tax rates &amp; laws</b>.</p>
2.	<p><b>Deferred Tax Assets &amp; Liabilities</b> Measured using <b>tax rates &amp; laws that are enacted or substantively enacted</b> by the balance sheet date.</p>
3.	<p><b>Discounting of Deferred Tax</b> Deferred tax assets &amp; liabilities should <b>not be discounted to their present value</b>.</p>

#### 6. Re-Assessment of Unrecognised Deferred Tax Assets

Reassessment of Deferred Tax Assets (DTA)	
At each balance sheet date	Unrecognized DTAs are reassessed.
Future taxable income is reasonably or virtually certain	Recognize previously unrecognized DTAs.



### 7. Review of Previously Recognised Deferred Tax Assets

1.	<b>Review of Recognized DTA</b> Carrying value of recognized DTAs must be reviewed at each balance sheet date.
2.	<b>Insufficient Future Taxable Income</b> If future taxable income is unlikely, the DTA must be written down.
3.	<b>Improved Future Taxable Income</b> If taxable income becomes reasonably or virtually certain, the write-down can be reversed.

### 8. Presentation and Disclosure - Offsetting Assets and Liabilities

Offsetting Tax Assets & Liabilities	
1.	<b>Current Tax Assets &amp; Liabilities</b> Offsetting allowed if: <ol style="list-style-type: none"> <li>Legally enforceable right to set off exists.</li> <li>Intent to settle on a net basis.</li> </ol>
2.	<b>Deferred Tax Assets &amp; Liabilities</b> Offsetting allowed if: <ol style="list-style-type: none"> <li>Legally enforceable right to set off exists.</li> <li>Both relate to taxes levied by the same taxation laws.</li> </ol>

### 9. Special Cases

Tax Holiday (Sections 10A, 10B, 80IA)	
Timing differences originate & reverse within tax holiday period	No Deferred Tax is created.
Timing differences originate in tax holiday period but reverse after it	Deferred Tax is created.
Reversal Order	Timing differences originating first are considered to reverse first.

Accounting for Taxes under Section 115JB (MAT)	
1.	<b>Tax paid under Section 115JB</b> Considered as current tax for the period.
2.	<b>Deferred Tax Measurement</b> DTAs & DTLs for timing differences during tax payment under 115JB must be measured using regular tax rates, not 115JB rates.
3.	<b>Reversal of Timing Differences</b> If timing differences of current period are expected to reverse in a period where tax under 115JB may apply, regular tax rates must be used for measuring DTAs & DTLs.



## Comparative Provisions between AS 22 and Ind AS 12

Aspect	Ind AS 12 (Income Taxes)	AS 22 (Accounting for Taxes on Income)
1. Approach	Based on <b>Balance Sheet</b> approach.	Based on <b>Income Statement</b> approach.
2. Recognition Basis	Recognizes the difference between carrying amounts of assets and liabilities and their tax base.	Recognizes the difference between taxable income and accounting income.
3. Types of Differences	Applies to <b>Timing Differences</b> and <b>Permanent Differences</b> .	Applies to <b>Taxable Temporary Differences</b> and <b>Deductible Temporary Differences</b> . Does not address <b>Permanent Differences</b> .
4. Recognition of Deferred Tax	Recognizes <b>deductible temporary differences</b> to the extent that future periods are likely to provide taxable earnings.	<b>Deferred tax assets</b> are <b>recognized</b> only when there is reasonable certainty of its realization.
5. Concept of Virtual Certainty	<b>No concept</b> of virtual certainty.	Deferred tax assets related to unabsorbed depreciation or carry forward losses are recognized only if there is <b>virtual certainty backed by convincing evidence</b> .
6. Tax Recognition in Income Statement	<b>Current and deferred tax</b> are recognized in the income statement, except for tax arising from transactions in <b>Other Comprehensive Income</b> or directly in equity.	<b>No specific guidance</b> on this.
7. Revaluation of Assets	Disparity between carrying amount of a revalued asset and its tax base is <b>addressed</b> .	<b>No specific guidance</b> on this.
8. Minimum Alternate Tax (MAT)	<b>No specific guidance</b> on Minimum Alternate Tax under Section 115JB.	<b>Specific guidance</b> on Minimum Alternate Tax under Section 115JB.
9. Tax Holiday & Capital Gains	<b>No specific guidance</b> on deferred tax for tax holiday situations and capital gain cases.	<b>Specific guidance</b> on deferred tax for tax holiday situations and capital gain cases.





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