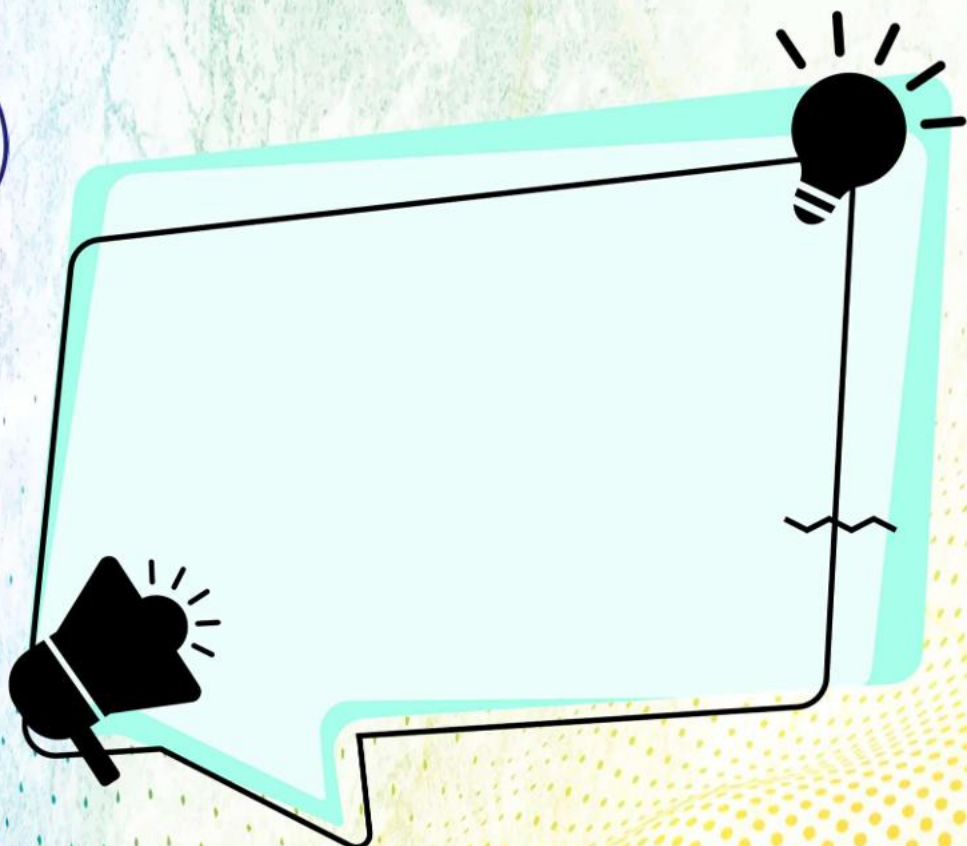


CMA Inter

Financial Accounting

Marathon June 24



Reconstitution of Partnership

Meaning of Partnership

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

Main features of Partnership are:

- i) **Two or more persons:** It is an association of two or more persons for a common interest.
- ii) **Agreement:** The Partnership is an agreement. It may be either oral or in writing.
- iii) **Lawful Business:** Partnership is formed to carry on a business; so it must follow the law.
- iv) **Profit Sharing:** Profit or loss of the firm is to share by the partners in an agreed ratio and equally where the ratio is not agreed.

Rules applicable in the absence of Partnership Deed

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

- (i) Profit sharing ratio will be equal
- (ii) No Interest on Capital and Drawings
- (iii) No Remuneration or Salary to the partners.
- (iv) Interest on Loan advanced by the partner @6% p.a.

Meaning of Reconstitution of Partnership

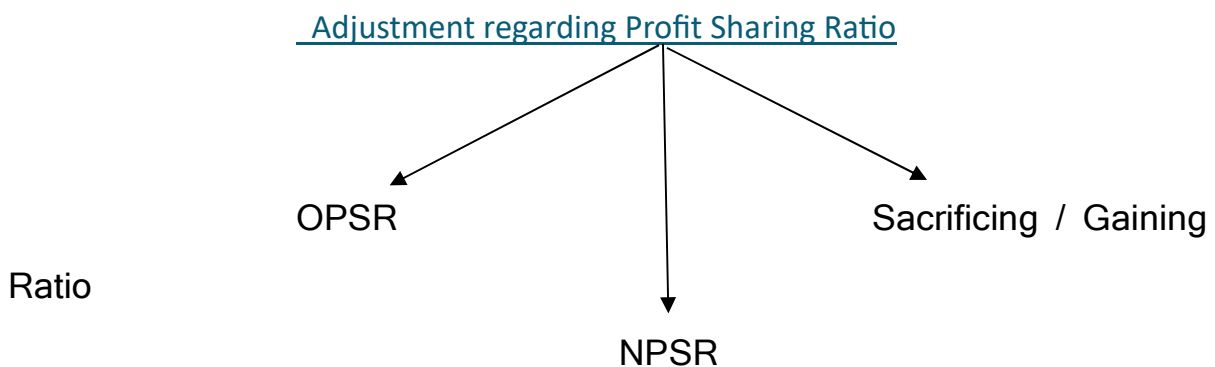
Change in agreement. Business continues:

- (i) Change in Profit Sharing Ratio
- (ii) Admission of a Partner
- (iii) Retirement of a Partner

(iv) Death of a Partner

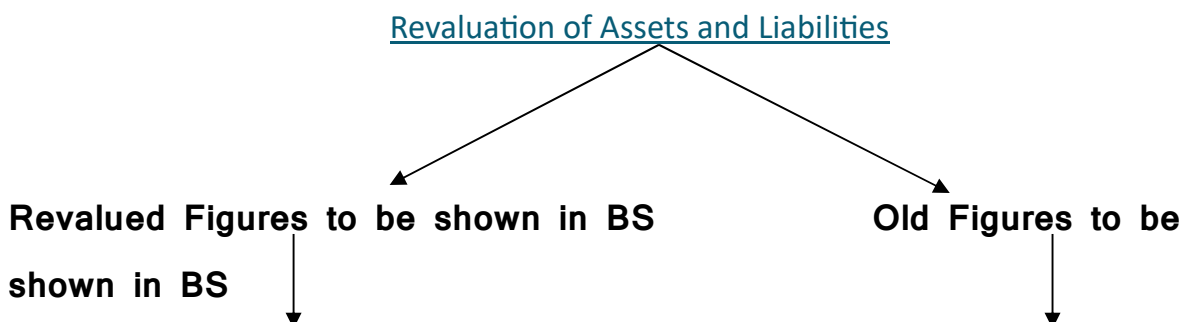
Requirements at the time of Reconstitution of Partnership

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



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

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



Revaluation Account
Account

Memorandum Revaluation

Revaluation Account

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

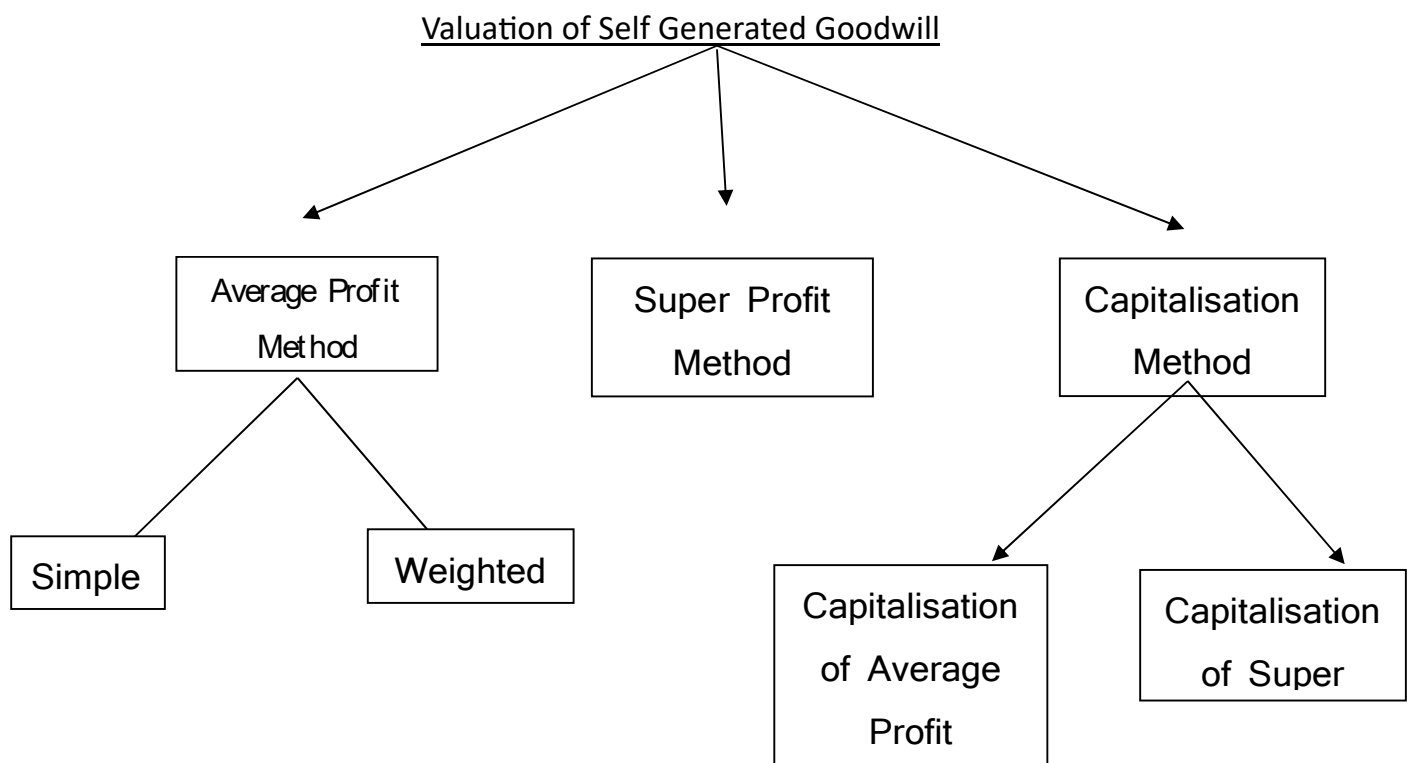
Memorandum Revaluation Account

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

Goodwill:

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

Goodwill can be a Purchased Goodwill or Self Generated Goodwill. As per AS 26, self generated Goodwill can not be recorded in the books. However at the time of reconstitution of Partnership (Change in PSR, Admission, Retirement, Death), Valuation of Self Generated Goodwill is done. Accounting for the same is done without recording goodwill in the books (Done through Capital Adjustments)



Goodwill as per Annuity Method = Annual Super Profit X Annuity Factor

Adjustment for Accumulated Reserves, Profits and Losses:

Example

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

Balances on the date of Admission:

₹

General Reserve	10000
Workmen Compensation Reserve	16000
Investment Fluctuation Fund	9000
Employees Provident Fund	4000
Investments	25000
Profit and Loss A/c Debit Balance	3000

Workmen Compensation Claim is ₹ 11000

Market value of investments is ₹ 20000

Show the treatment of reserves

when:

- When Reserve is not to be maintained in Balance Sheet?
- When Reserve is to be maintained at the same value in Balance Sheet?

Specific treatments at the time of retirement or death

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

- Balance of his capital and current account at the time of retirement/death.
- Share of goodwill, undistributed profit or loss, reserves and profit or loss on revaluation of assets and liabilities
- Salary, commission, interest on capital, if any and all other dues till the date of retirement/death.

4. Any adjustment in drawings and interest thereon.

Retirement/Death in the middle of the year:

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

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

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

Section 37 of Indian Partnership Act, 1932:

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

Maximum of:

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

OR

ii. Share of profit earned from the amount due

Dissolution of Firm and Insolvency

Insolvency of a Partner

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

Decision in Garner vs. Murray Case

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

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

- i. That the solvent partners should bring in cash equal to their respective shares of the loss on realization;
- ii. That the solvent partners should bear the loss arising due to the insolvency of a partner in the ratio of their Last Agreed Capitals.

Criticism of the decision of Garner vs. Murray

- i. If any solvent partner has a debit balance in capital account, he must not bear the deficiency of the insolvent partner;
- ii. This principle does not apply if there are only two partners;
- iii. In spite of having a credit balance in capital account the solvent partner must bring cash equal to the amount of loss on realization; and

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

Insolvency of All the Partners

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

Piecemeal Distribution:

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

Order of Payment in Piecemeal Distribution:

- 1 **Realisation Expenses**
- 2 For **provision for expenses** that are to be made
- 3 Preferential creditors (say, Income Tax or any payment made to the **Government**)
- 4 **Secured creditors** - upto the amount realized from the disposal of assets by which they are secured and for the balance, if any, to be paid to unsecured creditors.
- 5 **Unsecured creditors** - in proportion to the amount of debts, if more than one creditor
- 6 **Partners' loan** - if there is more than one partner - in that case, in proportion to the amount of loan
- 7 **Partners' capital** - the order of payment may be made by any one of the following two methods:
 - A. Surplus Capital Method/ Proportionate Capital Method/ Highest Relative Capital Method
 - B. Maximum Possible Loss Method

Incomplete Records

Features of Single Entry System?

Main Features of Single-Entry System are:

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

Benefits of Single Entry System?

Main advantages of Single Entry System are:

- a) Quick and easy
- b) Useful for small business run by individuals
- c) Economical
- d) Flexible Method
- e) Requires only basic accounting knowledge

Weaknesses or Limitations of Single Entry System?

1. Principles of Double Entry not followed
2. Trial Balance can not be prepared
3. Accurate Profit or Loss can not be ascertained.
4. Accurate Financial Position can not be ascertained.
5. Difficult to detect frauds or errors
6. External agencies like Banks cannot use financial information
7. Business and personal transactions of the proprietor get mixed.

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

Double Entry	Single Entry
Both the aspects (debit and credit) of all the transactions are recorded	<ul style="list-style-type: none"> - No record of some transactions. - Some transactions are recorded only in one of their aspects. - Some transactions are recorded in both of their aspects.
Various subsidiary books such as sales book, purchases book etc are maintained.	No such subsidiary books maintained except cash book.
Ledger contains personal, real and nominal accounts	Ledger contains some personal accounts only.
Preparation of trial balance is possible	Preparation of trial balance is not possible
Trading A/c, Profit & Loss A/c and the Balance Sheet are prepared in a scientific manner.	Not possible - only a rough estimate of profit or loss is made and a Statement of Affairs is prepared which resembles a balance sheet in appearance but which does not present an accurate picture of the financial position of the business.

Steps for preparing Final Accounts under Single Entry System

2 Statements are prepared:

- a. Statement of Profit and Loss
- b. Statement of Affairs (Just like Balance Sheet)

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

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

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

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

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

OR

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

Note: Drawings can be in cash and in kind like Stock, furniture etc. Consider total Drawings including in kind. Also, Interest on drawings should be calculated on the total amount of drawings. E.g. He withdrew goods of ₹2,100 and cash of ₹7,200 for his personal use. Interest on drawing is to be charged at 10%

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

Sol:

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

Step 2: Prepare necessary ledger accounts and Statements to find missing information. Give Dr and Cr effect of the missing information.

Step 3: Keep putting the figures at the correct place as you find them.

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

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

Points to remember:

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



Non-Profit Organisations

Meaning of Non-Profit Organisation

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

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

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

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

There are 2 main reasons for this:

- a. Nature of NPO is unique and certain items of revenue and expenses need special understanding (Like Donations, Entrance Fees, Subscriptions, Grants Received, Tournament Expenses, Prizes etc.)
- b. Final Accounts prepared by Non-Profit Organisations is slightly different from the Profit making organisations. NPOs prepare the following as part of their Financial Statements:
 - i. Receipts and Payments Account
 - ii. Income & Expenditure Account
 - iii. Balance Sheet

Some Special items of Incomes and Expenses in an NPO:

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

		Programme Expenses Allowances Consultancy Audit fees Any material consumed Stationery consumed	
--	--	--	--

Receipts and Payments Account for the year ended..

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

To Endowment Fund	XXX	By Balance c/d (Closing Balance):	
To Sale of Fixed Assets	XXX	Cash in Hand	XXX
To Receipts on Account of Special Fund, i.e., Match Fund, Prize Fund, etc.	XXX	Cash at Bank*	XXX
To Balance c/d (Bank Overdraft)*	XXX		
	XXXX		XXXX

Income and Expenditure Account for the period ended...

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

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

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

Format of Opening Balance Sheet

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

Format of Closing Balance Sheet:

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

Accrual Concept

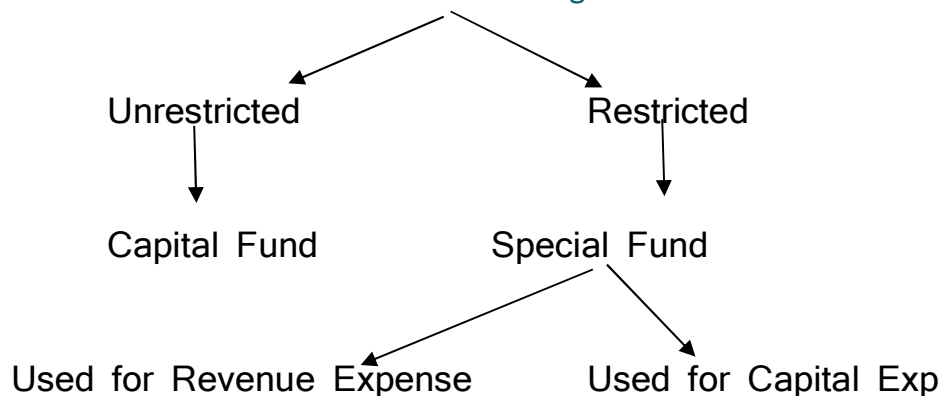
Treatment of Any Expense	Income & Exp. A/c	Balance Sheet
Amount given in Payment (Cr) side of Receipts and Payments A/c	Dr Side	-----
Outstanding / Due / Unpaid of Current Year	+	Liability in Closing BS
Outstanding / Due / Unpaid of Previous Year	-	Liability in Opening BS
Advance / Prepaid / Unexpired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

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

Cost of Material Consumed

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

Fund Based Accounting:



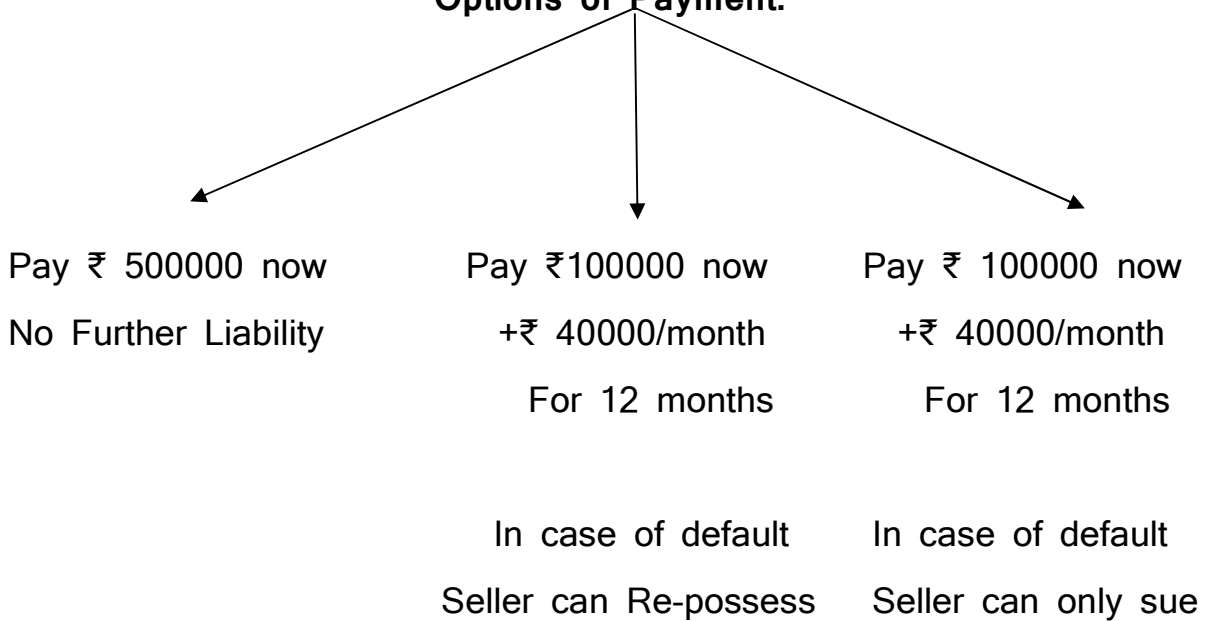
Hire-Purchase

Concept of Hire-Purchase and Installment System

Example:

Price of a car is ₹ 500000.

Options of Payment:



Difference between Hire-Purchase and Installment System

Particulars	Hire Purchase	Installment
Ownership	Ownership passes to the buyer on the payment of last installment.	Ownership passes at the time of sale.
Default in making payment	Seller can repossess the goods. Installments paid is treated as Hiring charges.	Seller can sue the buyer for the non-payment of price.

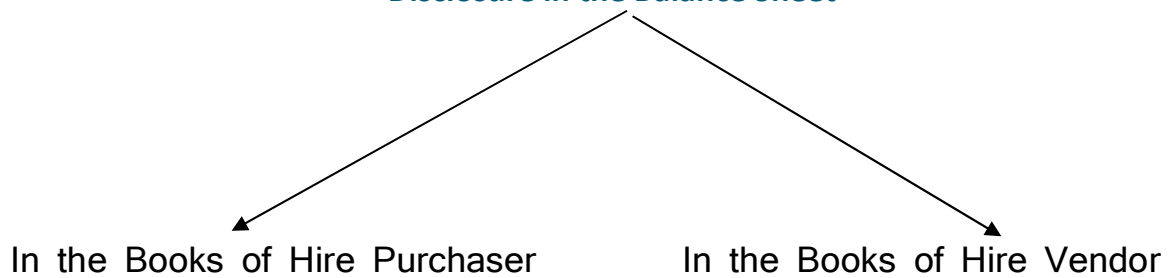
Right of sale or transfer	No right to sale or transfer since the legal position of the hirer is bailee.	Right to sale or otherwise transfer the goods.
Loss or damages to the goods.	To be borne by the seller if the buyer takes reasonable care.	To be borne by the buyer.

Accounting of Hire-Purchase Transaction

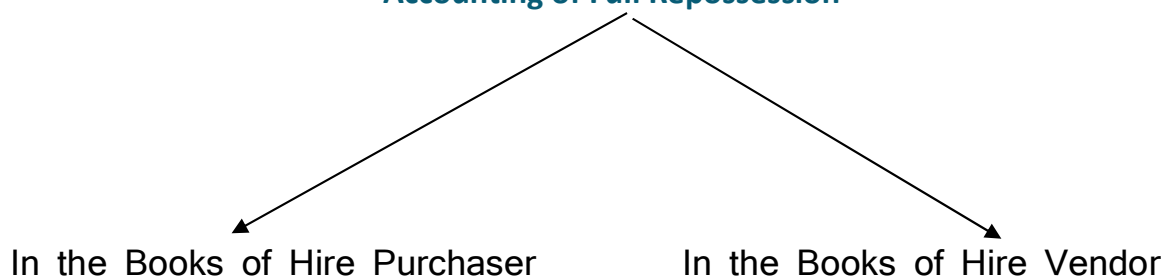
Transaction	In the books of Hire Purchaser	In the books of Hire Vendor
On transfer of Possession		
On making Down Payment		
On making Interest due on unpaid balance		

On making payment of Instalment		
On providing Depreciation		
On closure of Depreciation A/c and Interest A/c		

Disclosure in the Balance Sheet



Accounting of Full Repossession



Accounting of Partial Re-Possession

In the Books of Hire Purchaser

In the Books of Hire Vendor

Points to Remember

1. Cash Price = PV of all the payments
2. Loan Amortization Table should be prepared
3. Interest rate can be calculated using trial and error method and interpolation.
4. Interest amount in case of quarterly or monthly installments can be calculated using "Ratio Method".
5. If installment amount is same, Annuity Factor can be used.
6. Value of Goods Repossessed by the Vendor:

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

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

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

Insurance Claim

Step - 1

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

Step - 2

Calculate Actual Value of Stock Lost:

Book Value	XX
Deduct: Salvage Value	<u>XX</u>
Actual Value of Stock Lost	<u>XX</u>

Step - 3

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

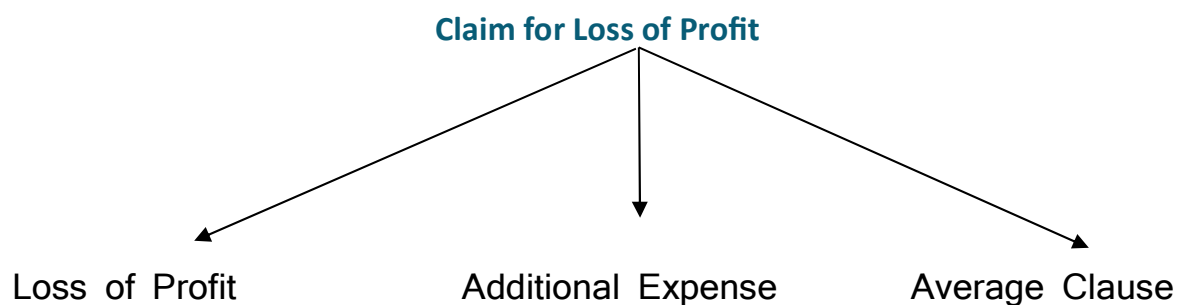
Net Claim = Actual Loss of Stock X Policy Value / Book Value

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

Notes:

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

2. To calculate GP Ratio, we may need to prepare Previous Year Trading Account. Adjust GP Ratio according to information (Different GP Ratio or Different Selling Price so different GP Ratio)
3. Abnormal Goods - Double Column Trading Accounts
4. Loss of Stock is both Normal Goods and Abnormal Goods (Realisable Value)
5. Drawings of Goods, Goods distributed, Goods sent on consignment or on approval basis and other similar items need to be treated at cost only.
6. If any amount is written off from stock on account of abnormality, add it back and then treat as segregated between Normal Goods and Abnormal goods.



Steps:

1. Determine the Trend
2. Calculation of Short Sales
3. $GP \text{ Ratio} = (NP + I.S.C) / \text{Sales}$
4. Calculate Loss of Profit due to short sale
5. Additional Expense:
 Lower of the following
 - a. Actual
 - b. Incremental Profit due to incremental sales in Loss period
 - c. $\text{Additional Expense} \times GP \text{ on AATO} / (GP \text{ on AATO} + U.I.S.C)$

Note: Trend will only be used on Current FY

6. Total Loss

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

7. Claim

Loss \times Policy Value / GP on AATO

Departmental Accounts

Reason for Departmental Accounts:

- a. **Proper Allocation:** Expenses that relate to a particular department are estimated on an exact basis. Hence, cost and profits of each department is estimated more accurately.
- b. **Control:** Availability of separate cost and profit figures for each department facilitates control. Proper control and fixation of responsibility is easier.
- c. **Proper absorption :** The processing times of different products in different departments may vary. Specific cost analysis on a department-wise basis facilitates scientific cost absorption and cost assignment.

Interdepartmental Transfer

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

Allocation of Expenses

Specific to any Department - Charge to that department only

Common Allocable Expense - Charge on suitable basis

Non Allocable Expense - Charge to General P/L A/c

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

1. Stock Reserve Accounting

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

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

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

Calculation of Stock Reserve

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

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

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

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

Branch Accounts

Types

- i) Inland
 - a. Dependent
 - i. Debtors' method
 - ii. Stock & Debtors Method
 - iii. Final accounts method
 - b. Independent
- ii) Foreign

Debtors Method

Step 1. Opening balances of assets and liabilities

Step 2. Recording transactions between HO and branch only

Step 3. Year end closing balances

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

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

Stock and Debtors Method

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

Mainly the following ledger are required to be prepared:

- i) Branch stock a/c (at invoice price)

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

Final A/C Method

- Everything at cost only except sales
- GSTB like purchase

Independent Branches

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

- * HO earns GP on GSTB (for loading)
- * branch earns GP on sales above I.P
- * HO also earns GP on direct sales
- * Stock reserve accounting to be done in HO P/L account
- * Goods in transit - stock reserves to be done as well
- * GRFHO and GIT relation

Independent Branch- Incorporation entries in HO Books

Branch

To Profit from Branch A/c

Assets

To Branch

Branch

To Liabilities

- * Branch Personal A/c will become NIL.

Consignment Accounting

Difference between Sale and Consignment

1. In sale the property in goods is transferred to the buyer immediately whereas in consignment the property is transferred to the buyer only when goods are sold by the consignee. The ownership of goods remains with the consignor when goods are transferred to the consignee by the consignor.
2. In sale, the risk attaching to the goods passes with ownership to the buyer. In case of a consignment, the risk attaching to the goods does not pass to the consignee who acts as a mere agent. If there is any damage or loss to the goods it is borne by the consignor provided the consignee has taken reasonable care of the goods and the damage or loss is not due to his negligence.
3. The relationship of consignor and consignee is that of a principal and an agent as in a contract of agency whereas the relationship of buyer and seller is governed by the Sale of Goods Act.
4. Unsold goods on consignment are the property of the consignor and may be returned if not saleable in the market whereas goods sold on sale basis are normally not returnable unless there is some defect in them.

Main Terms of Consignment Trade

Consignor - Who sends goods to agents e.g. a manufacturer or wholesaler.

Consignee - Agent to whom goods are sent for selling.

Proforma Invoice - Like an invoice, proforma invoice conveys information to the consignee regarding quantity, varieties and prices of goods sent and expenses incurred and not to make him liable like a trade debtor.

Over-riding Commission - It is an extra commission allowed over and above the normal commission. Offered for the following reasons:

- (i) When the agent is required to put in hard work in introducing a new product in the market.
- (ii) Where he is entrusted with the work of supervising the performance of other agents in a particular area.
- (iii) For effecting sales at prices higher than the price fixed by the consignor.

Del Credre Commission - Additional commission payable to the consignee for taking over additional responsibility of collecting money from customers. In case, the customers do not pay the consignee takes over the loss of bad debts in his books. Although it's paid for taking over risk of bad debts that arise out of credit sales only, this commission is calculated on total sales and not on credit sales.

Account Sales - Periodical statement prepared by consignee to be sent to the consignor giving details of all sales (cash and credit), expenses incurred and commission due for sales, destroyed-in-transit or in godown and deducting the amount of advance remitted by him.

Operating Cycle of Consignment Arrangement

- (i) Goods are sent by consignor to the consignee.
- (ii) Consignee may pay some advance or accept a bill of exchange.
- (iii) Consignee will incur expenses for selling the goods.
- (iv) Consignee maintains records of all cash and credit sale.
- (v) Consignee prepares a summary of results called as Account sales.
- (vi) Consignor pays commission to the consignee.

Sometimes, the consignor may send the goods at a price higher than cost so that the consignee gets no knowledge of the real cost of goods which is confidential for the consignor.

Bills of Exchange

A Bill of Exchange and Promissory Note both are legal Instruments which facilitate the credit sale of goods by assuring the seller that the amount will be recovered after a certain period of time. Both of these are legal instruments under the Negotiable Instruments Act, 1881.

Features of a Bill of Exchange are:

1. A bill of exchange must be in writing
2. It must contain an order (and note a request) to make payment.
3. The order of payment must be unconditional.
4. The amount of bill of exchange must be certain.
5. The date of payment should be certain.
6. It must be signed by the drawer of the bill.
7. It must be accepted by the drawee by signing on it.
8. The amount specified in the bill exchange is payable either on demand or on the expiry of a fixed period.

9. The amount specified in the bill is payable either to a certain person or to his order or to the bearer of the bill.

10. It must be stamped as per legal requirements

Parties to a bill of exchange

1. **Drawer:** Drawer is the person who makes or writes the bill of exchange. Drawer is a person who has sold goods on credit or granted credit to the person on whom the bill of exchange is drawn. The drawer is entitled to receive money from the drawee (acceptor).

2. **Drawee:** Drawee is the person on whom the bill of exchange is drawn for acceptance Drawee is the person who purchase goods on credit or to whom credit has been granted by drawer. The drawee is liable to pay money to the creditor / drawer.

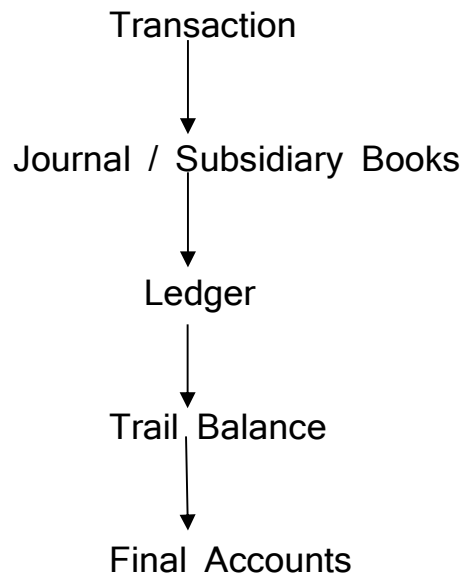
3. **Payee:** Payee is the person who receives the payment from the drawee. Usually the Drawer and the payee is the same person. In the following cases, drawer and payee are two different persons.
 - (i) When the bill is discounted by the drawer from his bank, payee is the bank.
 - (ii) When the bill is endorsed by the drawer to his creditors, payee is the endorsee.

Promissory note

A Promissory note is an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking signed by the maker to pay a certain sum of money only or to the order of a certain person or to be the bearer of the instrument.

Rectification of Errors

Accounting Process

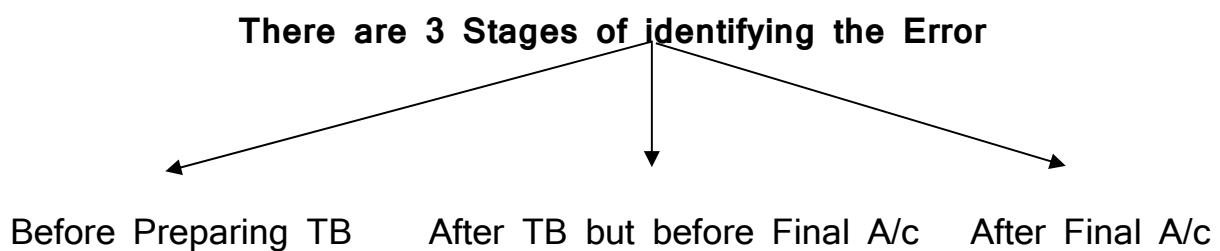


Error can be at any stage of the Accounting Process

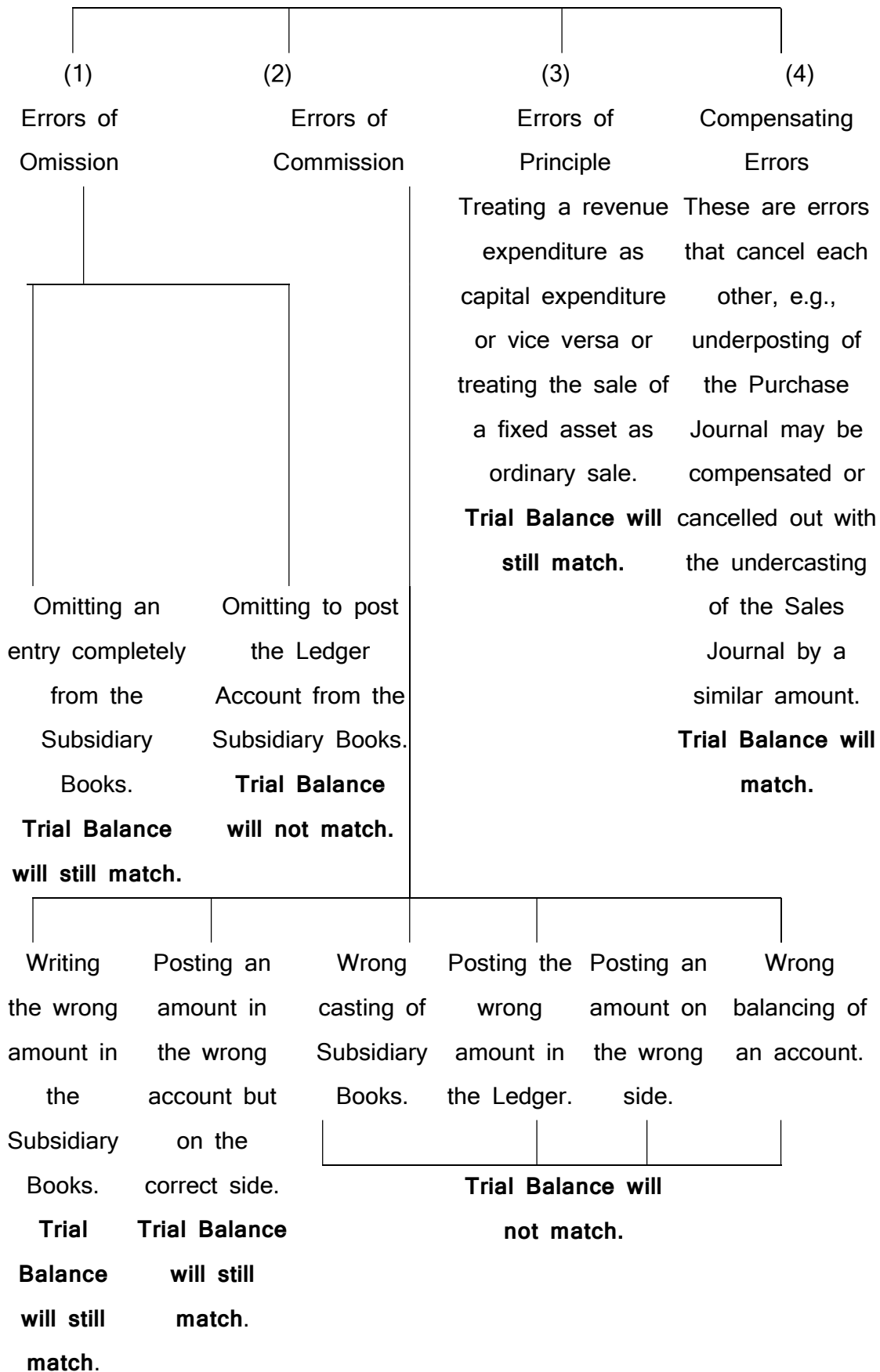
And

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

Understanding the Errors and their stage of identification



TYPES OF ERRORS



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

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