Referencer for Quick Revision

Intermediate Course Group-I

A compendium of subject-wise capsules published in the monthly journal "The Chartered Accountant Student"

Board of Studies
(Academic)
ICAI

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Accounting - A Capsule for Quick Revision

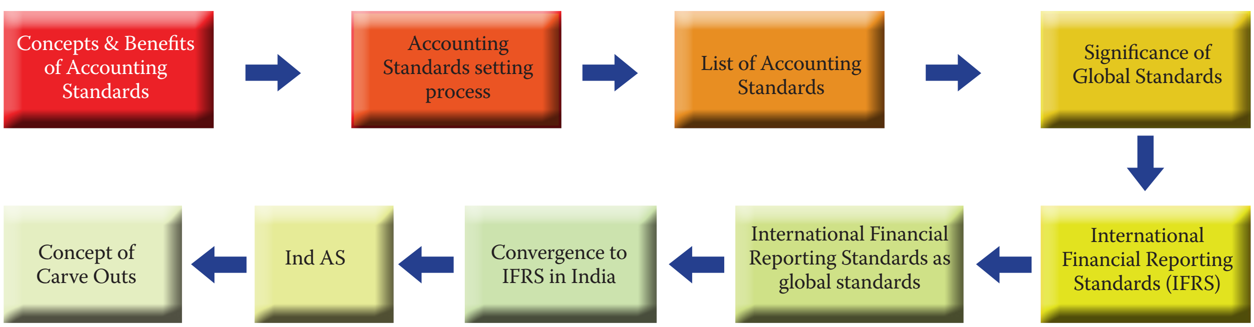
Accounting constitutes a significant area of core competence for Chartered Accountancy students. The significance of this subject can be judged from the fact that we have a paper on Accounting at every level of CA course. Accounting papers at Intermediate level under Chartered Accountancy curriculum concentrate on conceptual understanding of the crucial aspects of accounting and acquaint students with the basic concepts, theories and accounting techniques followed by different entities. The objective of Paper 1 "Accounting" at Intermediate level is to acquire the ability to apply specific accounting standards and legislations to different transactions and events and in preparation and presentation of financial statements of various business entities.

It has always been the endeavour of Board of Studies to provide quality academic inputs to the students. Keeping in mind this objective, it has been decided to bring forth a crisp and concise capsule for Intermediate Paper 1 'Accounting'. Chapter overview has been provided to present a broad outline of the topic coverage in each chapter. The significant points of the topics have been presented through pictorial presentations in this capsule which will help the students in grasping the intricate practical aspects of each topic. This will facilitate the students to recapitulate the whole concepts within minimum time and efforts in the later stages of preparation. Although, the capsule has been prepared keeping in view the new and revised scheme of Education and Training of ICAI, the students of earlier scheme may also be benefitted from it.

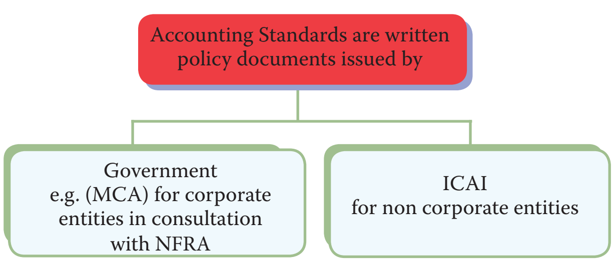
This capsule, though, facilitates the students in undergoing quick revision, under no circumstances, such revisions can substitute the detailed study of the material provided by the BoS.

CHAPTER 1: INTRODUCTION TO ACCOUNTING STANDARDS

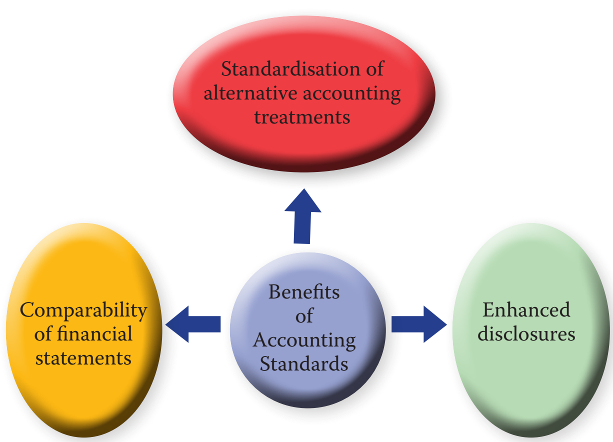
Chapter Overview



Issuance of Accounting Standards



Accounting Standards - Benefits			
Recognition of events and transactions	Measurement of transactions and events	Presentation of transactions and events	Disclosures



Accounting Standards Setting Process

Identification of area
↓
Constitution of study group
↓
Preparation of draft and its circulation
↓
Ascertainment of views of different bodies on draft
↓
Finalisation of exposure draft (E.D.)
↓
Comments received on exposure draft (E.D.)
↓
Modification of the draft
↓
Issuance of AS

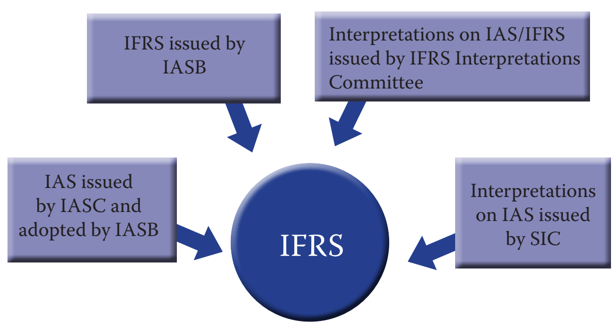
List of Accounting Standards

1	Disclosure of Accounting Policies
2	Valuation of Inventories
3	Cash Flow Statement
4	Contingencies and Events Occurring after the Balance Sheet Date
5	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies
7	Construction Contracts
9	Revenue Recognition
10	Property, Plant and Equipment
11	The Effects of Changes in Foreign Exchange Rates
12	Accounting for Government Grants
13	Accounting for Investments
14	Accounting for Amalgamations
15	Employee Benefits
16	Borrowing Costs
17	Segment Reporting
18	Related Party Disclosures
19	Leases
20	Earnings Per Share
21	Consolidated Financial Statements
22	Accounting for Taxes on Income
23	Accounting for Investments in Associates in Consolidated Financial Statements
24	Discontinuing Operations
25	Interim Financial Reporting
26	Intangible Assets
27	Financial Reporting of Interests in Joint Ventures
28	Impairment of Assets
29	Provisions, Contingent Liabilities and Contingent Assets

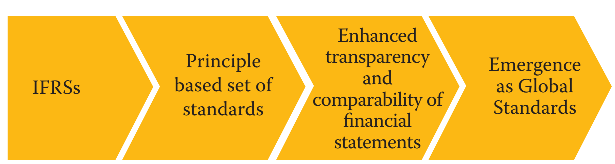
Effectively, there are now only 27 Accounting Standards.

Significance of Global Standards

International Financial Reporting Standards (IFRS)



International Financial Reporting Standards (IFRSs) as Global Standards



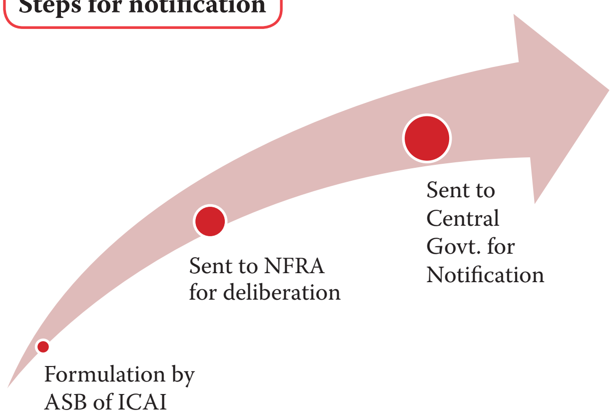
Convergence to IFRS in India

- ICAI
- Convergence to IFRS; not adoption
- Application of IFRS in India considering legal and other conditions prevailing in India
  - Deviation from corresponding IFRS, if required
  - Decision to have two sets of Accounting standards
    - Indian Accounting Standards (Ind AS)
    - Accounting Standards (AS)

Ind AS

Ind AS are IFRS converged standards issued by the Central Government with certain carve outs.

Steps for notification



Indian Accounting Standards - Benefits

Globalization and Liberalization	Transparency of financial statements	Comparability of financial statements	Enhanced Disclosure requirements

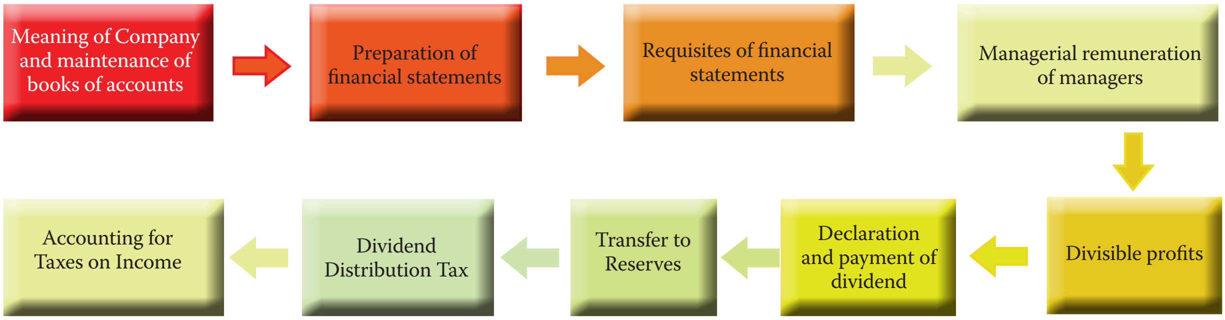
Objectives and Concepts of Carve Outs

- **Formulation of Ind AS**
  - **Departures**
    - **Resulting into carve-outs**
      - **Deviation from the accounting principles stated in IFRS**
    - **Not resulting into carve-outs**
      - **Removal of options in accounting principles and practices in Ind AS vis-a-vis IFRS**

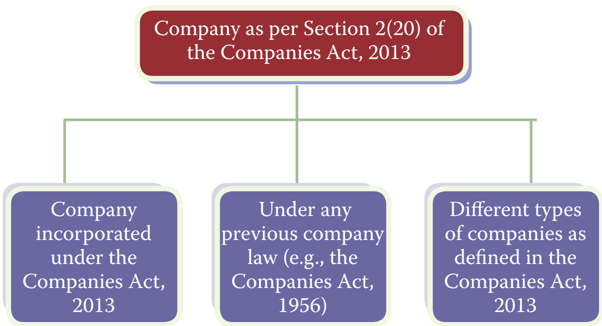
CHAPTER 4: FINANCIAL STATEMENTS OF COMPANIES

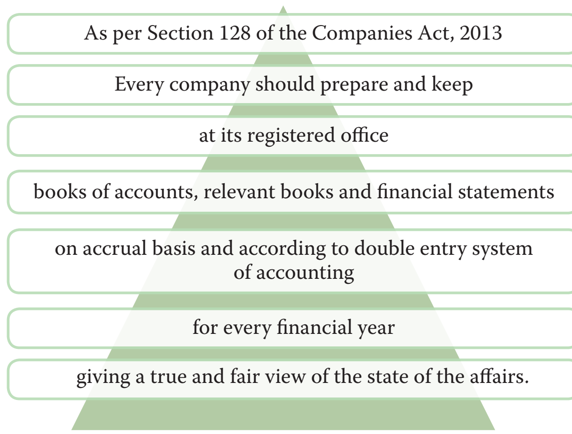
Unit 1: Preparation of Financial Statements of Companies

Unit Overview

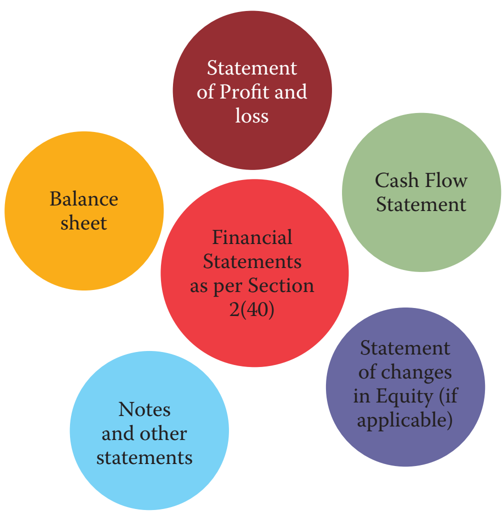


Meaning of Company and Maintenance of Books of Accounts of a Company

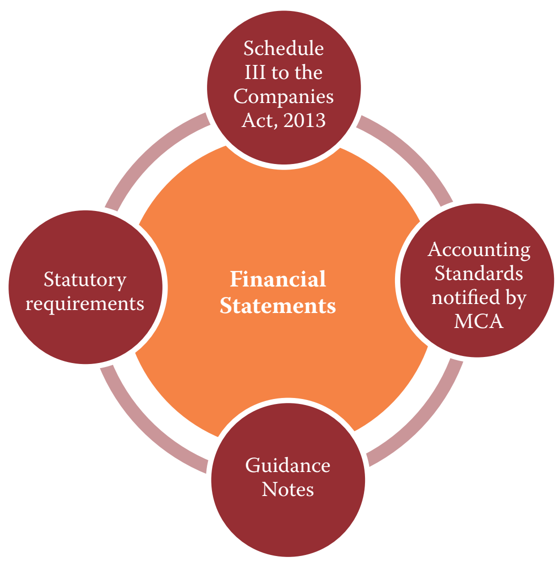




Preparation of Financial Statements



Requisites of Financial Statements



Managerial Remuneration

Managerial Remuneration (MR)

Adequacy of profits

- Calculated as Profit % as per Sec. 198
  - As per Schedule V and sections under the Companies Act, 2013.
- Total MR* < 11% of the net profits as per Sec. 198
  - As per Section 197
- Total MR > 11% of the net profits as per Sec. 198
  - with the approval of the Central Govt.
  - Subject to Schedule V.

*Total managerial remuneration payable includes payable to Directors + Managing director + Whole-time director+ Manager

Schedule V

- **Part I** – Lays down conditions to be fulfilled for the appointment of a managing or whole-time director or a manager without the approval of the Central Govt.
- **Part II** – Deals with remuneration payable to managerial person by companies having profits and also by companies having no profits or inadequate profits.
- **Part III** – Specifies the provisions applicable to parts 1 and 2 of this schedule
- **Part IV** – Deals with Central Government's power to relax any requirements in this Schedule.

Remuneration Payable by Companies having no Profit or Inadequate Profit without Central Government Approval

	Where the effective capital is	Limit of yearly remuneration payable should not exceed (Rupees)
(i)	Negative or less than 5 crores	60 Lakh
(ii)	5 crores and above but less than 100 crores	84 Lakh
(iii)	100 crores and above but less than 250 crores	120 Lakh
(iv)	250 crores and above	120 lakh plus 0.01% of the effective capital in excess of ₹ 250 crore.

Divisible Profits

The availability of Divisible Profits (available for distribution) depends on a number of factors, *e.g.*, their composition, the amount of provisions and appropriations that must be made out of them in priority, etc.

Dividend

Distribution of divisible profit as per number of shares held by share holder

A distribution may or may not entail a release of assets

Declaration of a dividend presupposes that there is a trading profit or a surplus available for distribution, arrived at after providing for depreciation on assets, not only for the year in which the profits were earned but also for any arrears of depreciation of the past years. Board of Directors of a company may declare interim dividend during any financial year out of the surplus in the profit and loss account and out of profits of the financial year in which such interim dividend is sought to be declared.

Declaration and Payment of Dividend

No Dividend can be declared except out of

- Trading profits after providing for depreciation
  - (a) Current financial year
  - (b) Previous financial years
  - Both (a) and (b)
- Money provided (in pursuance of guarantee) by
  - Central Government
  - State Government

Capital cannot be returned to the shareholders by way of dividend.
No dividend should be declared or paid by a company from its reserves other than free reserves.

Conditions as per Companies (Declaration and Payment of Dividend) Rules, 2014

Rate of Dividend	Should not exceed Average rates of dividend in the 3 years immediately preceding that year	This rule does not apply to a company, which has not declared any dividend in each of the three preceding financial year.
Amount	Total amount drawn from accumulated profits should not exceed 1/10 of Paid-up share capital + free reserves	as appearing in the latest audited Financial Statements
Utilization	Drawn amount should first be used to set off the losses	incurred in the FY in which dividend is declared.
Balance of reserves	After such withdrawal should not fall below 15% of paid up share capital	as appearing in the latest audited Financial Statements

No company should declare dividend unless carried over previous losses and depreciation not provided in previous year are set off against profit of the company of the current year. → Loss or depreciation, whichever is less, in previous years is set off against the profit of the company for the year for which dividend is declared or paid.

Transfer to Reserves

Appropriation of a part of Profit

- As per section 123 (1)of the Companies Act, 2013.
- As required under law.

Unit 2: Cash Flow Statement

Unit Overview

- Definition & Significance of cash flow statement
- Meaning of Cash & cash equivalents and Cash flow
- Difference between operating, investing and financing activities.
- Preparation of cash flow statement as per AS 3.

Definition of Cash Flow Statement

Cash flow statement is a summary of cash receipts and cash payments for accounting period.

Significance of Cash Flow Statement

Cash flow statement depicts

- Historical changes & Future requirement of cash & cash equivalents.
- Ability to generate cash & cash equivalents.
- Operational efficiency of different enterprises.
- Insolvency and liquidity position of an enterprise.
- Indicator of amount, timing and certainty of future cash flows.
- Accuracy of past assessments of future cash flows.

Cash and Cash Equivalents for the Purpose of Cash Flow Statement

'Cash' include: Cash, Bank balances

and

Cash equivalents

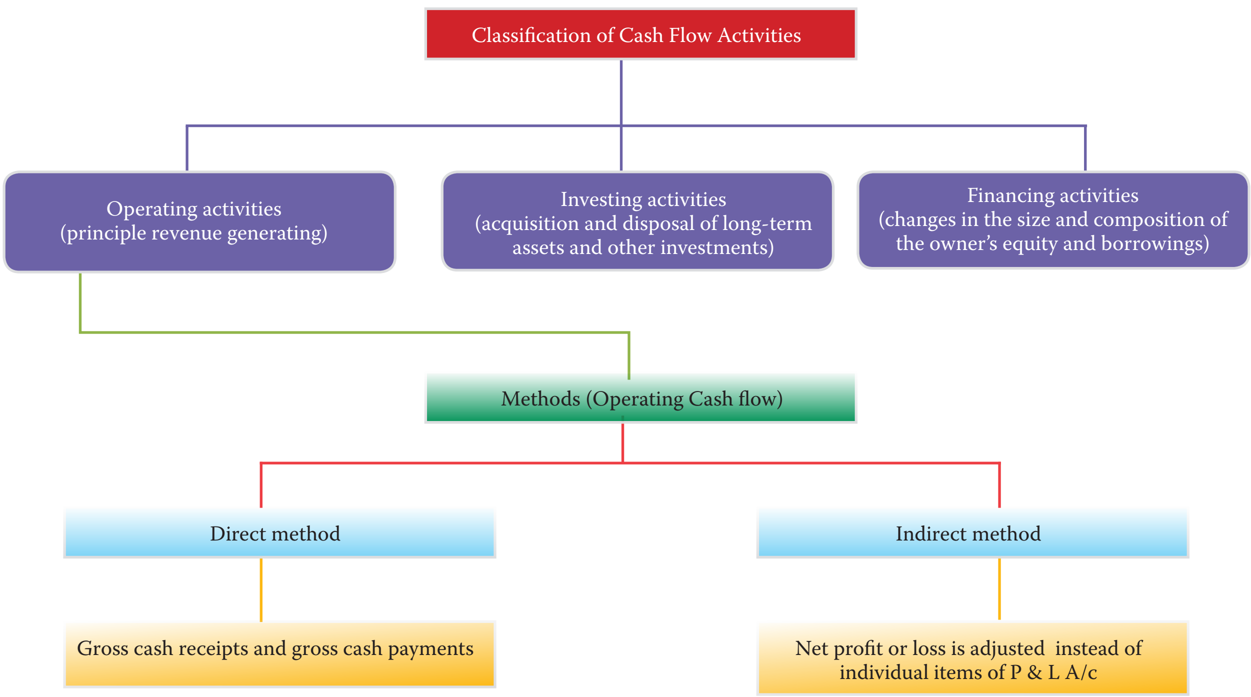
- Short term highly liquid investments that are readily convertible into known amounts of cash and subject to an insignificant risk of changes in value
- Securities with short maturity period of, say, three months or less from date of acquisition

Meaning of term Cash Flow

Cash Flow

- Inflow from Activities → Cash increase
- Outflow of Activities → Cash decrease

Classification of Cash Flow Activities



Proforma of Cash Flow Statement prescribed by AS 3

Direct Method

Particulars		
Operating Activities:		
Cash received from sale of goods	xxx	
Cash received from Trade receivables	xxx	
Cash received from sale of services	xxx	xxx
Less: Payment for Cash Purchases	xxx	
Payment to Trade payables	xxx	
Payment for Operating Expenses	xxx	
e.g. power, rent, electricity		
Payment for wages & salaries	xxx	
Payment for Income Tax	xxx	xxx
		xxx
Adjustment for Extraordinary Items		xxx
Net Cash Flow from Operating Activities		xxx

Indirect Method

Particulars		
Operating Activities:		
Closing balance of Profit & Loss Account	xxx	
Less: Opening balance of Profit & Loss Account	xxx	
	xxx	
Reversal of the effects of Profit & Loss Appropriation Account	xxx	
Net Profit after tax	xxx	
Add: Provision for Income Tax	xxx	
Net Profit Before Tax and Extraordinary Items	xxx	
Reversal of the effects of non-cash and non-operating items	xxx	
Effects for changes in Working Capital except cash & cash equivalent	xxx	
	xxx	
Less : Payment of Income Tax	xxx	xxx
Net Cash Flow from Operating Activities		xxx

CHAPTER 5: PROFIT OR LOSS PRE AND POST INCORPORATION

Chapter Overview

- Meaning of profit or loss prior to incorporation
- Methods for computation
- Apportionment of items of incomes and expenses in pre and post incorporation periods

Meaning of Profit or Loss prior to Incorporation

Profit or loss of a business

prior to the date

Company came into existence

referred as Pre-Incorporation Profits or Losses

Such profits or losses are of capital nature

disclose them separately

Methods for Computation

Methods for computation

- Close off old books and open new books with the assets and liabilities as they existed at the date of incorporation
- Split up the profit of the year in which the business has been transferred, between 'pre' and 'post' incorporation periods
  - Time basis (i)
  - Turnover basis (ii)
  - Combination of both (i+ii)

Apportionment of Items of Incomes and Expenses in Pre and Post Incorporation Periods

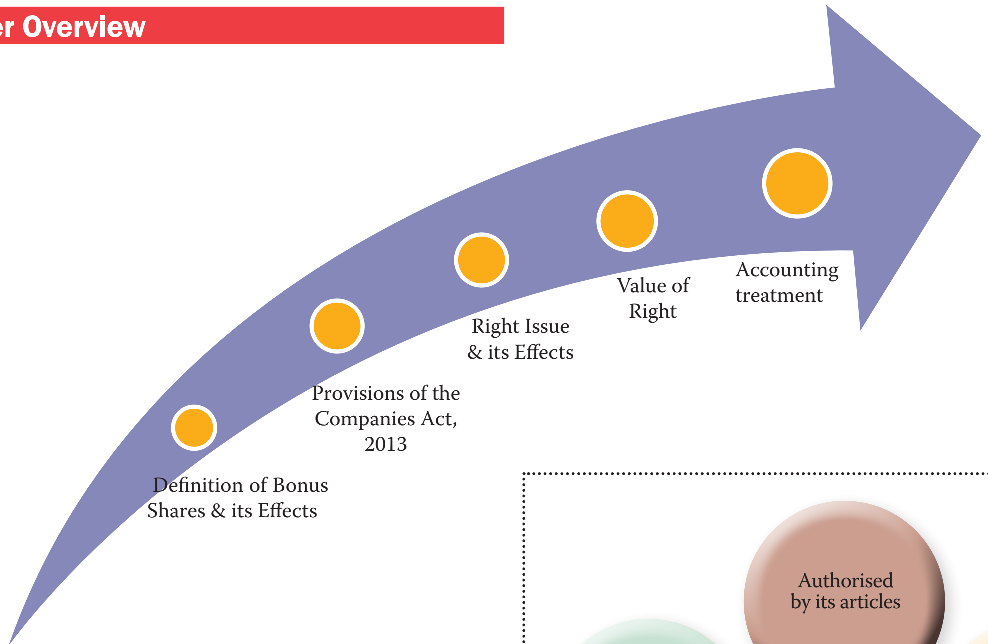
Item	**Basis of Apportionment between pre and Post incorporation period**
Gross Profit or Gross Loss	Sales Ratio or Cost of goods sold Ratio or Time Ratio
Variable expenses linked with Turnover [e.g. Selling and distribution expenses, etc.]	Sales Ratio
Fixed Common charges [e.g., Salaries, Office etc.]	Time Ratio
Expenses exclusively relating to pre-Incorporation period [e.g. Interest on Vendor's Capital]	Charge to Pre-incorporation period
Expenses exclusively relating to post-incorporation period [e.g. interest on debentures etc.]	Charge to Post-incorporation period

Audit Fees	**Types of Audit**
(i)For Company's Audit under the Companies Act	Charge to Post-incorporation period
(ii)For Tax Audit under the Income-tax Act, 1961	On the basis of turnover in the respective periods

Interest on purchase consideration to vendor	**Time basis**
(i) For the period from the date of acquisition of, business to date of incorporation	Charge to Pre-incorporation period
(ii) From the date of incorporation	Charge to Post-incorporation period

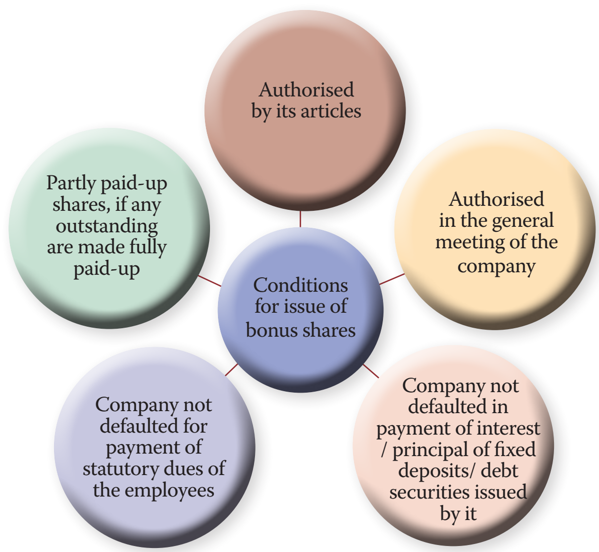
CHAPTER 6: ACCOUNTING FOR BONUS ISSUE AND RIGHT ISSUE*

Chapter Overview

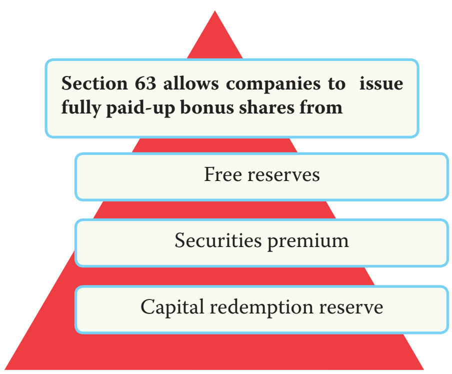


Definition of Bonus issue

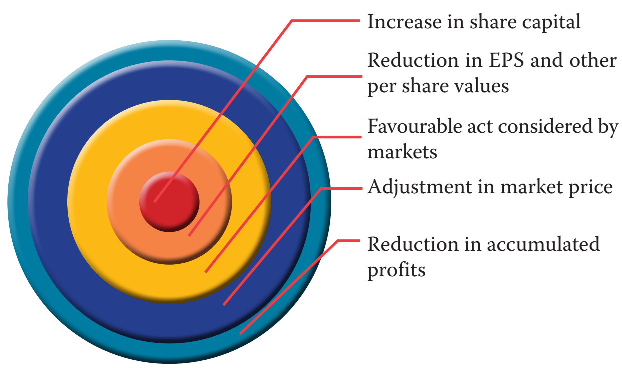
Issue of shares at no cost to current shareholders in a company → Based upon the number of shares → That the shareholder already owns

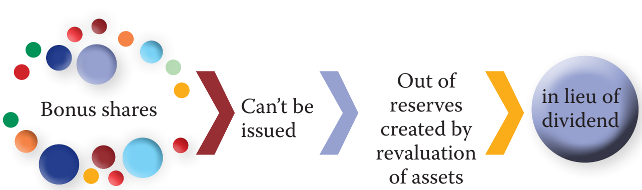


Provisions of the Companies Act



Effects of Bonus Issue





*Right Issue is not covered in the syllabus of Paper 1 under the earlier scheme

Accounting Entries

Upon the sanction of an issue of bonus shares

- Debit Capital Redemption Reserve Account
- Debit Securities Premium Account
- Debit General Reserve Account
- Debit Profit & Loss Account
- Credit Bonus to Shareholders Account.

Upon issue of bonus shares

- Debit Bonus to Shareholders Account
- Credit Share Capital Account.

Upon the sanction of bonus by converting partly paid shares into fully paid shares

- Debit General Reserve Account
- Debit Profit & Loss Account
- Credit Bonus to Shareholders Account.

On making the final call due

- Debit Share Final Call Account
- Credit Share Capital Account.

On adjustment of final call

- Debit Bonus to Shareholders Account
- Credit Share Final Call Account.

Definition of Right Issue; Value of Right and Right of Renunciation

The existing shareholders have a right to subscribe to any fresh issue of shares by the company in proportion to their existing holding for shares.

Value of right = Cum-right value of share Less Ex-right value of share

Ex-right value of the shares = [Cum-right value of the existing shares + (Rights shares X Issue Price)] Divided by (Existing Number of shares + Number of right shares)

Right of renunciation refers to the right of the shareholder to surrender his right to buy the securities and transfer such right to any other person.

Effects of Right Issue

Effects of Right issue

- Maintenance of existing shareholders' proportional holding in company and retain their financial and governance rights
- Dilution in the value of share.
- Image enhancement
- Convenience in handling issue

Conditions for right issue as per the Companies Act

- Notice specifying the number of shares offered and limiting a time not being < 15 days and not > 30 days from the date of the offer
- Offer to include a right exercisable by the person concerned to renounce the shares offered to him unless articles provide otherwise
- After the expiry of the time specified in notice or on receipt of earlier intimation from person that he declines to accept the shares offered, BoD may dispose of them in a manner which is not disadvantageous to shareholders and company

Situations when Right shares are offered

Situations when shares can be offered, without being offered to the existing shareholders, provided the company has passed a special resolution and shares are offered to

- Employees under a scheme of ESOP
- Any persons, either for cash or for a consideration other than cash, if the price of such shares is determined by registered valuer
- When companies borrow money through debentures / loans and give their creditor an option to buy equity shares of a company.
- When loan has been obtained from the government, and government in public interest, directs the debentures / loan to be converted into equity shares.

Accounting treatment

Same as ordinary share → Bank A/c debited → Equity share capital A/c credited

CHAPTER 9: INVESTMENT ACCOUNTS

Chapter Overview

Categories of Investments

Categories of Investment on the basis of Income

- Fixed income bearing scrips
  - Securities having fixed return of income
    - e.g. Government securities; debentures or bonds
- Variable income bearing scrips
  - Securities having variable return of income
    - e.g. Equity shares

Definition of Investments

Investments are assets held by an enterprise

- for earning income
  - Dividend
  - Interest
  - Rentals
- for capital appreciation or for other benefits

Assets held as Stock-in-trade are not 'Investments.'

Cost of Investments

Type of acquisition	Cost
Payment in Cash/ bank	Cash price including charges such as brokerages, fees and duties
By Issue of shares/ other securities	Fair value of securities issued
In exchange for another asset	Fair value of asset given up or fair value of investment acquired, whichever is more clearly evident

Classification and Carrying Amount of Investments

Classification of Investments as per AS 13

- Current Investments (readily realisable and intended to be held for not more than one year) — Carried at lower of cost and fair value
- Long Term Investments (other than Current) — Carried at cost

Accounting in the Books at the Time of Purchase and Sale of Investments

Particulars	Value in 'capital' column of Investment Account	
	Purchase	Sale
Transaction on ex-interest basis	Purchase price of investment, i.e., no impact of interest accrued up to the date of transaction	Entire sale proceeds i.e., no impact of accrued interest (from the date of last payment to the date of sale)
Transaction on cum-interest basis	Purchase price of investment less accrued interest up to the date of transaction	Sale proceeds, net of accrued interest (from the date of last payment to the date of sale)

Accounting for Income on Investments

Accounting of
Interest accrued/Dividend Declared

Pre-acquisition period

Deducted from cost of investment

Post-acquisition period

Recognized as an income

Accounting for Right Shares and Bonus Shares

Accounting for

Right shares

Subscribed
Cost of shares added to carrying amount

Not subscribed, but sold
Sale proceeds taken to P&L A/c

Bonus

No amount is entered in the capital column of investment account.

If acquired on cum-right basis & the market value of investments immediately after their becoming ex-right is lower than the cost for which they were acquired, the sale proceeds of rights is applied to reduce the carrying amount of such investments to the market value.

Reclassification of Investments

Reclassification of Investments

Long-term to Current

Transfer at lower of cost & carrying amount at the date of transfer

Current to Long-term

Transfer at Lower of cost & fair value on the date of transfer

Disposal of Investments

Difference between the carrying amount and the disposal proceeds, net of expenses is recognised in the P & L statement.

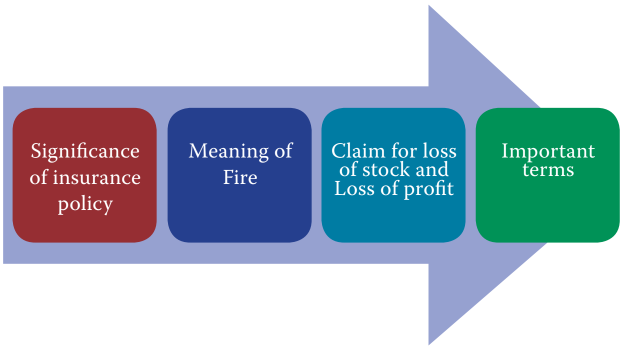
Part of investment is disposed:
Carrying amount is allocated to that part on the basis of average carrying amount of total investment.

Investments held as stock-in-trade:

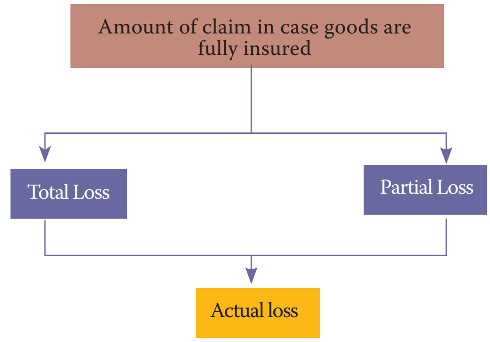
Cost of stocks disposed = formula as per AS 2.

CHAPTER 10: INSURANCE CLAIMS FOR LOSS OF STOCK AND LOSS OF PROFIT

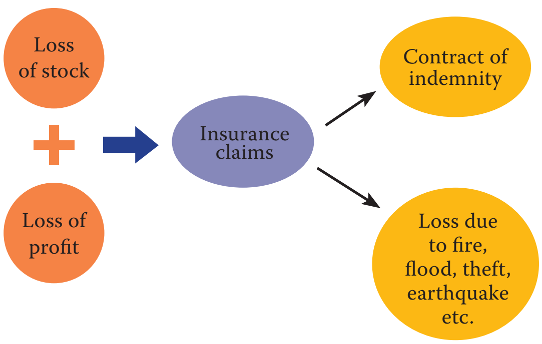
Chapter Overview

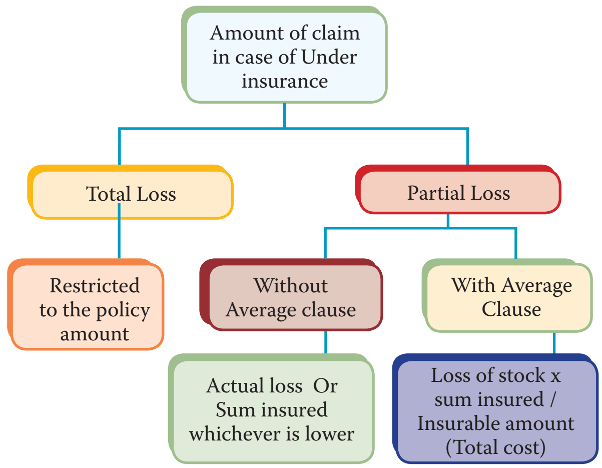


Claim For Loss Of Stock

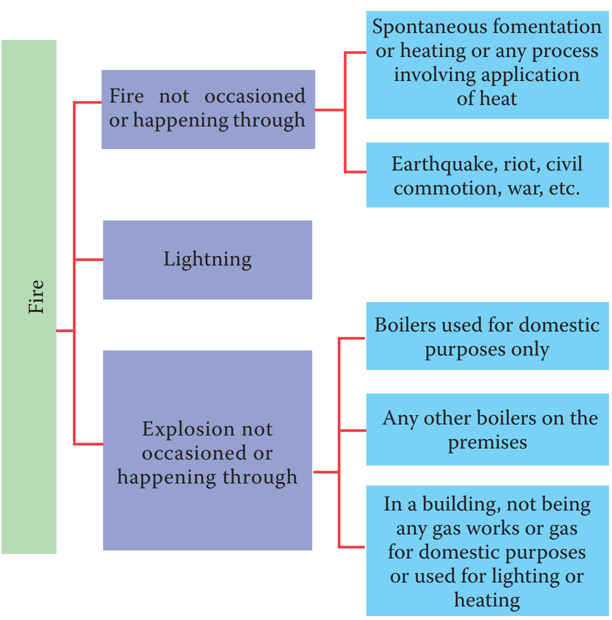


Significance of Insurance Policy





Meaning of Fire



Important Points

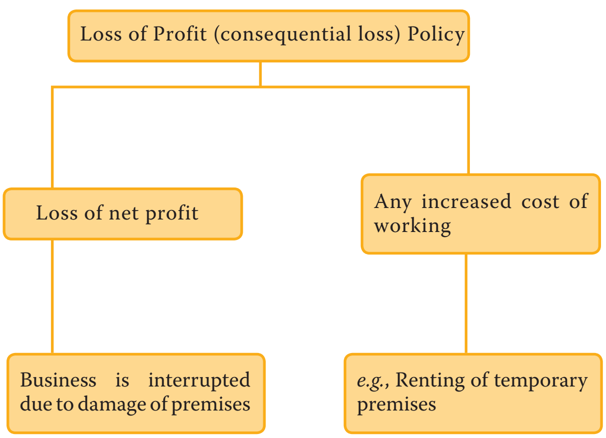
Stock records are maintained	• Value of the stock as at the date of the fire can be easily arrived.
Stock records are not available or are destroyed by fire	• Trading Account is prepared. After allowing for the usual gross profit, closing stock ascertained as balancing item.
Books of account are destroyed	• Trading Account preparation is difficult. Information is obtained from the customers and suppliers to ascertain the amount of sales and purchases.
Insurance company makes payment	• Damaged stocks are subrogated to the insurance company. Subrogation is the right of an insurer to legally pursue a third party that caused an insurance loss to the insured.
Salvaged stock is made saleable after it is reconditioned	• Cost of such stock credited to the Trading Account and debited to a salvaged stock account. The expenses on reconditioning debited and sales credited to this account, final balance being transferred to the P & L A/c

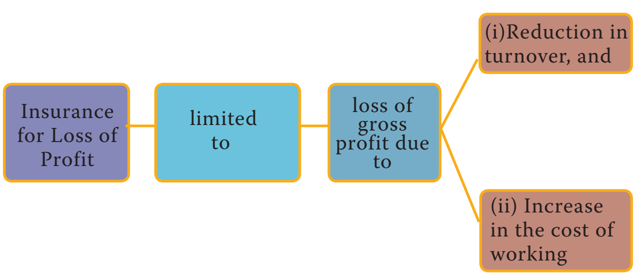
Loss of Stock

Particulars	Amount
Value of stock on the date of fire	xxx
Less:- Value of Salvaged stock	xxx
Amount of loss of stock	xxx

Particulars	Amount
Value of salvaged stock	xxx
Add: Expenses on re-conditioning	xxx
Less: Sales	xxx
Profit/(loss)	xxx

Claim for Loss of Profit



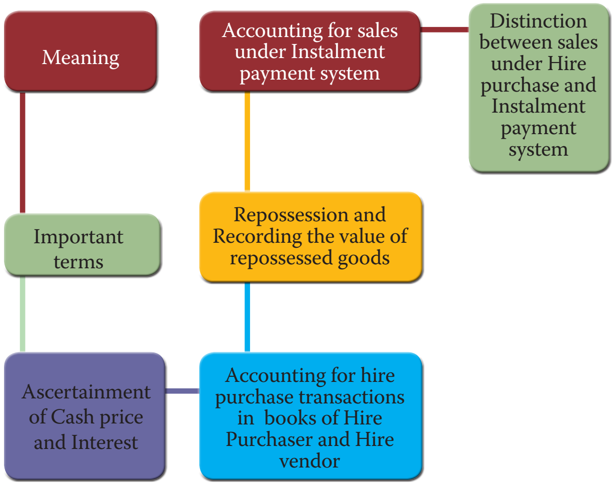


Important Terms

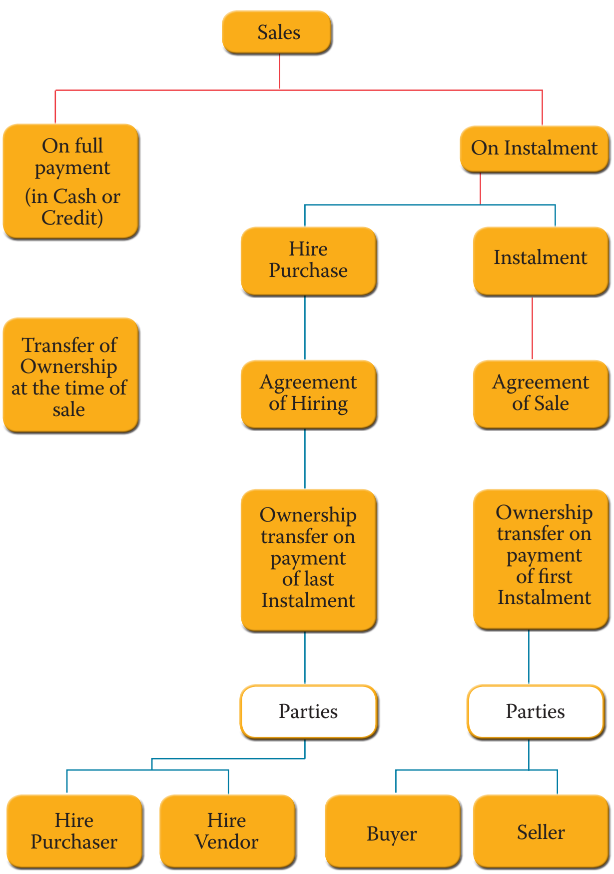
Claim for Loss of Profit	The Loss of Profit Policy normally covers the following items: (1) Loss of net profit (2) Any increased cost of working
Gross Profit	Net profit +Insured Standing charges OR Insured Standing charges – [Net Trading Loss (If any) X Insured Standing charges/ All standing charges of business]
Net Profit	The net trading profit (exclusive of all capital receipts and accretion and all outlay properly chargeable to capital) resulting from the business of the Insured at the premises after due provision has been made for all standing and other charges including depreciation.
Insured Standing Charges	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.
Rate of Gross Profit	The rate of Gross Profit earned on turnover during the financial year immediately before the date of damage.
Annual Turnover (adjusted)	The turnover during the twelve months immediately before the damage.
Standard Turnover	The turnover during that period (in the twelve months immediately before the date of damage) which corresponds with the Indemnity Period.
Indemnity Period	The period beginning with the occurrence of the damage and ending not later than twelve months.

CHAPTER 11: HIRE PURCHASE AND INSTALMENT SALE TRANSACTIONS

Chapter Overview



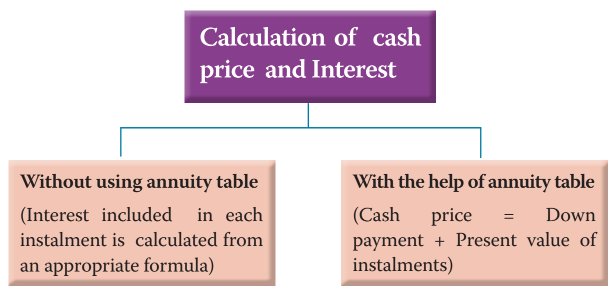
Sales under Hire Purchase and Instalment Payment System



Important Terms Used in Hire Purchase Arrangements and Instalment Payment System

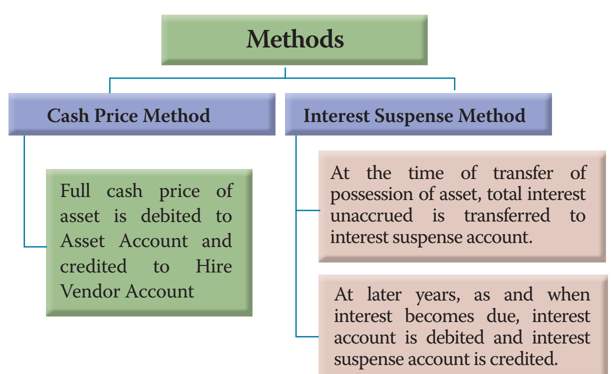
Hire Vendor	Person who delivers the goods along with its possession to the hire purchaser under a hire purchase agreement.
Hire Purchaser	Person who obtains the goods and rights to use the same from hire vendor under a hire purchase agreement.
Cash Price	Amount to be paid by the buyer on outright purchase in cash.
Down Payment	Initial payment made to the hire vendor by the hire purchaser at the time of entering into a hire purchase agreement.
Hire Purchase Instalment	Amount which the hire purchaser has to pay after a regular interval upto certain period as per the agreement to obtain the ownership of the asset purchased (on payment of the last Instalment). It comprises of principal amount and the interest on the unpaid amount.
Hire purchase price	Total sum payable by the hire purchaser to obtain the ownership of the asset purchased under hire purchase agreement. It comprises of cash price and interest on outstanding balances.
Repossession	If the hire purchaser fails to pay any of the instalments, the hire vendor takes the asset back in its actual form. This act of recovery of possession of the asset is termed as repossession.

Ascertainment of Cash Price



Accounting for Hire Purchase Transactions

Books of Hire Purchaser



Journal Entries

Cash Price Method

At the time of entering into the agreement	
Asset Account	Dr. [Full cash price]
To Hire Vendor Account	
When down payment is made	
Hire Vendor Account	Dr. [Down payment]
To Cash/Bank Account	
When an instalment becomes due	
Interest Account	Dr. [Interest on outstanding balance]
To Hire Vendor Account	
When an instalment is paid	
Hire Vendor Account	Dr. [Amount of instalment]
To Bank Account	
When depreciation is charged on the asset	
Depreciation Account	Dr. [Calculated on cash price]
To Asset Account	
For closing interest and depreciation account	
Profit and Loss Account	Dr.
To Interest Account	
To Depreciation Account	

Interest suspense method

When the asset is acquired onhire purchase	
Asset Account	Dr. [Full cash price]
To Hire Vendor Account	
For total interest payment	
H.P. Interest Suspense Account	Dr. [Total interest]
To Hire Vendor Account	
When down payment is made	
Hire Vendor Account	Dr.
To Bank Account	
For Interest of the relevant period	
Interest Account	Dr. [Interest of the relevant period]
To H.P. Interest Suspense Account	
When an instalment is paid	
Hire Vendor Account	Dr.
To Bank Account	
When depreciation is charged on the asset	
Depreciation Account	Dr. [Calculated on cash price]
To Asset Account	
For closing interest and depreciation account	
Profit and Loss Account	Dr.
To Interest Account	
To Depreciation Account	

Books of Hire Vendor

Methods

- Sales Method
  - Hire purchase sale is treated as a credit sale, subject to payment in instalments
- Interest Suspense Method
  - Hire purchaser is debited with full cash price and total interest included in the selling price.

Journal Entries

Sales Method

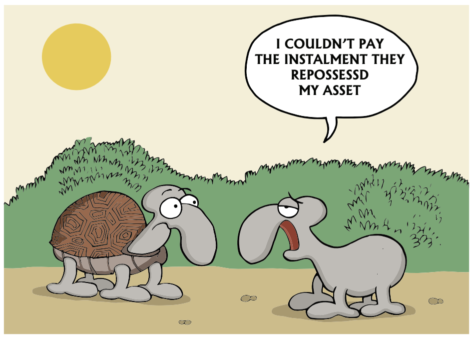
When Goods are sold and delivered	
Hire Purchaser Account	Dr. [Full cash price]
To H.P. Sales Account	
When the down payment is received	
Bank Account	Dr.
To Hire Purchaser Account	
When an instalment becomes due	
Hire Purchaser Account	Dr.
To Interest Account	
When the amount of instalment is received	
Bank Account	Dr.
To Hire Purchaser Account	
For closing interest Account	
Interest Account	Dr.
To Profit and Loss Account	
For closing Hire Purchase Sales Account	
H.P. Sales Account	Dr.
To Trading Account	

Interest Suspense Method

When Goods are sold and delivered	
Hire Purchaser Account	Dr. [Full cash price + total interest]
To H.P. Sales Account	[Full cash price]
To Interest Suspense Account	[Total Interest]
When down payment/instalment is received	
Bank Account	Dr.
To Hire Purchaser Account	

For interest of the relevant accounting period	
Interest Suspense Account	Dr.
To Interest Account	
For closing interest Account	
Interest Account	Dr.
To Profit and Loss Account	
For closing Hire Purchase Sales Account	
H.P. Sales Account	Dr.
To Trading Account	

REPOSSESSION



Repossession

- Books of Hire Purchaser
  - Hire Vendor A/c Dr.
    To Asset A/c
    - Complete
      - Hire vendor repossesses all the goods
      - Loss on surrender If the repossessed value is < book value
    - Partial
      - Hire vendor repossesses part of the goods & Balance of goods remains with the purchaser.
      - For remaining portion of asset
        - Application of usual rate of depreciation
        - Asset in books af W.D.V
- Books of Hire vendor
  - Goods Repossessed A/c Dr.
    To Hire Purchaser
  - Vendor may incur further expenses and sell at profit or loss

Accounting Treatment of Sales Under Instalment Payment System

Books of buyer		Books of Seller	
Asset A/c	Dr. Full cash price	Purchaser	Dr. Full Instalment price
Interest Suspense A/c	Dr. Full Instalment price less cash price	To Sales A/c	cash price
To Vendor	Full Instalment price	To Interest Suspense A/c	Full Instalment price less cash price

Differences Between Sales Under Hire Purchase And Instalment System

Basis of Distinction	*Hire Purchase*	*Instalment System*
Governing Act	It is governed by Hire Purchase Act,1972.	It is governed by the Sale of Goods Act, 1930.
Nature of Contract	It is an agreement of hiring.	It is an agreement of sale.
Passing of Title (ownership)	The title to goods passes on last payment.	The title to goods passes immediately as in the case of usual sales.
Right to Return goods	The hirer may return goods without further payment except for accrued instalments.	Unless seller defaults, goods are not returnable.
Seller's right to repossess	The seller may take possession of the goods if hirer is in default.	The seller can sue for price if the buyer is in default. He cannot take possession of the goods.
Right of Disposal	Hirer cannot hire out, sell, pledge or assign entitling transferee to retain possession as against the hire vendor.	The buyer may dispose of the goods and give good title to the purchaser.
Responsibility for Risk of Loss.	The hirer is not responsible for risk of loss of goods if he has taken reasonable precaution because the ownership has not yet transferred.	The buyer is responsible for risk of loss of goods because ownership has transferred.
Name of Parties involved	The parties involved are called Hirer and Hire vendor.	The parties involved are called buyer and seller.
Component other than cash price.	Component other than Cash Price included in instalment is called Hire charges.	Component other than Cash Price included in Instalment is called Interest.

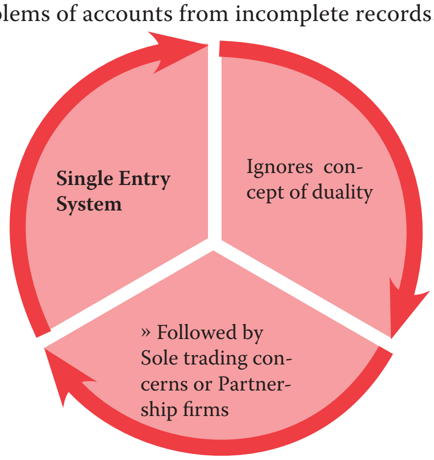
CHAPTER 14: ACCOUNTS FROM INCOMPLETE RECORDS

Chapter overview

- Definition of Single Entry System and its features
- Types of Single entry system
- Determination of profit by comparing capitals at different points of time
- Statement of Affairs and its comparison with Balance sheet
- Technique of obtaining complete information for preparation of financial statements

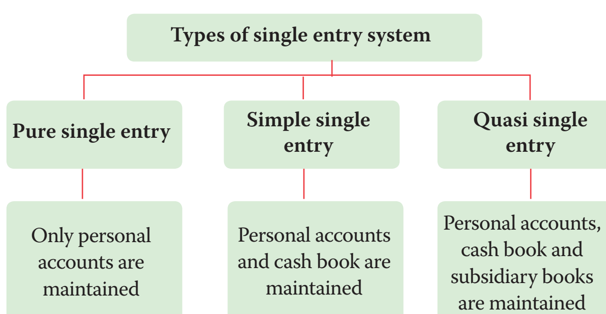
Definition of Single Entry System

The term "Single Entry System" is popularly used to describe the problems of accounts from incomplete records.

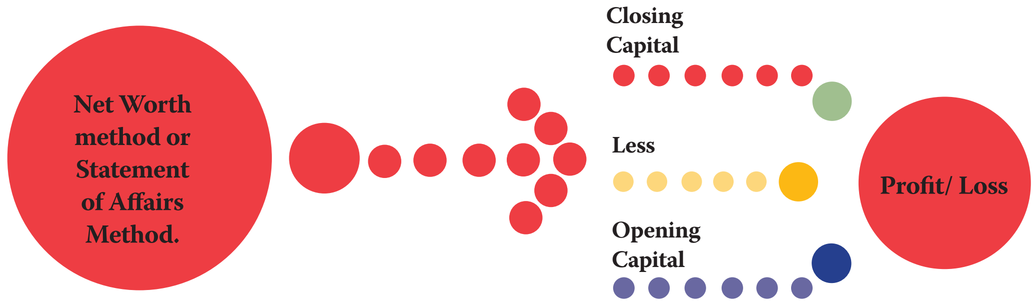


Features

Types of Single Entry System



Ascertainment of Profit by Capital Comparison at Different Points of Time



Particulars	₹
Capital at the end (a)	....
Add: Drawings	....
Less: Fresh capital introduced	....
Capital at the beginning (b)	....
Profit/Loss (a-b)	....

Preparation of Statement of Affairs

Sources utilized by Accountant	Collection of necessary information about assets and liabilities
Derivation of opening and closing capitals	Statement of Affairs at different points of time

Design of statement of affairs

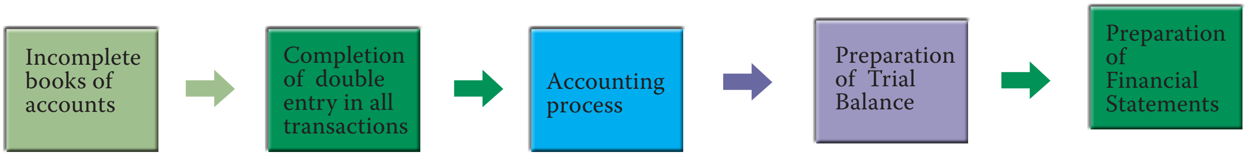
Statement of affairs as on...........

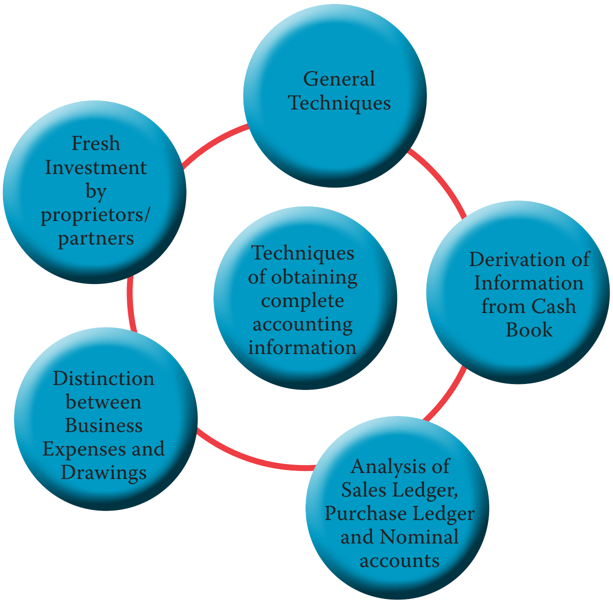
Liabilities	`	Assets	`
Capital (Bal. Fig.)	xx	Building	xx
Loans, Bank overdraft	xx	Machinery	xx
Sundry creditors	xx	Furniture	xx
Bills payable	xx	Inventory	xx
Outstanding expenses		Sundry debtors	xx
		Bills receivable	xx
		Loans and advances	xx
		Cash and bank	xx
		Prepaid expenses	xx
	xx		xx

Distinction between Statement of Affairs and Balance Sheet

Basis	Statement of affairs	Balance sheet
Reliability	It is prepared on the basis of transactions partly recorded on the basis of double entry book keeping and partly on the basis of single entry.	It is based on transactions recorded strictly on the basis of double entry book keeping.
Capital	In this statement, capital is merely a balancing figure being excess of assets over capital. Hence assets need not be equal to liabilities.	Capital is derived from the capital account in the ledger and total of assets side will always be equal to the total of liabilities side.
Omission	Since this statement is prepared on basis of incomplete records, it is difficult to locate assets and liabilities, if they are omitted from the books.	All items are properly recorded. It is easy to locate missing items since the balance sheet will not agree.
Basis of Valuation	The valuation of assets is generally done in an arbitrary manner; no method of valuation is disclosed.	The valuation of assets is done on scientific basis. Method of valuation is disclosed.
Objective	The object of preparing this statement in the calculation of capital figures in beginning and at end of accounting period respectively.	The object of preparing the balance sheet is to ascertain the financial position on a date.

Techniques of Obtaining Complete Accounting Information





ACCOUNTING - A CAPSULE FOR QUICK REVISION

Accounting constitutes a significant area of core competence for chartered accountancy students. The significance of this subject can be judged from the fact that we have a paper on accounting at every level of CA Course. Accounting papers at Intermediate Level under Chartered Accountancy curriculum concentrate on conceptual understanding of the crucial aspects of accounting and acquaint students with the basic concepts, theories and accounting techniques followed by different entities. The objective of Paper 1 "Accounting" at intermediate level is to acquire the ability to apply specific accounting standards and legislations to different transactions and events and in preparation and presentation of financial statements of various business entities. It has always been the endeavour of Board of Studies to provide quality academic inputs to the students. Keeping in mind this objective, it has been decided to bring forth a crisp and concise capsule for the topic on Accounting Standards covered in Intermediate Paper 1 "Accounting". The significant provisions of AS 1, AS 2, AS 3, AS 4, AS 5, AS 10, AS 11 and AS 12 have been gathered and presented through pictorial presentations in this capsule which will help the students in grasping the intricate practical aspects of each Accounting Standard. Although, the capsule has been prepared keeping in view the new and revised scheme of Education and Training of ICAI, the students of earlier scheme may also be benefitted from it. This capsule, though, facilitates the students in undergoing quick revision, under no circumstances, such revisions can substitute the detailed study of the material provided by the Board of Studies.

AS 1 "DISCLOSURE OF ACCOUNTING POLICIES"

Introduction

AS 1 deals with the disclosure of significant accounting policies followed in preparation and presentation of financial statements.

AS 1 covers

- **Fundamental Accounting Assumptions**: These assumptions underlie the preparation and presentation of financial statements.
- **Accounting Policies**: Accounting policies refer to the specific accounting principles and the methods of applying those principles adopted by the enterprise in the preparation and presentation of financial statements.

Fundamental Accounting Assumptions

- **Going Concern**: The enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future.
  - It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the operations.
- **Consistency**: Accounting policies are considered to be consistent from one period to another.
- **Accrual**: Revenues and costs are accrued, that is, recognised as they are earned or incurred and recorded in the financial statements of the periods to which they relate.

Considerations in selection of Accounting policies

- **Prudence**: In view of the uncertainty attached to future events, profits are not anticipated but recognised only when realised though not necessarily in cash.
  - Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.
- **Substance over Form**: The accounting treatment and presentation in financial statements of transactions and events should be governed by their substance and not merely by the legal form.
- **Materiality**: Financial statements should disclose all "material" items, i.e. items the knowledge of which might influence the decisions of the users of the financial statements.

Fundamental Accounting Assumptions

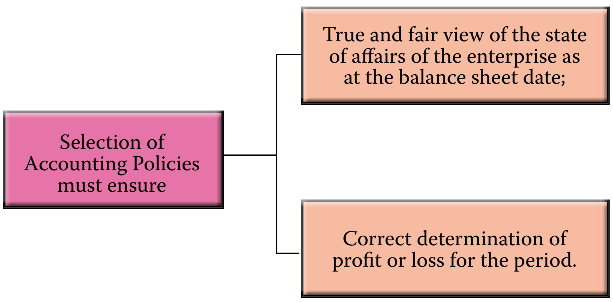
- If followed → Not required to be disclosed
- If not followed → Specific disclosure required in financial statements.

Accountant has to make decisions from various permitted alternative methods for recording or disclosing various items in the books of accounts for example:

Items to be disclosed	Method of disclosure or valuation
Inventories	FIFO, Weighted Average etc.
Cash Flow Statement	Direct Method, Indirect Method
Depreciation	Straight Line Method, Reducing Balance Method, Units of Production Method etc.

This list is not exhaustive.

Considerations in Selection of Accounting Policies



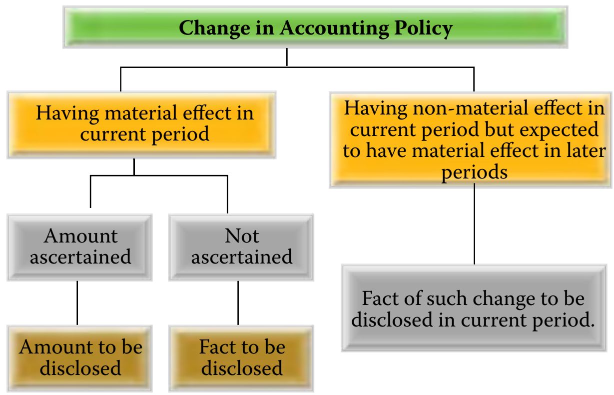
Disclosure of Accounting Policies

All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.

Disclosure should form part of the financial statements.

Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item in the accounts.

Disclosure of Changes in Accounting Policies

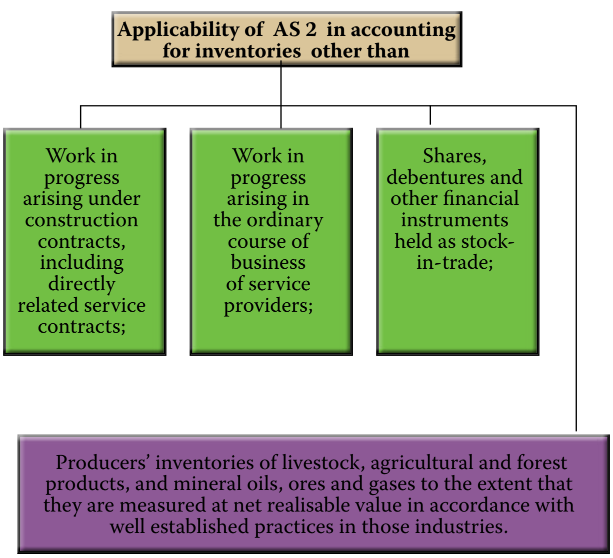


AS 2 "VALUATION OF INVENTORIES"

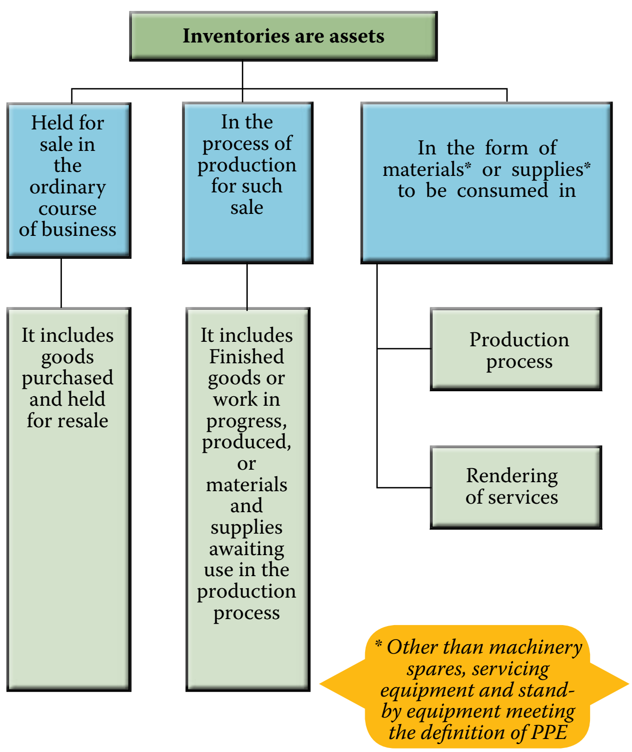
Introduction

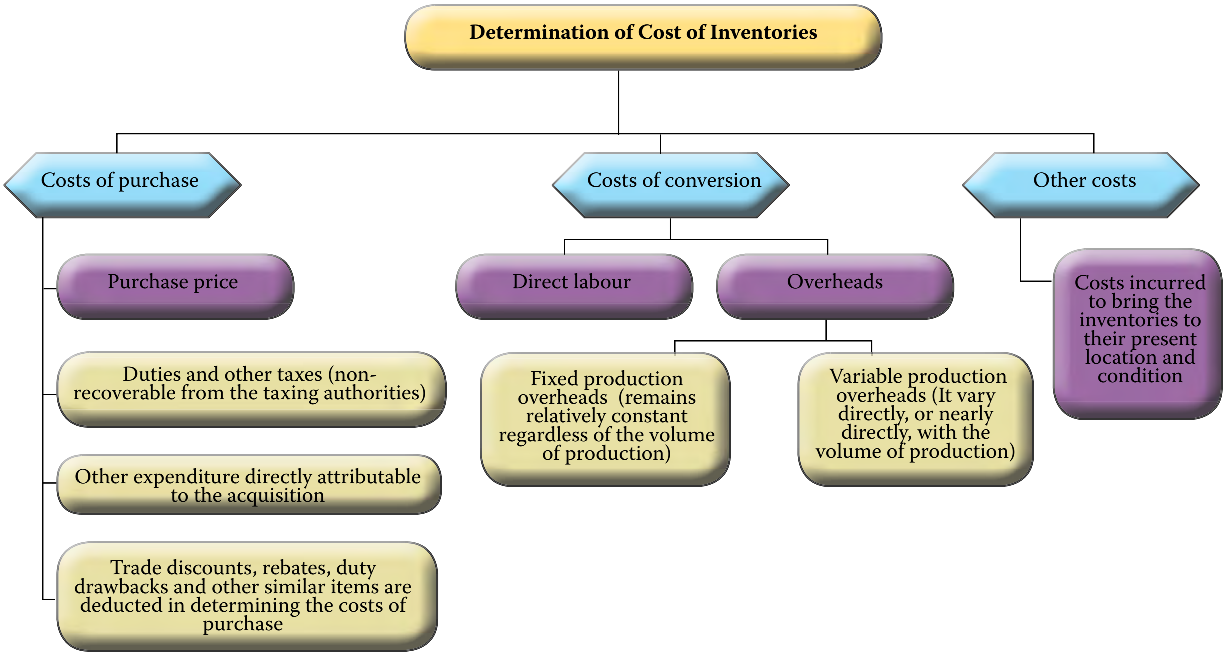
AS 2 (Revised) 'Valuation of Inventories', provides complete guidance for determining the value at which inventories, are carried in the financial statements until related revenues are recognised. It also provides guidance on the cost formulas that are used to assign costs to inventories and any write-down thereof to net realisable value.

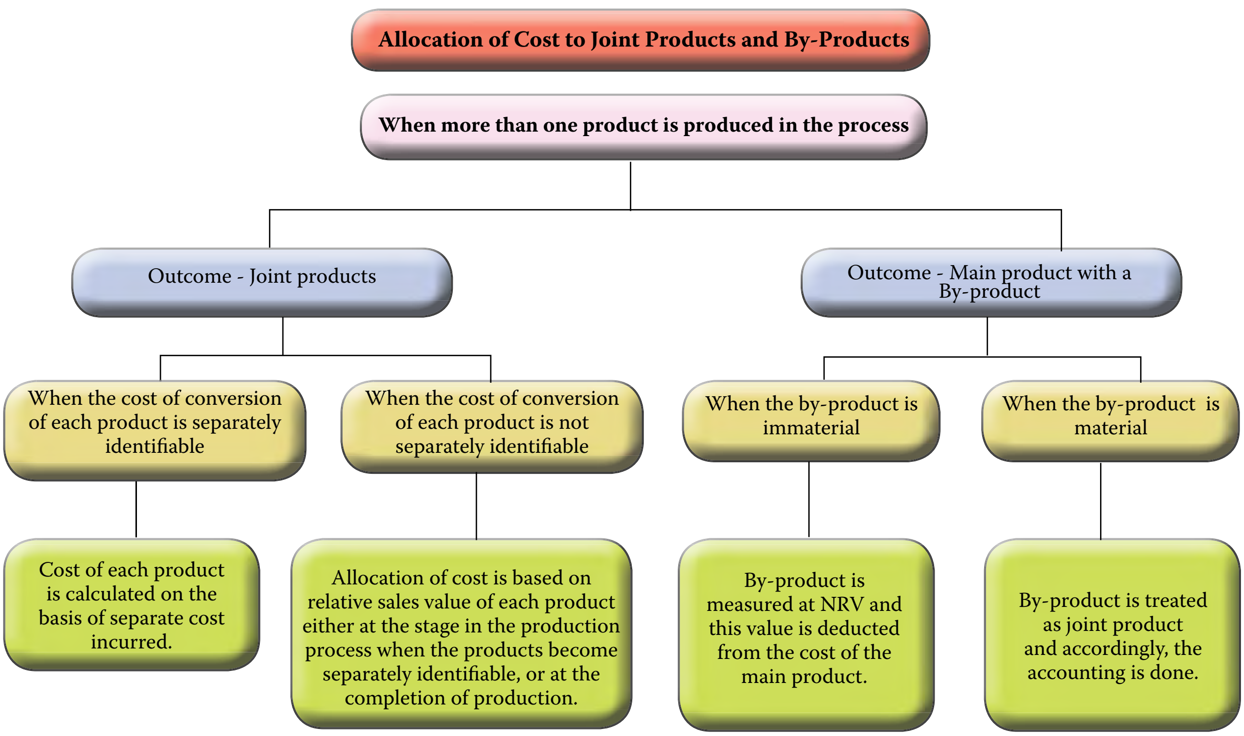
Scope of AS 2

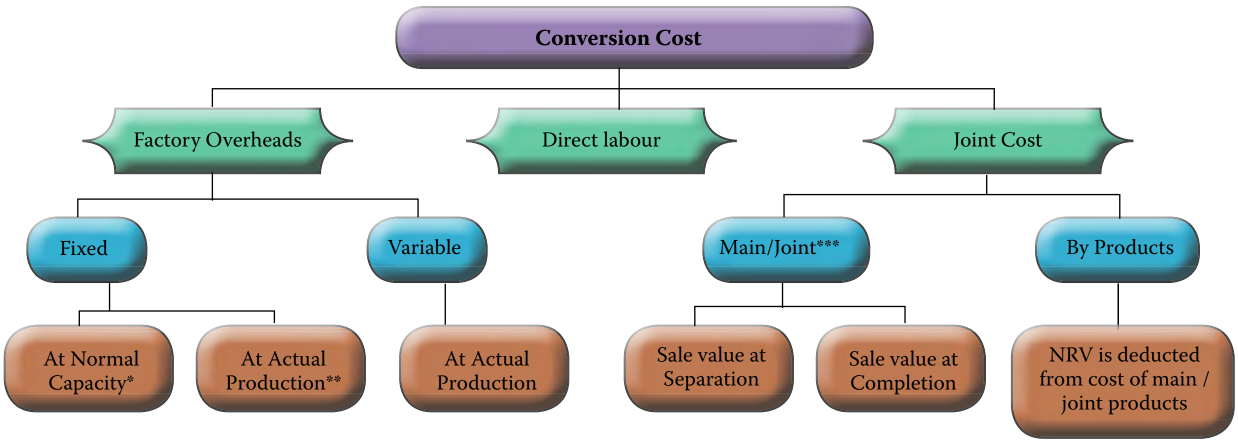


Definition of Inventories

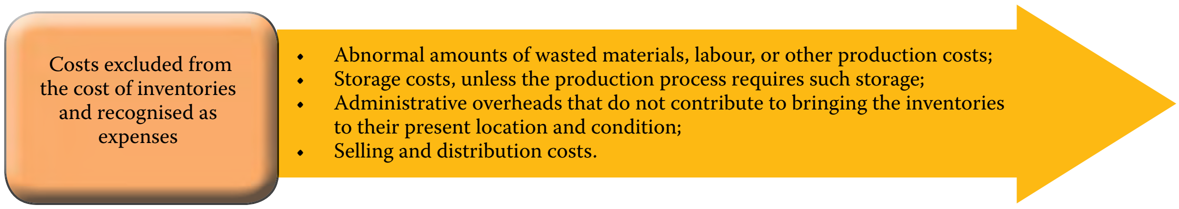


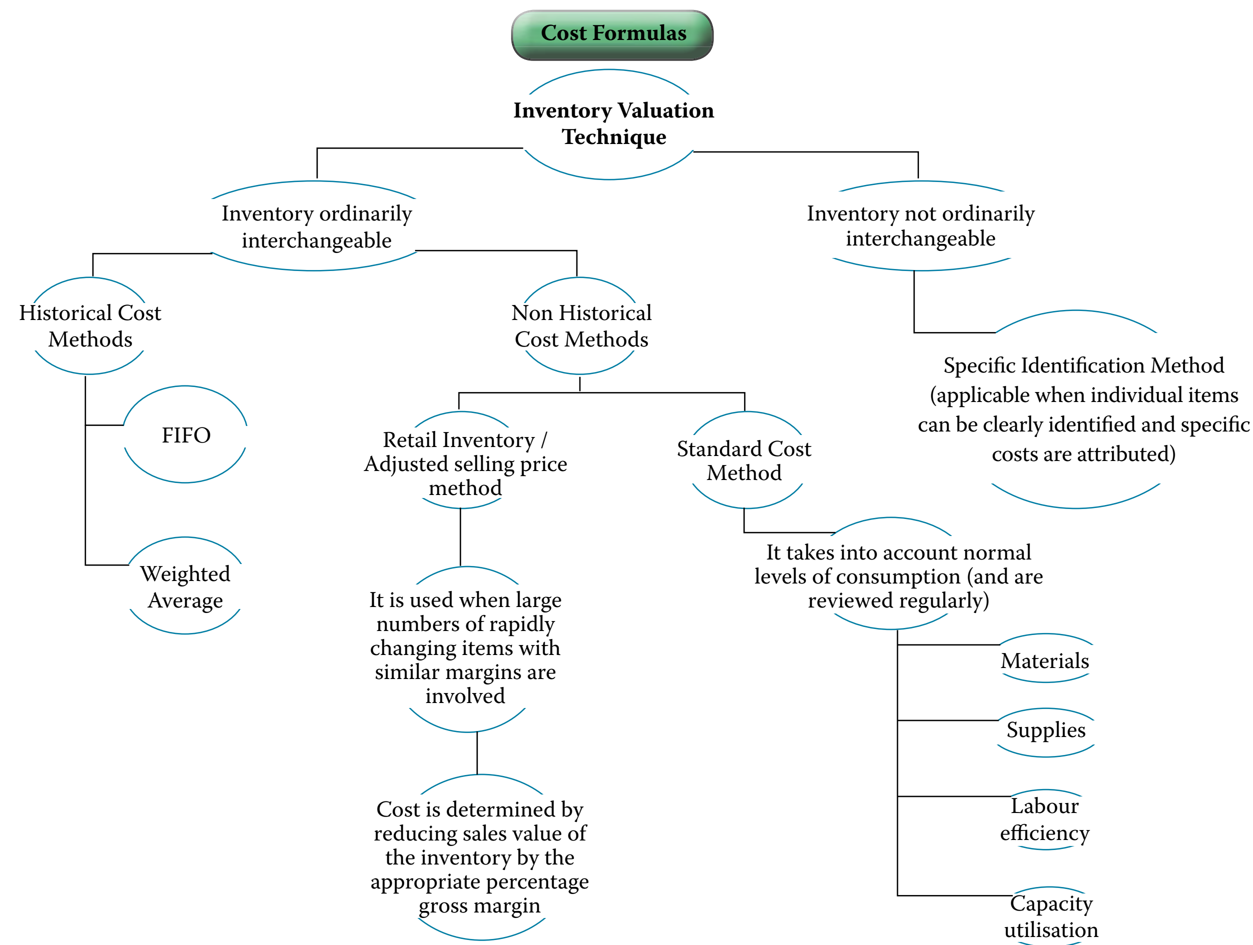

Determination of Cost of Inventories
Costs of purchase
Costs of conversion
Other costs
Purchase price
Duties and other taxes (non-recoverable from the taxing authorities)
Other expenditure directly attributable to the acquisition
Trade discounts, rebates, duty drawbacks and other similar items are deducted in determining the costs of purchase
Direct labour
Overheads
Fixed production overheads (remains relatively constant regardless of the volume of production)
Variable production overheads (It vary directly, or nearly directly, with the volume of production)
Costs incurred to bring the inventories to their present location and condition


Allocation of Cost to Joint Products and By-Products
When more than one product is produced in the process
Outcome - Joint products
Outcome - Main product with a By-product
When the cost of conversion of each product is separately identifiable
When the cost of conversion of each product is not separately identifiable
When the by-product is immaterial
When the by-product is material
Cost of each product is calculated on the basis of separate cost incurred.
Allocation of cost is based on relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production.
By-product is measured at NRV and this value is deducted from the cost of the main product.
By-product is treated as joint product and accordingly, the accounting is done.



**When actual production is almost equal or lower than normal capacity.*
*** When actual production is higher than normal capacity.*
**** Allocation at reasonable and consistent basis.*





Measurement of Inventories

- Raw Materials
  - At cost (if finished goods are sold at or above cost), otherwise at replacement cost
- Finished Goods and Work in progress
  - Lower of
    - Cost
    - Net Realisable Value
      - Realisable Value *less* Selling Expenses *less* estimated cost of completion

Disclosures

Information about the carrying amounts held in different classification of inventories and the extent of changes in these assets must be disclosed in financial statements.

Common Classifications of inventories

- Raw materials and components,
- Work in progress,
- Finished goods,
- Stock-in-trade (in respect of goods acquired for trading),
- Stores and spares,
- Loose tools,
- Others.

The financial statements should disclose — Accounting policies adopted in measuring inventories, including the cost formula used. — The total carrying amount of inventories together with its classification appropriate to the enterprise.

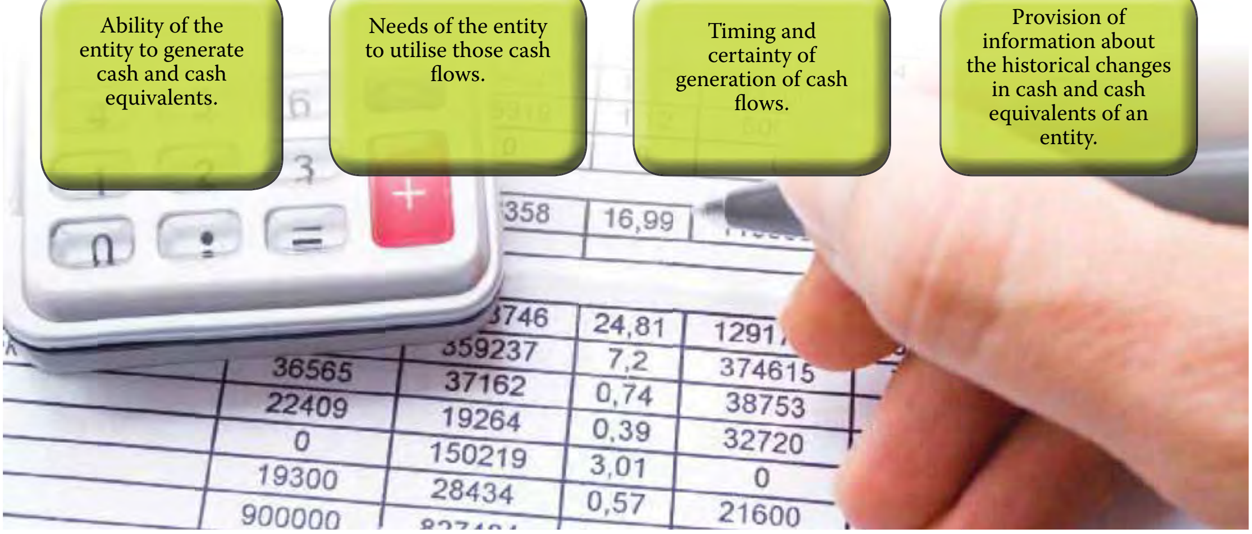
AS 3 "STATEMENT OF CASH FLOWS"

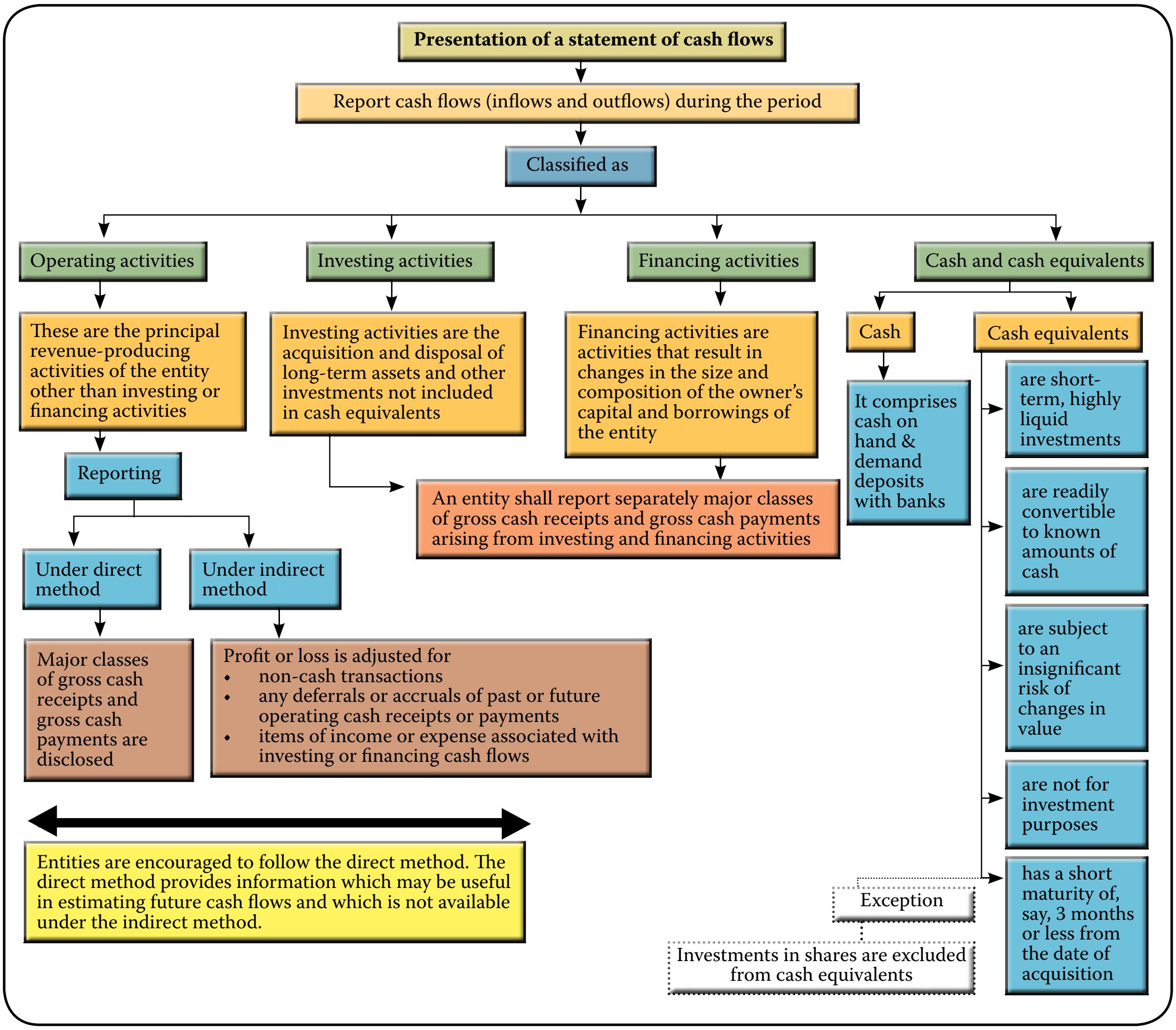
Introduction

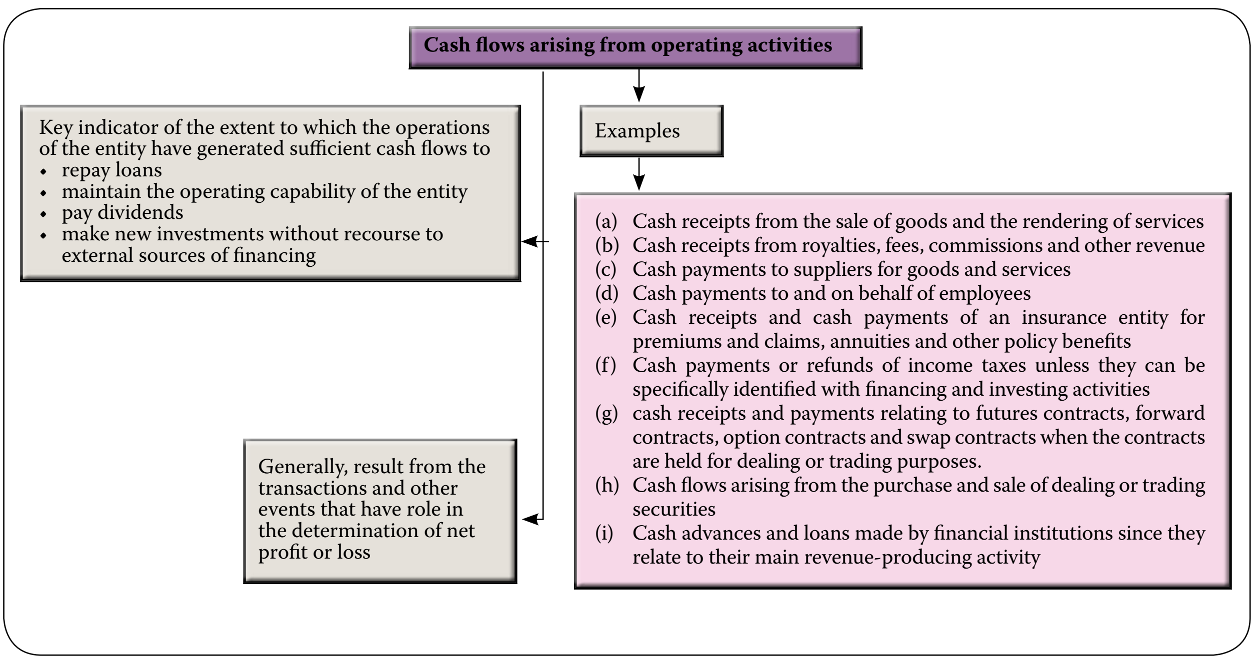
AS 3 provides information about historical changes in cash and cash equivalents of an enterprise by mean of a cash flow statement which classifies cash flows during an accounting period into operating, investing and financing activities.

Objectives of AS 3

- To assess
  - Ability of the entity to generate cash and cash equivalents.
  - Needs of the entity to utilise those cash flows.
  - Timing and certainty of generation of cash flows.
- To require
  - Provision of information about the historical changes in cash and cash equivalents of an entity.




Presentation of a statement of cash flows
Report cash flows (inflows and outflows) during the period
Classified as
Operating activities
Investing activities
Financing activities
Cash and cash equivalents
These are the principal revenue-producing activities of the entity other than investing or financing activities
Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents
Financing activities are activities that result in changes in the size and composition of the owner's capital and borrowings of the entity
Cash
Cash equivalents
It comprises cash on hand & demand deposits with banks
are short-term, highly liquid investments
are readily convertible to known amounts of cash
are subject to an insignificant risk of changes in value
are not for investment purposes
has a short maturity of, say, 3 months or less from the date of acquisition
Exception
Investments in shares are excluded from cash equivalents
Reporting
An entity shall report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities
Under direct method
Under indirect method
Major classes of gross cash receipts and gross cash payments are disclosed
Profit or loss is adjusted for
• non-cash transactions
• any deferrals or accruals of past or future operating cash receipts or payments
• items of income or expense associated with investing or financing cash flows
Entities are encouraged to follow the direct method. The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method.


Cash flows arising from operating activities
Examples
Key indicator of the extent to which the operations of the entity have generated sufficient cash flows to
• repay loans
• maintain the operating capability of the entity
• pay dividends
• make new investments without recourse to external sources of financing
Generally, result from the transactions and other events that have role in the determination of net profit or loss
(a) Cash receipts from the sale of goods and the rendering of services
(b) Cash receipts from royalties, fees, commissions and other revenue
(c) Cash payments to suppliers for goods and services
(d) Cash payments to and on behalf of employees
(e) Cash receipts and cash payments of an insurance entity for premiums and claims, annuities and other policy benefits
(f) Cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities
(g) cash receipts and payments relating to futures contracts, forward contracts, option contracts and swap contracts when the contracts are held for dealing or trading purposes.
(h) Cash flows arising from the purchase and sale of dealing or trading securities
(i) Cash advances and loans made by financial institutions since they relate to their main revenue-producing activity

Cash flows arising from investing activities

Represent the extent to which expenditures have been made for resources intended to generate future income and cash flows

Examples

(a) cash payments to acquire fixed assets (including intangibles). These payments include those relating to capitalised research and development costs and self-constructed fixed assets;
(b) cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;
(c) cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes);
(d) cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes);
(e) cash advances and loans made to other parties (other than advances and loans made by a financial institution);
(f) cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a financial institution);
(g) cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and
(h) cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

Note: *When a contract is accounted for as a hedge of an identifiable position the cash flows of the contract are classified in the same manner as the cash flows of the position being hedged.*

Cash flows arising from financing activities

useful in predicting claims on future cash flows by providers of funds to the entity.

Examples

(a) cash proceeds from issuing shares or other equity instruments;
(b) cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrowings;
(c) cash repayments of amounts borrowed.

Reporting cash flows on a net basis

Entities other than financial institutions

Cash flows arising from operating, investing or financing activities

Cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the entity

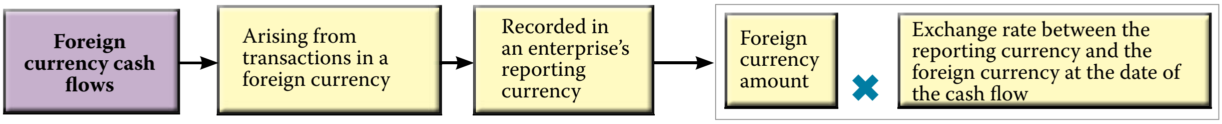
Examples are:
(a) The acceptance and repayment of demand deposits of a bank;
(b) Funds held for customers by an investment entity; and
(c) Rents collected on behalf of, and paid over to, the owners of properties

Cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short

Examples are advances made for, and the repayment of:
(a) Principal amounts relating to credit card customers;
(b) The purchase and sale of investments; and
(c) Other short-term borrowings, for example, those which have a maturity period of three months or less.

Financial institutions

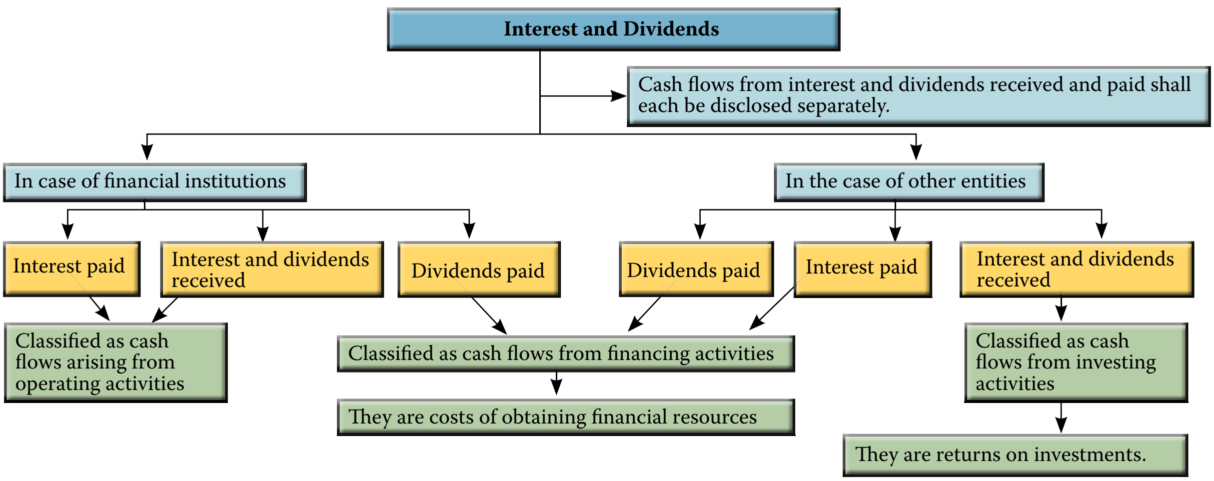
Cash flows arising from each of the following activities of a financial institution may be reported on a net basis:
(a) Cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date;
(b) The placement of deposits with and withdrawal of deposits from other financial institutions; and
(c) Cash advances and loans made to customers and the repayment of those advances and loans.



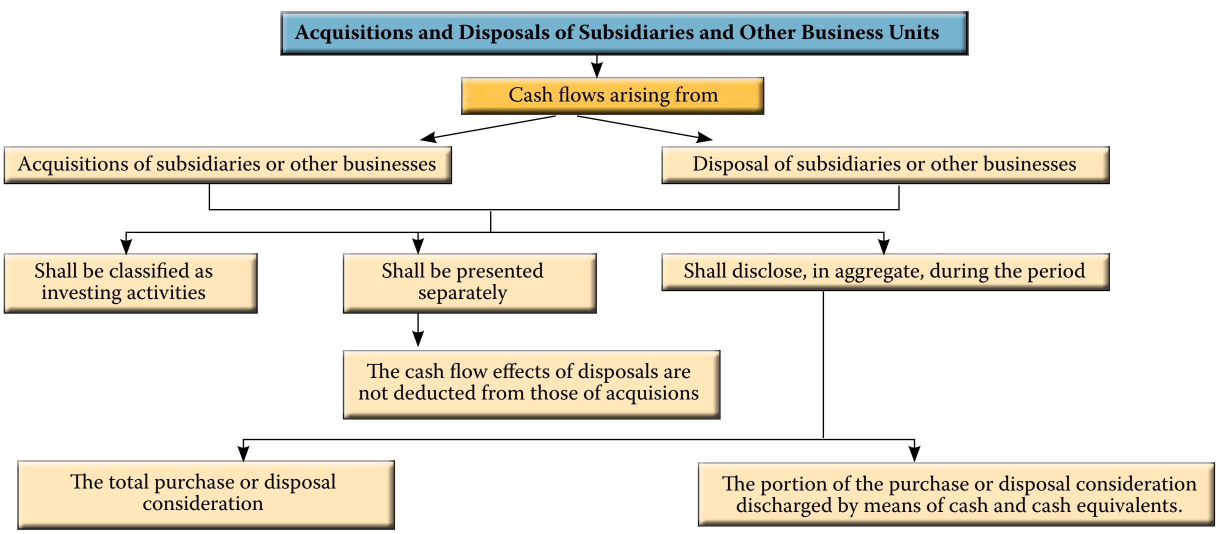
- Cash flows denominated in a foreign currency are reported in a manner consistent with AS 11.
- Weighted average exchange rate for a period may be used for recording foreign currency transactions.

Important Points

1.	**Unrealised gains and losses arising from changes in foreign currency exchange rates**	are not cash flows.
2.	**The effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency**	is reported in the statement of cash flows in order to reconcile cash and cash equivalents at the beginning and the end of the period.
		is presented separately from cash flows from operating, investing and financing activities and includes the differences, if any, had those cash flows been reported at end of period exchange rates.



Cash flows arising from taxes on income should be separately disclosed and should be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities.



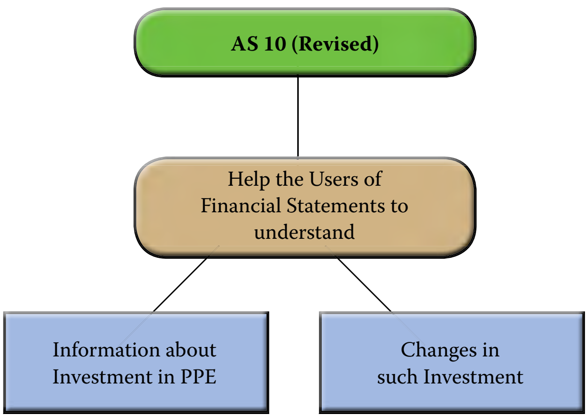
Important points/disclosures

Investing and financing transactions that do not require the use of cash or cash equivalents	shall be excluded from a statement of cash flows.
	disclosed elsewhere in the financial statements in a way that provides all relevant information.
Components of cash and cash equivalents	disclose the components of cash and cash equivalents.
	shall present a reconciliation of the amounts in its statement of cash flows with the equivalent items reported in the balance sheet.
	discloses the policy which entity adopts in determining the composition of cash and cash equivalents.
Other disclosures	disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the enterprise that are not available for use by it.

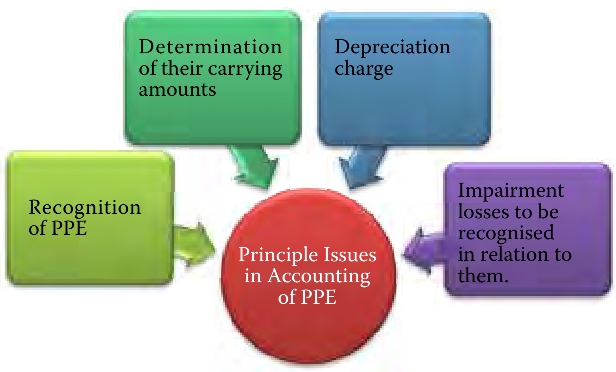
AS 10 "PROPERTY, PLANT AND EQUIPMENT"

Introduction

The objective of this Standard is to prescribe accounting treatment for Property, Plant and Equipment (PPE).

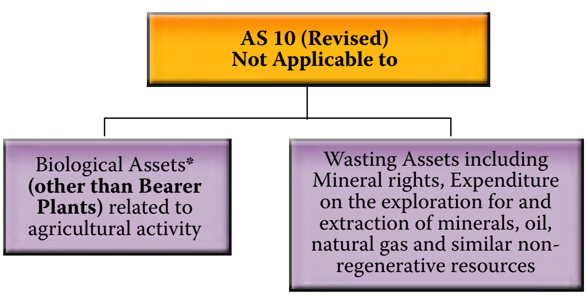


The principal issues in Accounting for PPE are:



Scope of Standard

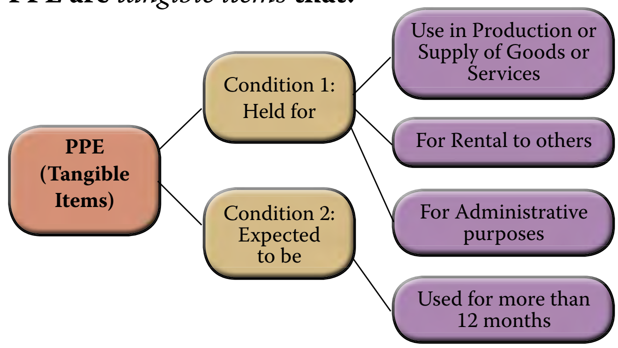
As a general principle, AS 10 (Revised) should be applied in accounting for PPE. Except when another Accounting Standard requires or permits a different accounting treatment.



***AS 10 (Revised) applies to Bearer Plants but it does not apply to the produce on Bearer Plants.**

Clarifications:
1. AS 10 (Revised) applies to PPE used to develop or maintain the assets described above.
2. Investment property (defined in AS 13 (Revised)), should be accounted for only in accordance with the Cost model prescribed in this standard.

PPE are *tangible items* that:



Intangible items are covered under AS 26.

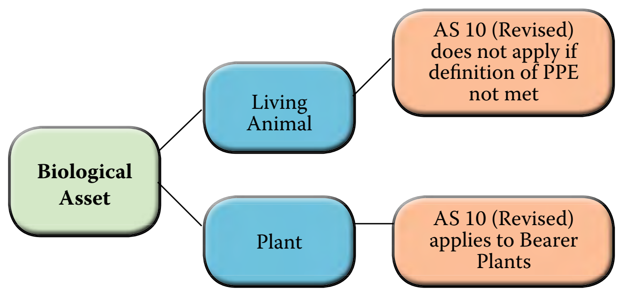
"Administrative purposes": **The term 'Administrative purposes' has been used** in wider sense **to** *include all business purposes.* Thus, PPE would include assets used for:

- Selling and distribution
- Finance and accounting
- Personnel and other functions of an Enterprise.

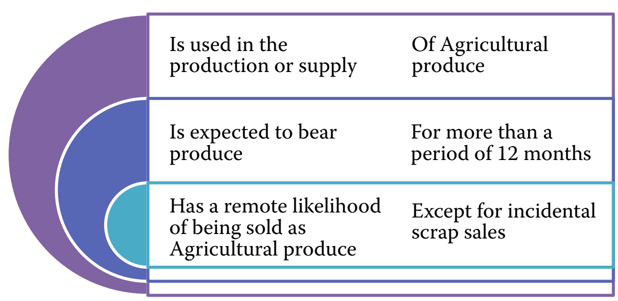
> Items of PPE may also be acquired for safety or environmental reasons.
>
> The acquisition of such PPE, although not directly increasing the future economic benefits of any particular existing item of PPE, may be necessary for an enterprise to obtain the future economic benefits from its other assets.
>
> Such items of PPE qualify for recognition as assets because they enable an enterprise to derive future economic benefits from related assets in excess of what could be derived had those items not been acquired.

Other definitions

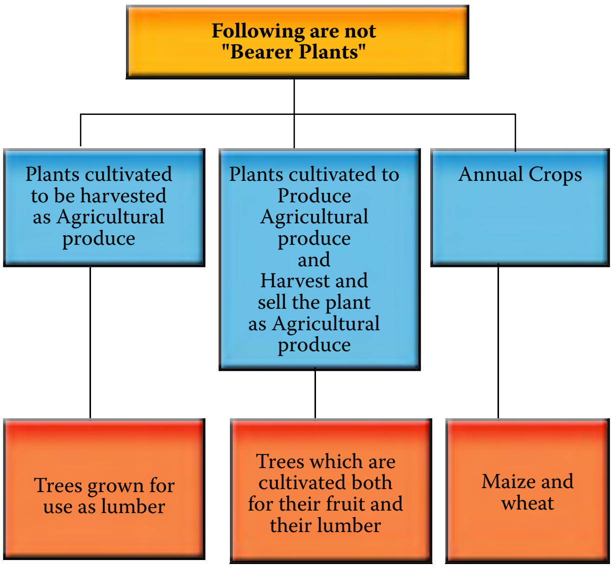
1. **Biological Asset:** Till the time, the Accounting Standard on "Agriculture" is issued, accounting for livestock meeting the definition of PPE, will be covered as per AS 10 (Revised).



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

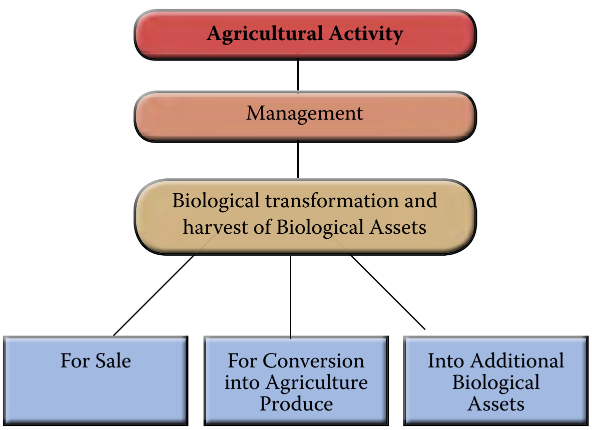


Note: When bearer plants are no longer used to bear produce they might be cut down and sold as scrap. For example - use as firewood. Such incidental scrap sales would not prevent the plant from satisfying the definition of a Bearer Plant.



Agricultural Produce is the harvested product **of** Biological Assets **of the enterprise.**

3. **Agricultural Activity:** is the management by an Enterprise of:
   - Biological transformation and Harvest of Biological Assets



Recognition Criteria for PPE

The *cost of an item of PPE* **should be recognised as an asset** *if, and only if:*

(a) It is probable that future economic benefits associated with the item will flow to the enterprise, and

(b) The cost of the item can be measured reliably.

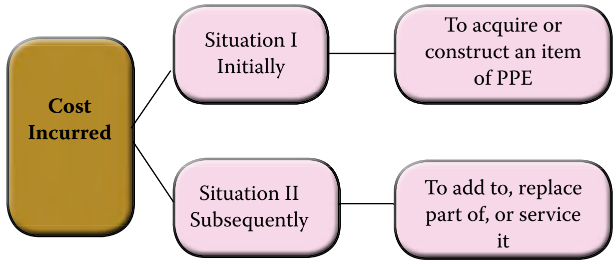
Notes:

1. It may be appropriate to aggregate individually insignificant items, such as moulds, tools and dies and to apply the criteria to the aggregate value.
2. An enterprise may decide to expense an item which could otherwise have been included as PPE, because the amount of the expenditure is not material.

When to apply the above criteria for Recognition?

An enterprise evaluates under this recognition principle all its costs on PPE at the time they are incurred.

These costs include costs incurred:



Treatment of Spare Parts, Stand by Equipment and Servicing Equipment

Case I If they meet the definition of PPE as per AS 10 (Revised):

- **Recognised as PPE as per AS 10 (Revised)**

Case II If they do not meet the definition of PPE as per AS 10 (Revised):

- **Such items are classified as Inventory as per AS 2 (Revised)**

Treatment of Subsequent Costs

Cost of day-to-day servicing

Costs of day-to-day servicing are primarily the costs of labour and consumables, and may include the cost of small parts. The purpose of such expenditures is often described as for the 'Repairs and Maintenance' of the item of PPE.

An enterprise does not recognise in the carrying amount of an item of PPE the costs of the day-to-day servicing of the item. Rather, these costs are recognised in the Statement of Profit and Loss as incurred.

Replacement of Parts of PPE

Parts of some items of PPE may require replacement at regular intervals.

An enterprise recognises in the carrying amount of an item of PPE the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met.

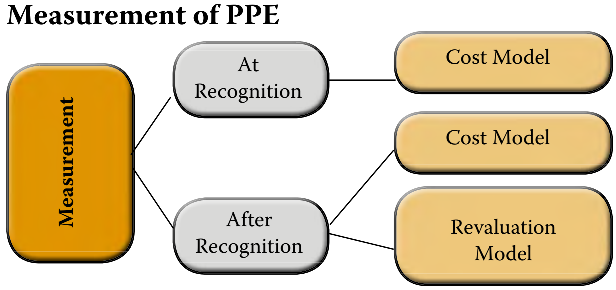
Notes: The carrying amount of those parts that are replaced is derecognised in accordance with the de-recognition provisions of this Standard.

Regular Major Inspections - Accounting Treatment

When each major inspection is performed, its cost is recognised in the carrying amount of the item of PPE as a replacement, if the recognition criteria are satisfied.

Any remaining carrying amount of the cost of the previous inspection (as distinct from physical parts) is derecognised.

Measurement of PPE

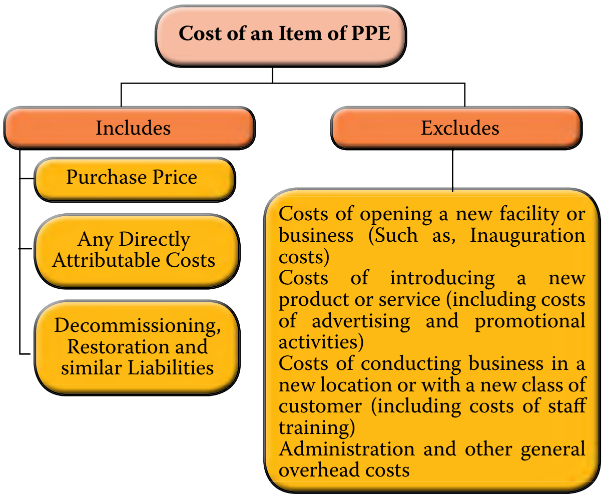


Measurement at Recognition

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

What are the elements of Cost?

Cost of an item of PPE comprises:



Recognition of costs in the carrying amount of an item of PPE ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management.

The following costs are not included in the carrying amount of an item of PPE:

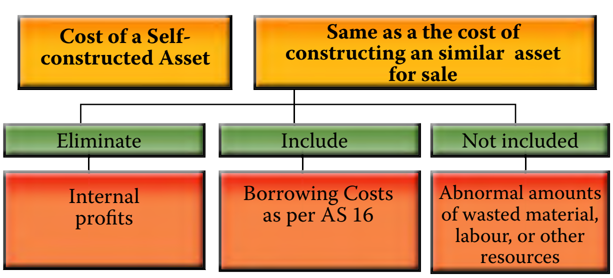
1. Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity.
2. Initial operating losses, such as those incurred while demand for the output of an item builds up. And
3. Costs of relocating or reorganising part or all of the operations of an enterprise.

Note: Some operations occur in connection with the construction or development of an item of PPE, but are not necessary to bring the item to the location and condition necessary for it to be capable of operating in the manner intended by management. These incidental operations may occur before or during the construction or development activities.

Decommissioning, Restoration and similar Liabilities:

The cost of an item of PPE comprises initial estimate of the costs of dismantling, removing the item and restoring the site on which it is located, referred to as 'Decommissioning, Restoration and similar Liabilities', the obligation for which an enterprise incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

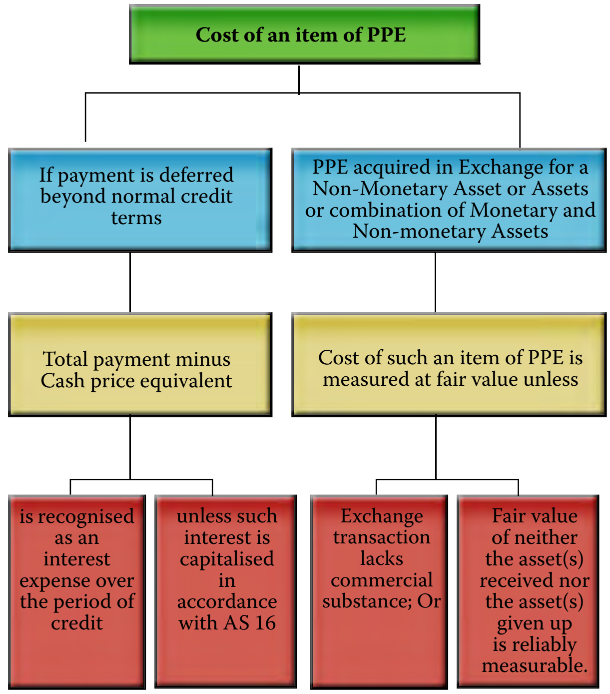
Exception: *An enterprise applies AS 2 (Revised) "Valuation of Inventories", to the costs of obligations for dismantling, removing and restoring the site on which an item is located that are incurred during a particular period as a consequence of having used the item to produce inventories during that period.*



Bearer plants are accounted for in the same way as self-constructed items of PPE before they are in the location and condition necessary to be capable of operating in the manner intended by management.

Measurement of Cost

Cost of an item of PPE is the cash price equivalent **at the recognition date.**



Note:

1. The acquired item(s) is/are measured in this manner even if an enterprise cannot immediately derecognise the asset given up.
2. If the acquired item(s) is/are not measured at fair value, its/their cost is measured at the carrying amount of the asset(s) given up.
3. An enterprise determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:
   (a) 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; or
   (b) the enterprise-specific value of the portion of the operations of the enterprise affected by the transaction changes as a result of the exchange;
   (c) and the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

PPE purchased for a Consolidated Price

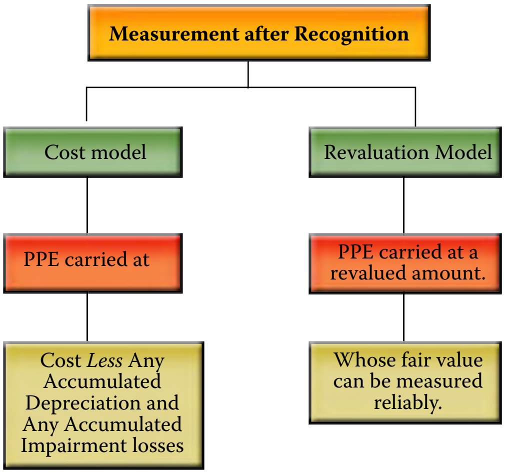
Where several items of PPE are purchased for a consolidated price, the consideration is apportioned to the various items on the basis of their respective fair values at the date of acquisition.

PPE held by a lessee under a Finance Lease

The cost of an item of PPE held by a lessee under a finance lease is determined in accordance with AS 19 (Leases).

Government Grant related to PPE

The carrying amount of an item of PPE may be reduced by government grants in accordance with AS 12 (Accounting for Government Grants).



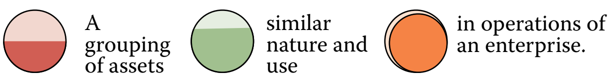
Revaluation for entire class of PPE

If an item of PPE is revalued, the entire class of PPE to which that asset belongs should be revalued.

Reason:

The items within a class of PPE are revalued simultaneously to avoid selective revaluation of assets and the reporting of amounts in the Financial Statements that are a mixture of costs and values as at different dates.

Class of PPE is

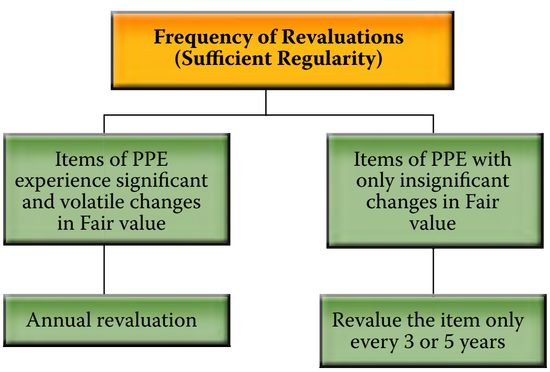


Frequency of Revaluations

Revaluations should be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using Fair value at the Balance Sheet date.

The frequency of revaluations depends upon the changes in fair values of the items of PPE being revalued.

When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is required.



Determination of Fair Value

Fair value of items of PPE is usually determined from market-based evidence by appraisal that is normally undertaken by professionally qualified valuers.

If there is no market-based evidence of fair value because of the specialised nature of the item of PPE and the item is rarely sold, except as part of a continuing business, an enterprise may need to estimate fair value using an income approach or a depreciated replacement cost approach.

Accounting Treatment of Revaluations

When an item of PPE is revalued, the carrying amount of that asset is adjusted to the revalued amount.

At the date of the revaluation, the asset is treated in one of the following ways:

Technique 1: Gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset.

Gross carrying amount

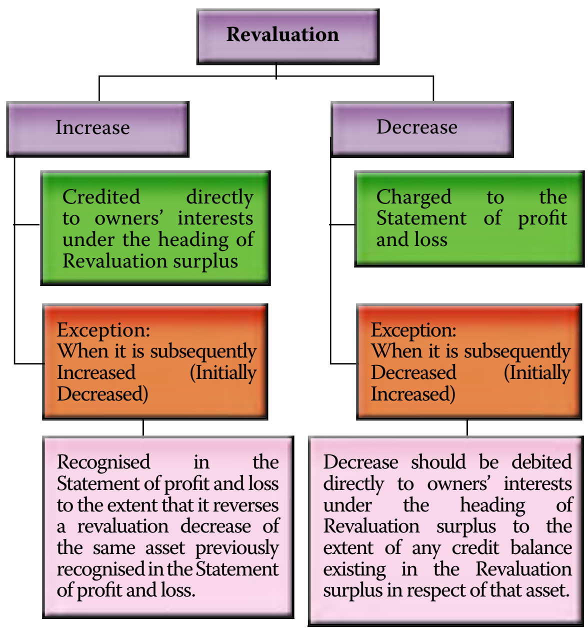
- May be restated by reference to observable market data, or
- May be restated proportionately to the change in the carrying amount.

Accumulated depreciation at the date of the revaluation is

- Adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account accumulated impairment losses

Technique 2: Accumulated depreciation is eliminated against the Gross Carrying amount of the asset

Revaluation - Increase or Decrease



Treatment of Revaluation Surplus

The revaluation surplus included in owners' interests in respect of an item of PPE may be transferred to the Revenue Reserves when the asset is derecognised.

Case I : When whole surplus is transferred:

If the asset is:

- Retired; Or
- Disposed of.

Case II : Some of the surplus may be transferred as the asset is used by an enterprise:

In such a case, the amount of the surplus transferred would be:

Depreciation (based on Revalued Carrying amount) – Depreciation (based on Original Cost)

Transfers from Revaluation Surplus to the Revenue Reserves are not made through the Statement of Profit and Loss.

Depreciation

Component Method of Depreciation

Each part of an item of PPE with a cost that is significant in relation to the total cost of the item should be depreciated separately.

A significant part of an item of PPE may have a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item. Such parts may be grouped in determining the depreciation charge.

Depreciation charge for each period should be recognised in the Statement of Profit and Loss unless it is included in the carrying amount of another asset.

Depreciable Amount and Depreciation Period

Depreciable amount is:

Cost of an asset (or other amount substituted for cost i.e. revalued amount) -Residual value

The depreciable amount of an asset should be allocated on a systematic basis over its useful life.

Review of Residual Value and Useful Life of an Asset

Residual value and the useful life of an asset should be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) should be accounted for as a change in an accounting estimate in accordance with AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'.

Commencement of period for charging Depreciation

Depreciation of an asset begins when it is available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by the management.

Cessation of Depreciation

I. **Depreciation ceases to be charged when asset's residual value exceeds its carrying amount**

The residual value of an asset may increase to an amount equal to or greater than its carrying amount. If it does, depreciation charge of the asset is zero unless and until its residual value subsequently decreases to an amount below its carrying amount.

II. **Depreciation of an asset ceases at the earlier of:**

- The date that the asset is retired from active use and is held for disposal, and
- The date that the asset is derecognised.

Therefore, depreciation does not cease when the asset becomes idle or is retired from active use (but not held for disposal) unless the asset is fully depreciated. However, under usage methods of depreciation, the depreciation charge can be zero while there is no production.

Land and Buildings

Land and buildings are separable assets and are accounted for separately, even when they are acquired together.

A. **Land:** Land has an unlimited useful life and therefore is not depreciated.

Exceptions: Quarries and sites used for landfill.

Depreciation on Land:

I. **If land itself has a limited useful life:**

It is depreciated in a manner that reflects the benefits to be derived from it.

II. **If the cost of land includes the costs of site dismantlement, removal and restoration:**

That portion of the land asset is depreciated over the period of benefits obtained by incurring those costs.

B. **Buildings:**

Buildings have a limited useful life and therefore are depreciable assets.

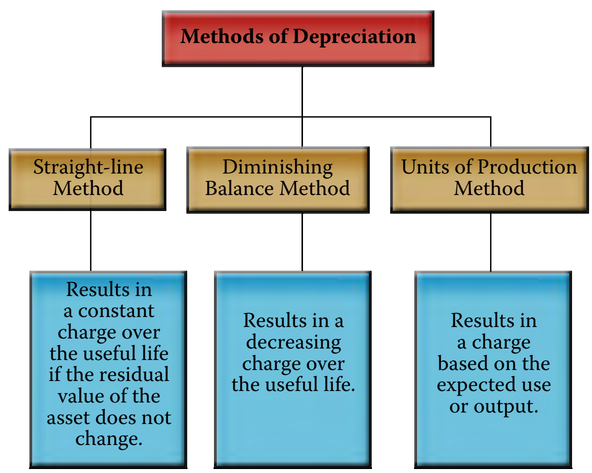
An increase in the value of the land on which a building stands does not affect the determination of the depreciable amount of the building.

Depreciation Method

The depreciation method used should reflect the pattern in which the future economic benefits of the asset are expected to be consumed by the enterprise.

The method selected is applied consistently from period to period unless:

- There is a change in the expected pattern of consumption of those future economic benefits; Or
- That the method is changed in accordance with the statute to best reflect the way the asset is consumed.



Review of Depreciation Method

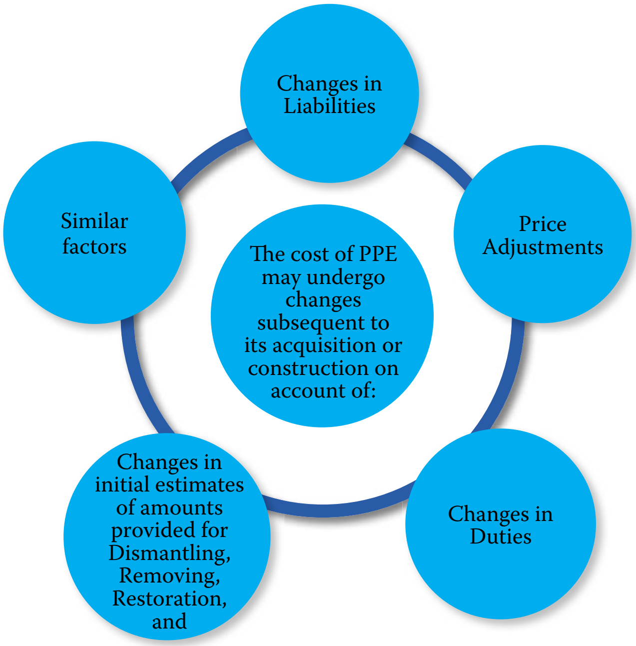
The depreciation method applied to an asset should be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern.

Such a change should be accounted for as a change in an accounting estimate in accordance with AS 5.

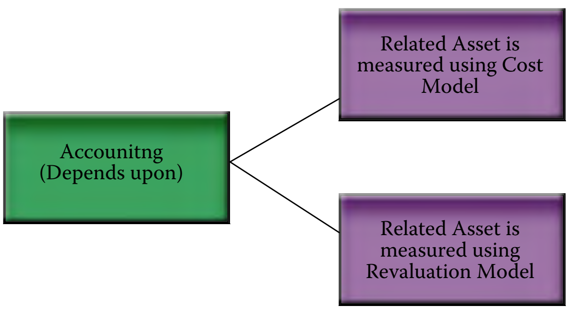
Depreciation Method based on Revenue:

A depreciation method that is based on revenue that is generated by an activity that includes the use of an asset is not appropriate.

Changes in Existing Decommissioning, Restoration and Other Liabilities



Accounting for the above changes:



If the related asset is measured using the Cost model

Changes in the Liability should be added to, or deducted from, the cost of the related asset in the current period

Note: Amount deducted from the cost of the asset should not exceed its carrying amount. If a decrease in the liability exceeds the carrying amount of the asset, the excess should be recognised immediately in the Statement of Profit and Loss.

If the adjustment results in an addition to the cost of an asset

- Enterprise should consider whether this is an indication that the new carrying amount of the asset may not be fully recoverable.

Note: If it is such an indication, the enterprise should test the asset for impairment by estimating its recoverable amount, and should account for any impairment loss, in accordance with applicable Accounting standards.

If the related asset is measured using the Revaluation model

Changes in the liability alter the revaluation surplus or deficit previously recognised on that asset, so that:

(i) **Decrease in the liability credited directly to revaluation surplus in the owners' interest**

Exception:

- It should be recognised in the Statement of Profit and Loss to the extent that it reverses a revaluation deficit on the asset that was previously recognised in the Statement of Profit and Loss.

Note: In the event that a decrease in the liability exceeds the carrying amount that would have been recognised had the asset been carried under the cost model, the excess should be recognised immediately in the Statement of Profit and Loss.

(ii) **Increase in the liability should be recognised in the Statement of Profit and Loss**

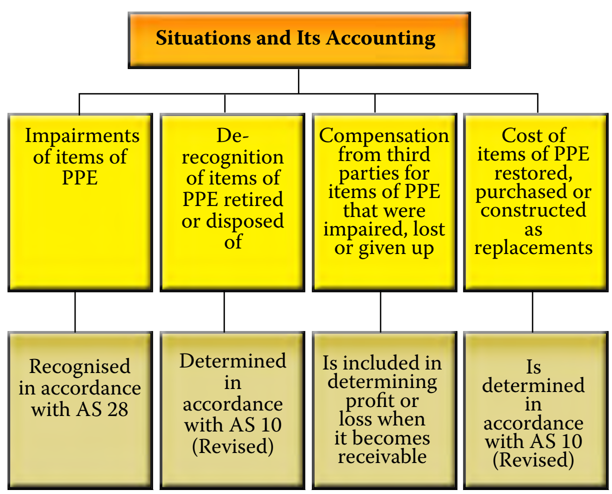
Exception:

- It should be debited directly to Revaluation surplus in the owners' interest to the extent of any credit balance existing in the Revaluation surplus in respect of that asset

Caution:
A change in the liability is an indication that the asset may have to be revalued in order to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.

What happens if the related asset has reached the end of its useful life?

All subsequent changes in the liability should be recognised in the Statement of Profit and Loss as they occur. This applies under both the cost model and the revaluation model.



Retirements

Items of PPE retired from active use and held for disposal should be stated at the lower of:

- Carrying Amount, and
- Net Realisable Value

Note: Any write-down in this regard should be recognised immediately in the Statement of Profit and Loss.

De-Recognition

Derecognition of Carrying amount PPE:

- On disposal
  - By sale
  - By entering into a finance lease, or
  - By donation,
- When no future economic benefits are expected from its use or disposal
- Accounting Treatment
  - Gain or loss arising from de-recognition of an item of PPE should be included in the Statement of Profit and Loss when the item is derecognised unless AS 19 on Leases, requires otherwise on a sale and leaseback (AS 19 on Leases, applies to disposal by a sale and leaseback.)
  - Gain or loss arising from de-recognition of an item of PPE = Net disposal proceeds (if any) - Carrying Amount of the item

Note: Gains should not be classified as revenue, as defined in AS 9 'Revenue Recognition'.

Exception:

An enterprise that in the course of its ordinary activities, routinely sells items of PPE that it had held for rental to others should transfer such assets to inventories at their carrying amount when they cease to be rented and become held for sale.

The proceeds from the sale of such assets should be recognised in revenue in accordance with AS 9 on Revenue Recognition.

Determining the date of disposal of an item:

An enterprise applies the criteria in AS 9 for recognising revenue from the sale of goods.

Disclosure

Disclosures

- General
- Additional
- Disclosures related to Revalued Assets

General Disclosures:

(a) The measurement bases (i.e., cost model or revaluation model) used for determining the gross carrying amount;

(b) The depreciation methods used;

(c) The useful lives or the depreciation rates used.

In case the useful lives or the depreciation rates used are different from those specified in the statute governing the enterprise, it should make a specific mention of that fact;

- The gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and
- A reconciliation of the carrying amount at the beginning and end of the period showing:
  (i) additions
  (ii) assets retired from active use and held for disposal
  (iii) acquisitions through business combinations
  (iv) increases or decreases resulting from revaluations and from impairment losses recognised or reversed directly in revaluation surplus
  (v) impairment losses recognised in the statement of profit and loss
  (vi) impairment losses reversed in the statement of profit and loss
  (vii) depreciation
  (viii) net exchange differences arising on the translation of the financial statements of a non-integral foreign operation in accordance with AS 11
  (ix) other changes.

Additional Disclosures:

The financial statements should also disclose:

- The existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities;
- The amount of expenditure recognised in the carrying amount of an item of property, plant and equipment in the course of its construction;
- The amount of assets retired from active use and held for disposal;
- The amount of contractual commitments for the acquisition of property, plant and equipment;
- If amount of contractual commitments is not disclosed separately on the face of the statement of profit and loss, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in the statement of profit and loss.

Disclosures related to Revalued Assets:

If items of property, plant and equipment are stated at revalued amounts, the following should also be disclosed:

- The effective date of the revaluation;
- Whether an independent valuer was involved;
- The methods and significant assumptions applied in estimating fair values of the items;
- The extent to which fair values of the items were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms or were estimated using other valuation techniques; and
- The revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.

Transitional Provisions

Previously Recognised Revenue Expenditure

Where an entity has in past recognised an expenditure in the Statement of Profit and Loss which is eligible to be included as a part of the cost of a project for construction of PPE in accordance with the requirements of this standard:

- It may do so retrospectively for such a project.

> ***Note:*** The effect of such retrospective application, should be recognised net-of-tax in Revenue reserves.

PPE acquired in Exchange of Assets

The requirements of AS 10 (Revised) regarding the initial measurement of an item of PPE acquired in an exchange of assets transaction should be applied prospectively only to transactions entered into after this Standard becomes mandatory.

Spare parts

On the date of this Standard becoming mandatory, the spare parts, which hitherto were being treated as inventory under AS 2 (Revised), and are now required to be capitalised in accordance with the requirements of this Standard, should be capitalised at their respective carrying amounts.

> ***Note:*** The spare parts so capitalised should be depreciated over their remaining useful lives prospectively as per the requirements of this Standard.

Revaluations

The requirements of AS 10 (Revised) regarding the revaluation model should be applied prospectively.

In case, on the date of this Standard becoming mandatory, an enterprise does not adopt the revaluation model as its accounting policy but the carrying amount of items of PPE reflects any previous revaluation it should adjust the amount outstanding in the Revaluation reserve against the carrying amount of that item.

> ***Note:*** The carrying amount of that item should never be less than residual value. Any excess of the amount outstanding as Revaluation reserve over the carrying amount of that item should be adjusted in Revenue reserves.

AS 11 "THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES"

Introduction

The standard deals with the issues involved in accounting for foreign currency transactions and foreign operations i.e., to decide which exchange rate to use and how to recognise the financial effects of changes in exchange rates in the financial statements.

Important points/disclosures

AS 11

Applicable

- (a) In accounting for transactions in foreign currencies.
- (b) In translating the financial statements of foreign operations.
- (c) Accounting for foreign currency transactions in the nature of forward exchange contracts.

Not applicable for

- (a) Specifying the currency in which an enterprise presents its financial statements. However, an enterprise normally uses the currency of the country in which it is domiciled. If it uses a different currency, the Standard requires disclosure of the reasons for using that currency. The Standard also requires disclosure of the reason for any change in the reporting currency.
- (b) Presentation in a cash flow statement of cash flows arising from transactions in a foreign currency and the translation of cash flows of a foreign operation, which are addressed in AS 3 'Cash flow statement'.
- (c) Exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.
- (d) Restatement of an enterprise's financial statements from its reporting currency into another currency for the convenience of users accustomed to that currency or for similar purposes.

Definitions of the Terms used in the Standard

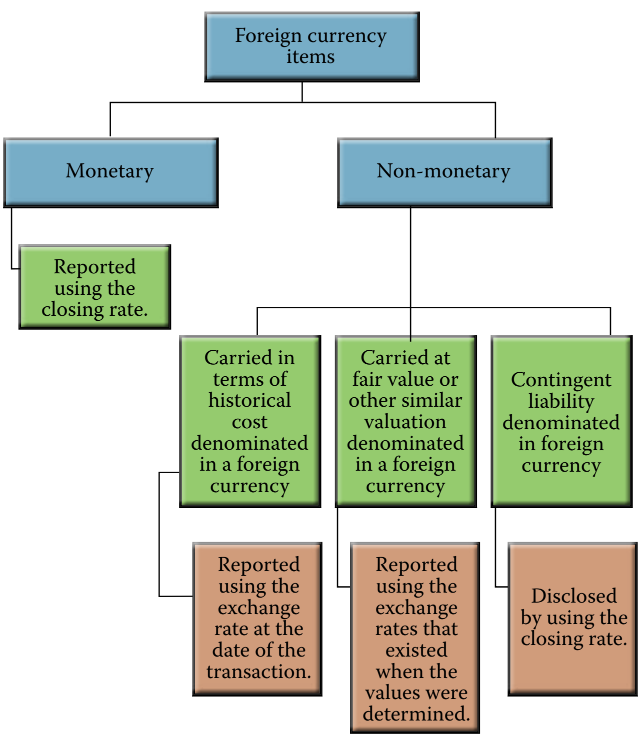
A foreign currency transaction is a transaction which is denominated in or requires settlement in a foreign currency, including transactions arising when an enterprise either:

- Buys or sells goods or services whose price is denominated in a foreign currency or
- Borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency or
- Becomes a party to an unperformed forward exchange contract or
- Otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

Monetary items	are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money. Example, cash, receivables and payables.
Non-monetary items	are assets and liabilities other than monetary items. Examples: fixed assets, inventories and investments in equity shares.
Foreign operation (FO)	is a subsidiary, associate, joint venture 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.
Integral foreign operation (IFO)	is a foreign operation, the activities of which are an integral part of those of the reporting enterprise. A foreign operation that is integral to the operations of the reporting enterprise and carries on its business as if it were an extension of the reporting enterprise's operations.
Non-integral foreign operation (NFO)	is a foreign operation that is not an integral foreign operation. 'Net investment in a non-integral foreign operation' is the reporting enterprise's share in the net assets of that operation.
Forward exchange contract	an agreement to exchange different currencies at a forward rate.
Forward rate	is specified exchange rate for exchange of two currencies at specified future date.
Foreign currency	is a currency other than the reporting currency of an enterprise.

Initial Recognition
A foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction.

Reporting at each Balance Sheet Date



Recognition of Exchange Differences

- Exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expenses in the period in which they arise.
- An exchange difference results when there is a change in the exchange rate between the transaction date and the date of settlement of any monetary items arising from a foreign currency transaction.
- When the transaction is settled within the same accounting period as that in which it occurred, all the exchange difference is recognised in that period.
- When the transaction is settled in a subsequent accounting period, exchange difference recognised in each intervening period up to the period of settlement is determined by the change in exchange rates during that period.
- Alternatively, exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, insofar as they relate to the acquisition of a depreciable capital asset, can be added to or deducted from the cost of the asset and should be depreciated over the balance life of the asset;
- In other cases, can be accumulated in the Foreign Currency Monetary Item Translation Difference (FCMITD) Account and (amortised over the balance period of such long term assets or liability, by recognition as income or expense in each of such periods)
- Such option is irrevocable and should be applied to all such foreign currency monetary items.

Classification of Foreign Operations as Integral or Non-Integral

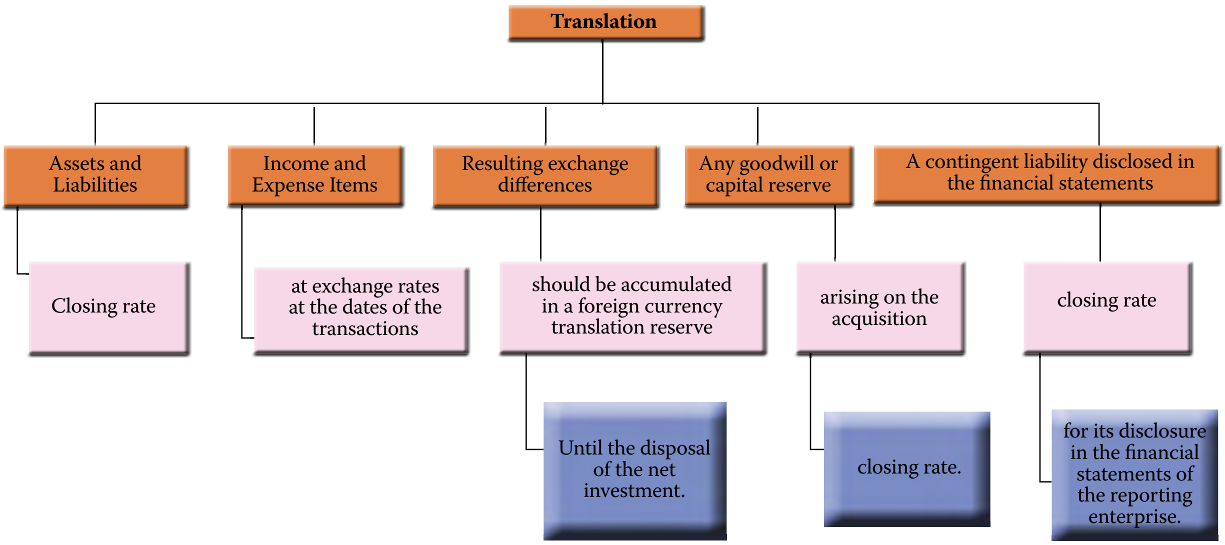
- The method used to translate the financial statements of a foreign operation
- depends on the way in which it is financed
- and operates in relation to the reporting enterprise.
- foreign operations are classified as either 'integral foreign operations' or 'non-integral foreign operations'.

Translation of Integral Foreign Operations (IFO)

- The individual items in the financial statements of the foreign operation are translated as if all its transactions had been entered into by the reporting enterprise itself.
- The cost and depreciation of tangible fixed assets is translated using the exchange rate at the date of purchase of the asset or, if the asset is carried at fair value or other similar valuation, using the rate that existed on the date of the valuation.
- The cost of inventories is translated at the exchange rates that existed when those costs were incurred.
- The recoverable amount or realisable value of an asset is translated using the exchange rate that existed when the recoverable amount or net realisable value was determined.

Translation of Non-Integral Foreign Operations (NFO)

The translation of the financial statements of a non-integral foreign operation is done using the following procedure:



Procedure of Translation for Non-Integral Foreign Operations (NFO)

For practical reasons, a rate that approximates the actual exchange rates, for example an average rate for the period is often used to translate income and expense items of a foreign operation.

Incorporation of the financial statements of a non-integral foreign operation in those of the reporting enterprise follows normal consolidation procedures, such as the elimination of intra-group balances and intra-group transactions of a subsidiary.

When the financial statements of a non-integral foreign operation are drawn up to a different reporting date from that of the reporting enterprise, the non-integral foreign operation often prepares, for purposes of incorporation in the financial statements of the reporting enterprise, statements as at the same date as the reporting enterprise.

The exchange differences are not recognised as income or expenses for the period because the changes in the exchange rates have little or no direct effect on the present and future cash flows from operations of either the non-integral foreign operation or the reporting enterprise.

When a non-integral foreign operation is consolidated, but is not wholly owned, accumulated exchange differences arising from translation and attributable to minority interests are allocated to, and reported as part of, the minority interest in the consolidated balance sheet.

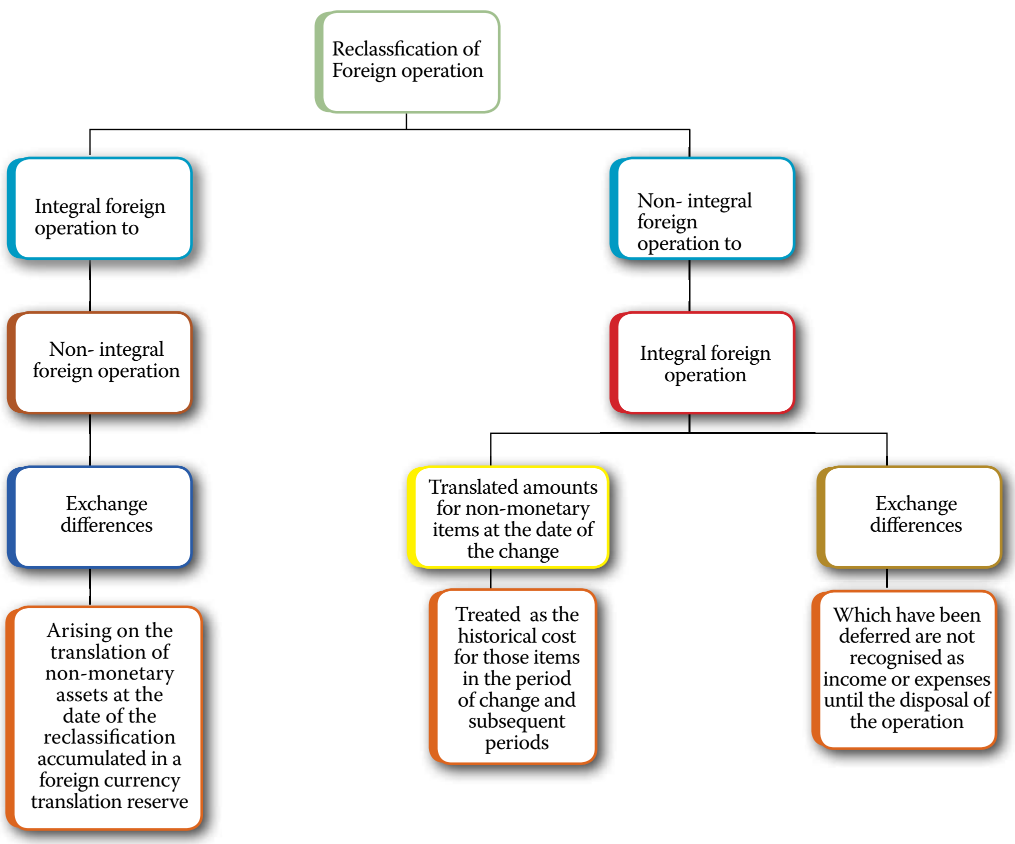
An enterprise may dispose of its interest in a non-integral foreign operation through sale, liquidation, repayment of share capital, or abandomnent of all, or part ot: that operation. The payment of a dividend forms part of a disposal only when it constitutes a return of the investment. Remittance from a non-integral foreign operation by way of repatriation of accumulated profits does not form part of a disposal unless it constitutes return of the investment. In the case of a partial disposal, only the proportionate share of the related accumulated exchange differences is included in the gain or loss. A write-down of the carrying amount of a non-integral foreign operation does not constitute a partial disposal. Accordingly, no part of the deferred foreign exchange gain or loss is recognised at the time of a write-down.

Indications that a FO is a non-integral foreign operation rather than an integral foreign operation

Indications	
Control	RE may control the FOA of the FO are carried out with a significant degree of autonomy from those of the **RE**
Transactions	With the **RE** are not a high proportion of the **FOA**
Finance	**FOA** are financed mainly from its own operations or local borrowings rather than from RE
Cost	Costs of labour, material and other components of the FO'S products or services are primarily paid or **settled in the local currency** rather than in the **RE** currency
Sales	FO's sales are mainly in currencies other than the RE currency
Cash Flows	RE cash flows are insulated from the day-to-day activities of the FO rather than being directly affected by the FOA
Sales prices	Sales prices for the FO'S products are not primarily responsive on a short-term basis to changes in exchange rates but are determined more by local competition or local government regulation.
Local sales market	There is an active local sales market for the FO'S products, although there also might be significant amounts of exports.

RE - Reporting Enterprise
FO- Foreign Operation
FOA - Foreign Operation Activities

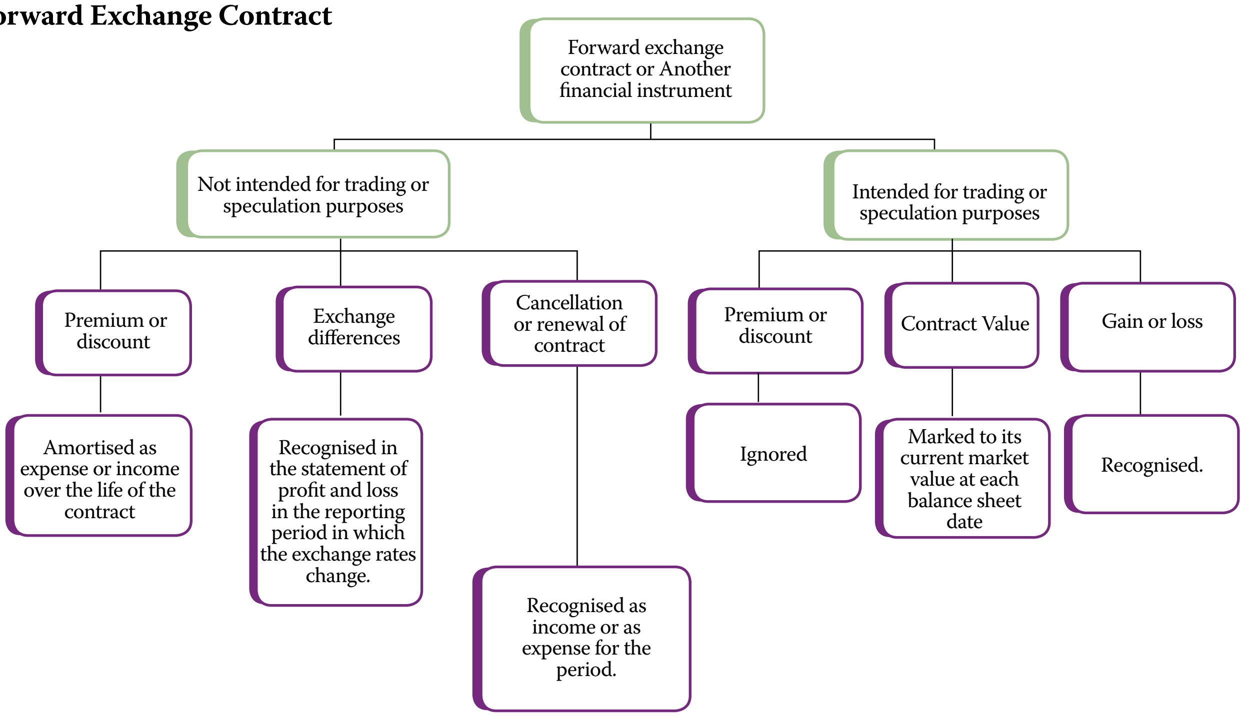
Change in the Classification of a Foreign Operation



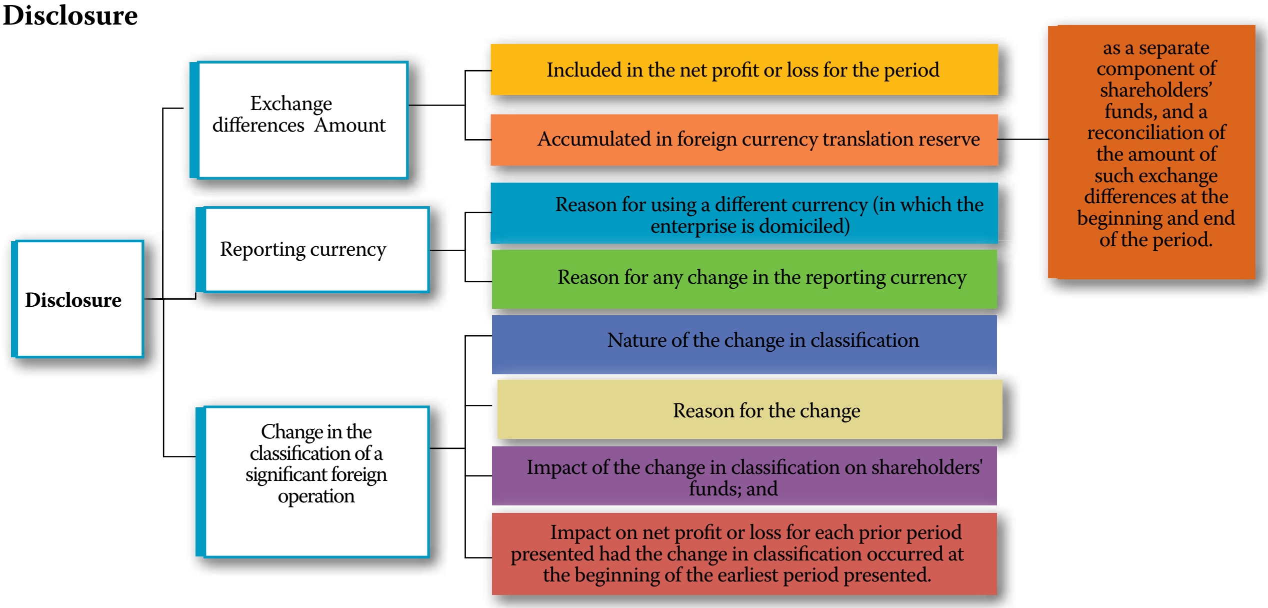
Tax Effects of Exchange Differences

Accounted for in accordance with AS 22. { Gains and losses on foreign currency transactions and exchange differences arising on the translation of the financial statements of foreign operations may have associated tax effects.

Forward Exchange Contract



Disclosure



Presentation of Foreign Currency Monetary Item Translation Difference Account (FCMITDA)

Debit or credit balance in FCMITDA should be shown on the "Equity and Liabilities" side of the balance sheet under the head 'Reserves and Surplus' as a separate line item.

AS 12 "ACCOUNTING FOR GOVERNMENT GRANTS"

AS 12

Deals with
- ◊ Accounting for government grants such as subsidies,
- ◊ Cash incentives,
- ◊ Duty drawbacks, etc.

Does not deal with:
- ◊ The special problems arising in accounting for government grants in financial statements reflecting the effects of changing prices or in supplementary information of a similar nature.
- ◊ Government assistance other than in the form of government grants.
- ◊ Government participation in the ownership of the enterprise

AS 12 describes
- Treatment of non-monetary government grants;
- Presentation of grants related to specific fixed assets;
- Revenue grants and those in the nature of promoters' contribution;
- Treatment for refund of government grants etc.

Meaning of Government Grants

Assistance by government — in cash or kind — to an enterprise for past or future compliance — with certain conditions

They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the enterprise.

Accounting Treatment of Government Grants

Two approaches

- 'Capital approach'
  - Grant is treated as part of shareholders' funds
    - Grants which have the characteristics similar to those of promoters' contribution should be treated as part of shareholders' funds.
- 'Income approach'
  - Grant is taken to income over one or more periods.
    - Income approach may be more appropriate in the case of other grants.

Recognition of Government Grants

A government grant is not recognised until there is reasonable assurance that → Enterprise will comply with the conditions attached to it; and → 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 befulfilled.

Non-Monetary Government Grants

Non-Monetary Government Grants — Land or other resources,
- Concessional rates → Account at their acquisition cost.
- Free of cost → Recorded at a nominal value.

Presentation of Grants

- Presentation of Grants
  - Related to Specific Fixed Assets
    - Method I :
      - The grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value.
      - The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge.
      - Where the grant equals the whole, or virtually the whole, of the cost of the asset, the asset is shown in the balance sheet at a nominal value.
    - Method II:
      - Grants related to depreciable assets are treated 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.
      - Grants related to non-depreciable assets are credited to capital reserve as there is usually no charge to income in respect of such assets.
      - If a grant related to a non-depreciable asset requires the fulfilment of certain obligations, the grant is credited to income over the same period over which the cost of meeting such obligations is charged to income.
  - Related to Revenue
    - Grants related to revenue are sometimes presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, they are deducted in reporting the related expense.
  - In nature of Promoters' Contribution
    - 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.

Refund of Government Grants

If certain conditions are not fulfilled grants become refundable and are treated as an extraordinary item.

- Refund of Government Grant
  - Related to Revenue
    - is applied first against any unamortised deferred credit remaining in respect of the grant
    - To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists,
    - the amount is charged immediately to profit and loss statement.
  - Related to a Specific fixed asset
    - is recorded by increasing the book value of the asset or by reducing the deferred income balance, as appropriate, by the amount refundable.
    - In the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value is provided prospectively over the residual useful life of the asset.
  - In the nature of promoters' contribution
    - Refundable, in part or in full, to the government on non-fulfilment of some specified conditions, the relevant amount recoverable by the government is
    - Reduced from the capital reserve.

Disclosure

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

CAPSULE ON ACCOUNTING STANDARDS AND FRAMEWORK FOR PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS

It has always been the endeavour of Board of Studies to provide quality academic inputs to the students. Considering this objective in mind, it has been decided to bring forth a crisp and concise capsule for the topic on Accounting Standards and Framework covered in Intermediate Accounting Papers (Paper 1 "Accounting" and Paper 5 "Advanced Accounting"). The significant provisions of AS 13, AS 16, AS 17, AS 22 and Framework on Preparation and Presentation of Financial Statements have been gathered and presented through pictorial presentations in this capsule which will help the students in grasping the intricate practical aspects of each Accounting Standard. The Capsules containing provisions of AS 1, AS 2, AS 3, AS 4, AS 5, AS 7, AS 9, AS 10, AS 11, AS 12, AS 14, AS 18, AS 19, AS 20, AS 24, AS 26 and AS 29 have already been published and the students are advised to access them at https://www.icai.org/post.html?post_id=16431. Although, the capsule has been prepared keeping in view the new and revised scheme of Education and Training of ICAI, the students of earlier scheme may also be benefitted from it. This capsule, though, facilitates the students in undergoing quick revision, under no circumstances, such revisions can substitute the detailed study of the material provided by the Board of Studies.

AS 13 "ACCOUNTING FOR INVESTMENTS"

AS 13 deals with accounting for investments in the financial statements of enterprises and related disclosure requirements.

AS 13 does not deal with

- Basis for recognition of interest, dividends and rentals earned on investments which are covered by AS 9
- Operating or finance leases
- Investments on retirement benefit plans and life insurance enterprises
- Mutual funds, venture capital funds and/ or the related asset management companies, banks and public financial institutions formed under a Central or State Government Act or so declared under the Companies Act, 2013

DEFINITION OF INVESTMENTS

Investments are assets held by an enterprise

- for earning income
  - Dividends
  - Interests
  - Rentals
- for capital appreciation or for other benefits

Assets held as Stock-in-trade are not 'Investments'.

Fair value	• Amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction. • Under appropriate circumstances, market value or net realisable value provides an evidence of fair value.
Market value	• Amount obtainable from the sale of an investment in an open market, net of expenses necessarily to be incurred on or before disposal.

CLASSIFICATION OF INVESTMENTS

Classification of Investments

- Current Investments: By nature readily realisable; intended to be held for not more than one year from the date on which such investment is made.
- Long Term Investments: Other than a current investment

Type of acquisition	Cost of investments
In Cash/ bank	Cash price including charges such as brokerages, fees and duties
By Issue of shares/ other securities	Fair value of securities issued
In exchange for another asset	Fair value of asset given up or fair value of investment acquired, whichever is more clearly evident

Accounting for
Interest accrued/Dividend declared

- **Pre-acquisition period**: ***Deducted from cost of investment***
- **Post-acquisition period**: ***Recognized as an income***

Accounting for

- Right shares
  - **Subscribed**
    Cost of shares added to carrying amount
  - **Not subscribed, but sold**
    Sale proceeds taken to P&L A/c
    - If acquired on cum-right basis & the market value of investments immediately after their becoming ex-right is lower than the cost for which they were acquired, apply the sale proceeds of rights to reduce the carrying amount of such investments to the market value.
- Bonus
  - No amount is entered in the capital column of investment account.

CARRYING AMOUNT OF INVESTMENTS

Carrying Amount

- Current investments
  - Lower of cost and fair value.
    - Any reduction to fair value is debited to profit and loss account, however, if fair value of investment is increased subsequently, the increase in value of current investment up to the cost of investment is credited to the profit and loss account (and excess portion, if any, is ignored).
  - Valuation
    - on overall (or global) basis is not considered appropriate; prudent method is to carry investment individually.
- Long term investments
  - carried
    - at cost.
      - Where there is a decline, other than temporary,in the carrying amounts of long term valued investments, the resultant reduction in the carrying amount is charged to the profit and loss statement. The reduction in carrying amount is reversed when there is a rise in the value of the investment, or if the reasons for the reduction no longer exist.
  - Valuation
    - Determined on an individual investment basis.

INVESTMENT PROPERTIES

- An investment property is an investment in land or buildings that are not intended to be occupied substantially for use by, or in the operations of, the investing enterprise.
- An investment property is accounted for in accordance with cost model as prescribed in AS 10 (Revised), 'Property, Plant and Equipment'.
- The cost of any shares in a co-operative society or a company, the holding of which is directly related to the right to hold the investment property, is added to the carrying amount of the investment property.

DISPOSAL OF INVESTMENTS

- Difference between the carrying amount and the disposal proceeds, net of expenses, is recognised in the P & L statement.
- When part of investment is disposed, carrying amount is allocated to that part on the basis of average carrying amount of total investment.
- If investments held as stock-in-trade, cost of stocks disposed calculated as per cost formula as per AS 2.

RECLASSIFICATION OF INVESTMENTS

Reclassification of Investments

- Current to Long-term
  - Transfer at Lower of cost & fair value at the date of transfer
- Long-term to Current
  - Transfer at lower of cost & carrying amount at the date of transfer

DISCLOSURE

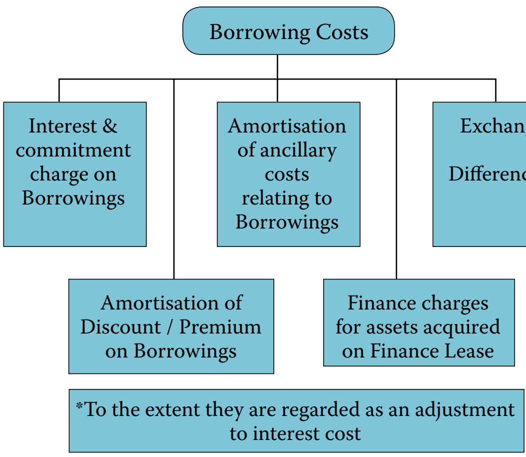
- Accounting policies followed for valuation of investments;
- Amounts included in profit and loss statement for:
  - Interest, dividends (showing separately dividends from subsidiary companies), and rentals on investments showing separately such income from long term and current investments.
  - Gross income should be stated, the amount of income tax deducted at source being included under Advance Taxes Paid.
  - Profits and losses on disposal of current investments and changes in carrying amount of such investments.
  - Profits and losses on disposal of long term investments and changes in carrying amount of such investments.
- Significant restrictions on the right of ownership, realizability of investments or remittance of income and proceeds of disposal.
- Aggregate amount of quoted and unquoted investments, giving aggregate market value of quoted investments.
- Other disclosures as specifically required by relevant statute governing enterprise.

AS 16 "BORROWING COSTS"

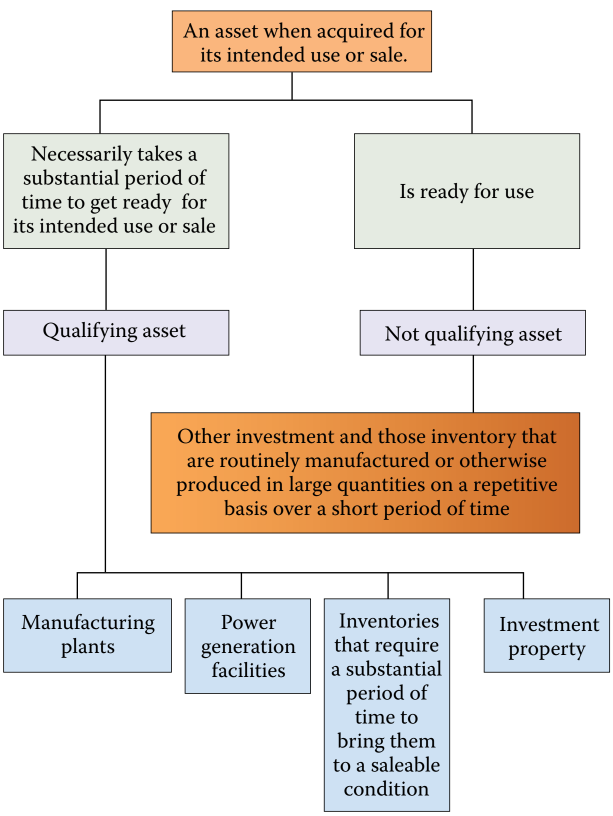
The objective of AS 16 is to account for borrowing costs. It does not deal with the actual or imputed cost of owners' equity, including preference share capital not classified as a liability.

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

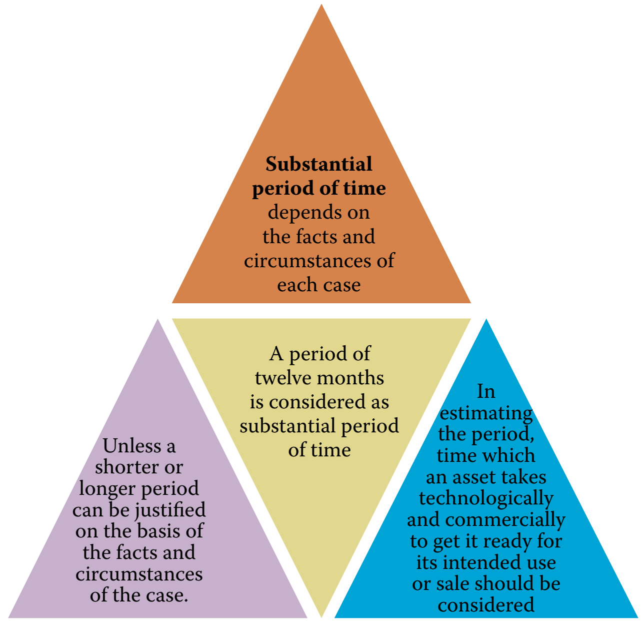
BORROWING COSTS MAY INCLUDE



A QUALIFYING ASSET



SUBSTANTIAL PERIOD OF TIME



EXCHANGE DIFFERENCES ON FOREIGN CURRENCY BORROWINGS

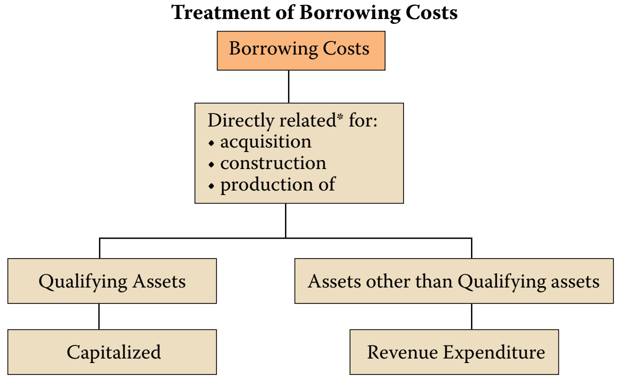
Exchange differences arising from foreign currency borrowing and considered as borrowing costs are those exchange differences which arise on the amount of principal of the foreign currency borrowings to the extent of the difference between interest on local currency borrowings and interest on foreign currency borrowings.

Amount of exchange difference not exceeding the difference between interest on local currency borrowings and interest on foreign currency borrowings is considered as borrowing cost to be accounted for under this Standard and the remaining exchange difference, if any, is accounted for under AS 11, 'The Effects of Changes in Foreign Exchange Rates'.

Interest rate for the local currency borrowings is considered as that rate at which the enterprise would have raised the borrowings locally had the enterprise not decided to raise the foreign currency borrowings.

BORROWING COSTS ELIGIBLE FOR CAPITALISATION

Treatment of Borrowing Costs



*or that could have been avoided if the expenditure on qualifying assets had not been made.

Thus, borrowing costs are capitalised as part of the cost of a qualifying asset when it is probable that they will result in future economic benefits to the enterprise and the costs can be measured reliably. Other borrowing costs are recognised as an expense in the period in which they are incurred.

Borrowings

- Specific borrowings
  - Borrowed funds specifically for the purpose of obtaining a particular qualifying asset
  - Borrowing costs that directly relate to that qualifying asset can be readily identified.
  - If funds temporarily invested .
    - Capitalised borrowing costs= borrowing costs less any income earned on the temporary investment of those borrowings
- General borrowings
  - No Direct relationship between particular borrowings and a qualifying asset
  - Amount of borrowing costs eligible for capitalisation determined by applying a capitalisation rate to the expenditure on that asset.
    - The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset.
  - The amount of borrowing costs capitalised during a period should not exceed the amount of borrowing costs incurred during that period.

EXCESS OF THE CARRYING AMOUNT OF THE QUALIFYING ASSET OVER RECOVERABLE AMOUNT

When the carrying amount or the expected ultimate cost of the qualifying asset

Exceeds its recoverable amount or net realisable value,

Carrying amount is written down or written off in accordance with the requirements of other Accounting Standards.

In certain circumstances, the amount of the write-down or write-off is written back in accordance with those other Accounting Standards.

COMMENCEMENT OF CAPITALISATION

The capitalisation of borrowing costs as part of the cost of a qualifying asset should commence when all the following conditions are satisfied

- **Expenditure for the acquisition, construction or production of a qualifying asset is being incurred:**
- **Borrowing costs are being incurred.**
- **Activities that are necessary to prepare the asset for its intended use or sale are in progress:**

Expenditure on a qualifying asset includes only such expenditure that has resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities. Expenditure is reduced by any progress payments received and grants received in connection with the asset. The average carrying amount of the asset during a period, including borrowing costs previously capitalised, is normally a reasonable approximation of the expenditure to which the capitalisation rate is applied in that period.

The activities necessary to prepare the asset for its intended use or sale encompass more than the physical construction of the asset. They include technical and administrative work prior to the commencement of physical construction. However, such activities exclude the holding of an asset when no production or development that changes the asset's condition is taking place. For example, borrowing costs incurred while land is under development are capitalised during the period in which activities related to the development are being undertaken. However, borrowing costs incurred while land acquired for building purposes is held without any associated development activity do not qualify for capitalisation.

SUSPENSION OF CAPITALISATION

Capitalisation of borrowing costs

- Suspended
  - during extended periods in which active development is interrupted.
- Not suspended
  - during a period when substantial technical and administrative work is being carried out.
  - when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

CESSATION OF CAPITALISATION

Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications, such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete.

When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

DISCLOSURE

The financial statements should disclose:

- The accounting policy adopted for borrowing costs; and
- The amount of borrowing costs capitalised during the period.

FRAMEWORK FOR PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS

The framework for preparation and presentation of financial statements (referred as Framework in this capsule) sets out the concepts underlying the preparation and presentation of general-purpose financial statements (financial statements which are prepared for general users) prepared by enterprises for external users. The framework explains components of financial statements, users of financial statements, qualitative characteristics of financial statements and elements of financial statements. The framework also explains concepts of capital, capital maintenance and determination of profit.*

The principal areas covered by the framework are :

- Components of financial statements;
- Objectives of financial statements;
- Assumptions underlying financial statements;
- Qualitative characteristics of financial statements;
- Elements of financial statements;
- Criteria for recognition of elements of financial statements;
- Principles of measurement of financial elements;
- Concepts of Capital and Capital Maintenance.

STATUS AND SCOPE

The framework applies to general-purpose financial statements (hereafter referred to as 'financial statements' usually prepared annually) for external users, by all commercial, industrial and business enterprises, whether in public or private sector. The special purpose financial reports, for example computations prepared for tax purposes are outside the scope of the framework. Nevertheless, the framework may be applied in preparation of such reports, to the extent not inconsistent with their requirements.

Nothing in the framework overrides any specific Accounting Standard. In case of conflict between an Accounting Standard and the Framework, the requirements of the Accounting Standard will prevail over those of the Framework.

COMPONENTS OF FINANCIAL STATEMENTS

A complete set of financial statements normally consists of a Balance Sheet, a Statement of Profit and Loss and a Cash Flow Statement together with notes, statements and other explanatory materials that form integral parts of the financial statements. All parts of financial statements are interrelated because they reflect different aspects of same transactions or other events. Although each statement provides information that is different from each other, none in isolation is likely to serve any single purpose nor can anyone provide all information needed by a user.

The major information contents of different components of financial statements are:

Balance Sheet	Statement of Profit and Loss	Cash Flow Statement	Notes and other statements
portrays value of economic resources controlled by an enterprise. It also provides information about liquidity and solvency of an enterprise which is useful in predicting the ability of the enterprise to meet its financial commitments as they fall due.	presents the result of operations of an enterprise for an accounting period, i.e., it depicts the performance of an enterprise, in particular its profitability.	shows the way an enterprise has generated cash and the way they have been used in an accounting period and helps in evaluating the investing, financing and operating activities during the reporting period.	present supplementary information explaining different items of financial statements. For example, they may contain additional information that is relevant to the needs of users about the items in the balance sheet and statement of profit and loss. per share, etc.

*The concepts of capital, capital maintenance and determination of profit will be discussed in next issue of Students' Journal.

OBJECTIVES AND USERS OF FINANCIAL STATEMENTS

The objective of financial statements is to provide information about the financial position, performance and cash flows of an enterprise that is useful to a wide range of users. The framework identifies seven broad groups of users of financial statements.

Users of Financial Statements

- Investors
- Employees
- Lenders
- Suppliers and Creditors
- Customers
- Govt.
- Public

FUNDAMENTAL ACCOUNTING ASSUMPTIONS

As per the framework, there are three fundamental accounting assumptions:

Fundamental Accounting Assumptions

Going concern

Financial statements are normally prepared on the assumption that an enterprise will continue in operation in the foreseeable future and neither there is an intention, nor there is a need to materially curtail the scale of operations.

Accrual

According to AS-1 Revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate.

Consistency

It is assumed that accounting policies are consistent from one period to another. The consistency improves comparability of financial statements through time. According to Accounting Standards, an accounting policy can be changed if the change is required by statute or by an AS or for more appropriate presentation of financial statements.

TRUE AND FAIR VIEW OF FINANCIAL STATEMENTS

Financial statements are required to show a true and fair view of the performance, financial position and cash flows of an enterprise. The framework does not deal directly with this concept of true and fair view, yet application of the principal qualitative characteristics (understandability, relevance, reliability and comparability) and appropriate accounting standards normally results in financial statements portraying true and fair view of information about an enterprise.

ELEMENTS OF FINANCIAL STATEMENTS

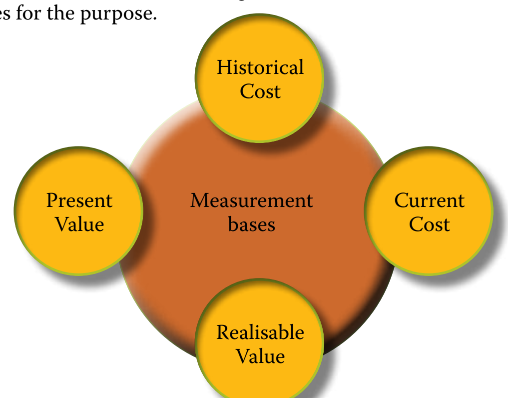
The framework classifies items of financial statements in five broad groups depending on their economic characteristics.

Elements of Financial Statements

- Asset
- Liability
- Equity
- Income
- Expenses

MEASUREMENT OF ELEMENTS OF FINANCIAL STATEMENTS

Measurement is the process of determining money value at which an element can be recognised in the balance sheet or statement of profit and loss. The framework recognises four alternative measurement bases for the purpose.



In preparation of financial statements, all or any of the measurement basis can be used in varying combinations to assign money values to financial items, subject to the requirement under the Accounting Standards.

1. Historical Cost: Historical cost means acquisition price. According to this, assets are recorded at an amount of cash or cash equivalent paid or the fair value of the asset at the time of acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation. In some circumstances a liability is recorded at the amount of cash or cash equivalent expected to be paid to satisfy it in the normal course of business.

2. Current Cost: Current cost gives an alternative measurement basis. Assets are carried out at the amount of cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.

3. Realisable (Settlement) Value: For assets, this is the amount of cash or cash equivalents currently realisable on sale of the asset in an orderly disposal. For liabilities, this is the undiscounted amount of cash or cash equivalents expected to be paid on settlement of liability in the normal course of business.

4. Present Value: Assets are carried at the present value of the future net cash inflows that the item is expected to generate in the normal course of business. Liabilities are carried at the present value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

ACCOUNTING: A CAPSULE FOR QUICK RECAP

It has always been the endeavour of Board of Studies to provide quality academic inputs to the students. Considering this objective in mind, it has been decided to bring forth a crisp and concise capsule for Paper 1 'Accounting' at Intermediate level. The topics of "Framework for Preparation and Presentation of Financial Statements" (in continuation of the matter given in May, 2020 issue of Students' Journal); "Redemption of Preference Shares and Debentures" and "Departmental Accounts" have been covered in this Capsule. The significant points of these topics have been presented through pictorial presentations in this capsule which will help the students in grasping the intricate practical aspects of each topic. This will facilitate the students to recapitulate the whole concepts within minimum time and efforts in the later stages of preparation. Although, the capsule has been prepared keeping in view the new and revised scheme of Education and Training of ICAI, the students of earlier scheme may also be benefitted from it. This capsule, though, facilitates the students in undergoing quick revision, under no circumstances, such revisions can substitute the detailed study of the material provided by the Board of Studies.

CHAPTER 2 FRAMEWORK FOR PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS

The principal areas covered by the framework, status and scope of Framework, components of financial statements, objectives and users of financial statements, fundamental accounting assumptions, true and fair view of financial statements and measurement of elements of financial statements have already been discussed in the Capsule published in May, 2020 issue of Students' Journal. Continuing this, the concepts of capital maintenance and determination of profit are being discussed below:

Capital Maintenance

Capital refers to net assets of a business. It is important for any business to maintain its net assets in such a way, as to ensure continued operations, at least at the same level, year after year. In other words, dividends should not exceed profit after appropriate provisions for replacement of assets consumed in operations.

The point is explained below as:

- P = (CA – CL) – (OA – OL) – C + D
- Where: Profit = P
- Opening Assets = OA and Opening Liabilities = OL
- Closing Assets = CA and Closing Liabilities = CL
- Introduction of capital = C and Drawings / Dividends = D
- Retained Profit = P – D = (CA – CL) – (OA – OL) – C

A business must ensure that Retained Profit (RP) is not negative, i.e. closing equity should not be less than capital to be maintained, which is sum of opening equity and capital introduced. The value of retained profit depends on the valuation of assets and liabilities.

The concept of capital maintenance is concerned with how an enterprise defines the capital that it seeks to maintain. It provides the linkage between the concepts of capital and the concepts of profit because it provides the point of reference by which profit is measured. It is a prerequisite for distinguishing between an enterprise's return on capital and its return of capital; only inflows of assets in excess of amounts needed to maintain capital can be regarded as profit and therefore as a return on capital.

In order to check maintenance of capital, i.e. whether or not retained profit is negative, we can use any of these bases:

Financial capital maintenance at historical cost:	Financial capital maintenance at current purchasing power:	Physical capital maintenance at current costs:
Under this convention, opening and closing assets are stated at respective historical costs to ascertain opening and closing equity. If retained profit is greater than or equal to zero, the capital is said to be maintained at historical costs. This means the business will have enough funds to replace its assets at historical costs. This is quite right as long as prices do not rise.	Under this convention, opening and closing equity at historical costs are restated at closing prices using average price indices. A positive retained profit by this method means the business has enough funds to replace its assets at average closing price. This may not serve the purpose because prices of all assets do not change at average rate in real situations. For example, price of a machine can increase by 30% while the average increase is 20%.	Under this convention, the historical costs of opening and closing assets are restated at closing prices using specific price indices applicable to each asset. The liabilities are also restated at a value of economic resources to be sacrificed to settle the obligation at closing date. The opening and closing equity at closing current costs are obtained as an excess of aggregate of current cost values of assets over aggregate of current cost values of liabilities. A positive retained profit by this method ensures retention of funds for replacement of each asset at respective closing prices.

The selection of the appropriate concept of capital by an enterprise should be based on the needs of the users of its financial statements. Thus, a financial concept of capital should be adopted if the users of financial statements are primarily concerned with the maintenance of nominal invested capital or the purchasing power of invested capital. If, however, the main concern of users is with the operating capability of the enterprise, a physical concept of capital should be used. The concept chosen indicates the goal to be attained in determining profit, even though there may be some measurement difficulties in making the concept operational. The selection of the measurement bases and concept of capital maintenance will determine the accounting model used in the preparation of the financial statements.

CHAPTER 7 REDEMPTION OF PREFERENCE SHARES

Introduction

Redemption is the process of repaying an obligation, at prearranged amounts and timings. It is a contract giving the right to redeem preference shares within or at the end of a given time period at an agreed price. The redeemable shares are issued on the terms that shareholders will at a future date be repaid the amount which they invested in the company (along with frequent payment of a specified amount as return on investment during the tenure of the preference shares).

Purpose of Issuing Redeemable Preference Shares

A company may issue redeemable preference shares because of the following:

1. A company may face difficulty in raising share capital, if its shares are not traded on the stock exchange. Potential investors, hesitant in putting money into shares that cannot easily be sold, may be encouraged to invest if the shares are redeemable by the company.
2. The preference shares may be redeemed when there is a surplus of capital and the surplus funds cannot be utilised in the business for profitable use. In India, the issue and redemption of preference shares is governed by the Companies Act, 2013.

Provisions of the Companies Act

A company limited by shares, if so authorised by its Articles, may issue preference shares which at the option of the company, are liable to be redeemed within a period, normally not exceeding 20 years from the date of their issue. It should be noted that:

(a) no shares can be redeemed except out of profit of the company which would otherwise be available for dividend or out of proceeds of fresh issue of shares made for the purpose of redemption;

(b) no such shares can be redeemed unless they are fully paid;

(c) (i) in case of prescribed companies whose financial statements comply with the accounting standards prescribed for such class of companies under Section 133 of the Companies Act, the premium, if any, payable on redemption shall be provided for out of the profits of the company, before the shares are redeemed;

(ii) in case of other companies (not falling under (i) above), the premium, if any payable on redemption shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

(d) where any such shares are proposed to be redeemed out of the profits of the company, there shall, out of profits which would otherwise have been available for dividends, be transferred to a reserve account to be called Capital Redemption Reserve Account, a sum equal to the nominal amount of the shares redeemed; and the provisions of the Act relating to the reduction of the share capital of a company shall, except as provided in the Companies Act, apply as if the Capital Redemption Reserve (CRR) Account were the paid-up share capital of the company.

The utilisation of CRR Account is further restricted to issuance of fully paid-up bonus shares only.

On the redemption of redeemable preference shares out of accumulated profits it will be necessary to transfer to the Capital Redemption Reserve Account an amount equal to the amount repaid on the redemption of preference shares on account of face value less proceeds of a fresh issue of capital made for the purpose of redemption.

Section 55 of the Companies Act, 2013, deals with provisions relating to redemption of preference shares. It ensures that there is no reduction in shareholders' funds due to redemption and, thus, the interest of outsiders is not affected. For this, it requires that either fresh issue of shares is made or distributable profits are retained and transferred to 'Capital Redemption Reserve Account'.

Methods of Redemption of Fully Paid-Up Shares

Methods of redemption of redeemable preference shares

- (a) the proceeds of a fresh issue of shares;
- (b) the capitalisation of undistributed profits; or
- (c) combination of (a) and (b).

Redemption of Preference Shares by Fresh Issue of Shares

One of the methods for redemption of preference shares is to use the proceeds of a fresh issue of shares. A company can issue new shares (equity share or preference share) and the proceeds from such new shares can be used for redemption of preference shares.

The proceeds from issue of debentures cannot be utilised for the purpose.

Section 52 of the Companies Act, 2013 provides that the securities premium account may be applied by the company:

(a) Towards issue of un-issued shares of the company to be issued to members of the company as fully paid bonus securities

(b) To write off preliminary expenses of the company

(c) To write off the expenses of, or commission paid, or discount allowed on any of the securities or debentures of the company

(d) To provide for premium on the redemption of redeemable preference shares or debentures of the company.

(e) For the purchase of its own shares or other securities.

Note : If may be noted that certain class of Companies whose financial statements comply with the Accounting Standards as prescribed under Section 133 of the Companies Act, 2013, can't apply the securities premium account for the purposes (b) and (d) mentioned above. Any other way, except the above prescribed ways, in which securities premium account is utilised will be in contravention of law.

The proceeds of a fresh issue of shares will not include the amount of securities premium for the purpose of redemption of preference shares.

Reasons for issue of New Equity Shares

A company may prefer issue of new equity shares for the following reasons:

(a) When the company has come to realise that the capital is needed permanently and it makes more sense to issue Equity Shares in place of Redeemable Preference Shares which carry a fixed rate of dividend.

(b) When the balance of profit, which would otherwise be available for dividend, is insufficient.

(c) When the liquidity position of the company is not good enough.

Advantages and Disadvantages of Redemption of Preference Shares by Issue of Fresh Equity Shares

Redemption of preference shares by issue of fresh equity shares

Advantages

- No cash outflow of money – now or later.
- New equity shares may be issued at a premium.
- Shareholders retain their equity interest.

Disadvantages

- There will be dilution of future earnings.
- Share-holding pattern in the company is changed.

Calculation of Minimum Fresh Issue of Shares to Provide Funds for Redemption

(1) Maximum amount of reserves and surplus available for redemption is ascertained taking into account the balances appearing in the balance sheet before redemption and the additional information provided in the problem.

(2) Make adjustment for premium payable on redemption out of profits and then compute

Minimum Proceeds of Fresh Issue of shares :	Nominal value of preference shares to be redeemed – Maximum amount of reserve and surplus available for redemption.

(3) After computation of minimum proceeds, calculate

Minimum Number of Shares	Minimum proceeds divided by face value of one share

(4) if minimum number of shares as per (3) above includes a fraction, it must be approximated to the next higher figure to ensure that provisions of Section 55 are not violated.

Thus to calculate minimum number of fresh shares to be issued to provide funds, amount payable to preference shareholders is compared with funds available for redemption and the balance of funds to be raised by fresh issue of shares are calculated.

Undistributed Profits

Another method for redemption of preference shares, as per the Companies Act, is to use the distributable profits in place of issuing new shares.

When shares are redeemed by utilising distributable profit, an amount equal to the face value of shares redeemed is transferred to Capital Redemption Reserve Account by debiting the distributable profit.

Advantages and Disadvantages of Redemption of Preference Shares by Capitalisation of Undistributed Profits

Advantages

- No change in the percentage of equity share-holding of the company;
- Surplus funds can be used.

Disadvantage

- There may be a reduction in liquidity.

Redemption of Preference Shares by Combination of Fresh Issue and Capitalisation of Undistributed Profits

A company can redeem the preference shares partly from the proceeds from new issue and partly out of profits.

(i) Amount to be Transferred to Capital Redemption Reserve	
Face value of shares redeemed	***
Less: Proceeds from new issue	***
(ii) Proceeds to be collected from New Issue	
Face value of shares redeemed	***
Less: Profits available for distribution as dividend	***

Companies may have sufficient investments, which can be sold, in the market to arrange funds for redemption of preference shares.

Redemption Of Fully Called But Partly Paid-Up Preference Shares

The problem of unpaid calls on fully called up shares may be studied under following categories:

When Calls-In-Arrears is received by the Company

If the amount of unpaid calls is received by the Company before redemption, the entry passed is as under:
Bank A/c Dr.
To Calls-in-Arrears A/c

After receipt of calls in arrears, the shares become fully paid up and, then, company can proceed with redemption in the normal course.

In Case of Forfeited Shares

If, on getting a proper notice from the company, the shareholders fail to pay the unpaid calls, the Board of Directors may decide to forfeit the shares and cancel these shares instead of reissuing the forfeited shares because redemption of these shares is due immediately or in near future. In this case, entry for forfeiture is passed as usual.

Accounting Entries for Redemption of Preference Shares

When preference shares are redeemed at par	
Redeemable Preference Share Capital Account	Dr.
To Preference Shareholders Account	
When preference shares are redeemed at a premium	
Redeemable Preference Share Capital Account	Dr.
Premium on Redemption of Preference Shares Account	Dr.
To Preference Shareholders Account	
When payment is made to preference shareholders	
Preference Shareholders Account	Dr.
To Bank Account	
For adjustment of premium on redemption	
Profit and Loss Account	Dr.
To Premium on Redemption of Preference Shares Account	
(Being the premium on redemption adjusted against Profit and Loss Account)	
For transferring nominal amount of shares redeemed to Capital Redemption Reserve Account	
General Reserve Account	Dr.
Profit and Loss Account	Dr.
To Capital Redemption Reserve Account	
(Being the amount transferred to Capital Redemption Reserve Account as per the requirement of the Act)	

CHAPTER 8 REDEMPTION OF DEBENTURES

Introduction

Chapter on "Redemption of Debentures" covers the meaning of redemption of debentures along with related legal provisions. The requirement of creation of Debenture Redemption Reserve, Debenture Redemption Reserve Investments (i.e. making investments for purpose of redemption of debentures) and accounting treatment for redemption of debentures has been discussed, in detail, in this chapter.

A debenture is an instrument issued by a company under its seal, acknowledging a debt and contains provisions as regards repayment of the principal and interest. Under Section 71 (1) of the Companies Act, 2013, a company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption.

Types of Debentures

- Security
  - Secured Debentures
  - Unsecured Debentures
- Convertibility
  - Covertible Debentures
  - Non-convertible Debentures
- Permanence
  - Redeemable Debentures
  - Irredeembale Debentures
- Negotiability
  - Registered Debentures
  - Bearer Debentures
- Priority
  - First Mortgage Debentures
  - Second Mortgage Debentures

Methods of Redemption of Debentures

Redemption by paying off the debt on account of debentures issued can be done by one of these methods:

- **By payment in lumpsum**: At maturity or at the expiry of a specified period of debenture, the payment of entire debentures is made in one lot.
- **By payment in Instalments**: The payment of specified portion of debenture is made in instalments at specified intervals.
- **Purchase of Debentures in Open Market**: Debentures sometimes are purchased in open market, by debiting own debentures account.

Provisions under the Companies Act, 2013 for issue of debentures

- A company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption.
  - Provided that the issue of debentures with an option to convert such debentures into shares, wholly or partly, should be approved by a special resolution passed at a duly convened general meeting.
- No company can issue any debentures which carry any voting rights.
- Where debentures are issued by a company, the specified companies need to create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account should not be utilised by the company for any purpose other than the redemption of debentures.

Debentures are usually redeemable i.e. either redeemed in cash or convertible after a specified time period.

Redeemable debentures may be redeemed:

- after a **fixed number** of years; or
- any time after a **certain number of years** has elapsed since their issue; or
- on giving a **specified notice;** or
- by **annual drawing.**

A company may also purchase its debentures, as and when convenient, in the open market and when debentures are quoted at a discount on the Stock Exchange, it may be profitable for the company to purchase and cancel them. As per Rule 18 (1) of the Companies (Share Capital and Debentures) Rules, 2014, a company shall not issue secured debentures, unless it complies with the following conditions, namely:

An issue of secured debentures may be made, provided the date of its redemption shall not exceed ten years from the date of issue:

Provided that the following classes of companies may issue secured debentures for a period exceeding ten years but not exceeding thirty years,

(i) Companies engaged in setting up of infrastructure projects;

(ii) Infrastructure Finance Companies' as defined in clause (viia) of sub-direction (1) of direction 2 of Non-Banking Financial (Non-deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007;

(iii) Infrastructure Debt Fund Non-Banking Financial Companies' as defined in clause (b) of direction 3 of Infrastructure Debt Fund Non-Banking Financial Companies (Reserve Bank) Directions, 2011;

(iv) Companies permitted by a Ministry or Department of the Central Government or by Reserve Bank of India or by the National Housing Bank or by any other statutory authority to issue debentures for a period exceeding ten years.

Such an issue of debentures shall be secured by the creation of a charge on the properties or assets of the company or its subsidiaries or its holding company or its associates companies, having a value which is sufficient for the due repayment of the amount of debentures and interest thereon.

The company shall appoint a debenture trustee before the issue of prospectus or letter of offer for subscription of its debentures and not later than sixty days after the allotment of the debentures, execute a debenture trust deed to protect the interest of the debenture holders; and

The security for the debentures by way of a charge or mortgage shall be created in favour of the debenture trustee on-

(i) any specific movable property of the company or its holding company or subsidiaries or associate companies or otherwise.

(ii) any specific immovable property wherever situate, or any interest therein:

Provided that in case of a non-banking financial company, the charge or mortgage under sub-clause (i) may be created on any movable property.

Note: Provided further that in case of any issue of debentures by a Government company which is fully secured by the guarantee given by the Central Government or one or more State Government or by both, the requirement for creation of charge under this sub-rule shall not apply.

Provided also that in case of any loan taken by a subsidiary company from any bank or financial institution the charge or mortgage under this sub-rule may also be created on the properties or assets of the holding company

Debenture Redemption Reserve

A company issuing debentures may be required to create a debenture redemption reserve account (DRR) out of the profits available for distribution of dividend and amounts credited to such account cannot be utilised by the company except for redemption of debentures. Such an arrangement would ensure that the company will have sufficient liquid funds for the redemption of debentures at the time they fall due for payment.

An appropriate amount is transferred from profits every year to Debenture Redemption Reserve and its investment is termed as Debenture Redemption Reserve Investment (or Debenture Redemption Fund). In the last year or at the time of redemption of debentures, Debenture Redemption Reserve Investments are encashed and the amount so obtained is used for the redemption of debentures.

Requirement to Create Debenture Redemption Reserve

Section 71 of the Companies Act 2013 covers the requirement of creating a debenture redemption reserve account. This states as follows:

(1) Where a company issues debentures under this section, it should create a debenture redemption reserve account out of its profits which are available for distribution of dividend every year until such debentures are redeemed.

(2) The amounts credited to the debenture redemption reserve should not be utilised by the company for any purpose except for the purpose aforesaid.

(3) The company should pay interest and redeem the debentures in accordance with the terms and conditions of their issue.

(4) Where a company fails to redeem the debentures on the date of maturity or fails to pay the interest on debentures when they fall due, the Tribunal may, on the application of any or all the holders of debentures or debenture trustee and, after hearing the parties concerned, direct, by order, the company to redeem the debentures forthwith by the payment of principal and interest due thereon.

Balance In Debenture Redemption Reserve

When the company is required to create DRR, the amount prescribed, is credited to the Debenture Redemption Reserve account and debited to profit and loss account. That shows the intention of the company to set aside sum of money to build up a fund for redeeming debentures. Immediately, the company should also purchase outside investments. The entry for the purpose naturally will be to debit Debenture Redemption Reserve Investments and credit Bank.

Adequacy of debenture redemption reserve

As per Rule 18 (7) of the Companies (Share Capital and Debentures) Amendment Rules, 2019, the company shall comply with the requirements with regard to Debenture Redemption Reserve (DRR) and investment or deposit of sum in respect of debentures maturing during the year ending on the 31st day of March of next year in accordance with the conditions.

- **Debenture Redemption Reserve shall be created out of the profits of the company available for payment of dividend;**
- **the limits with respect to adequacy of DRR and investment or deposits, as the case may be, shall be as per table below:**

S. No	Debentures issued by	Adequacy of Debenture Redemption Reserve (DRR)
1	**All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures**	No DRR is required
2	**Other Financial Institutions (FIs) within the meaning of clause (72) of section 2 of the Companies Act, 2013**	DRR will be as applicable to NBFCs registered with RBI (as per (3) below)
3	**For listed companies (other than AIFIs and Banking Companies as specified in Sr. No. 1 above):**	
a	**All listed NBFCs (registered with RBI under section 45-IA of the RBI Act,) and listed HFCs (Housing Finance Companies registered with National Housing Bank) for both public as well as privately placed debentures**	No DRR is required
b.	**Other listed companies for both public as well as privately placed debentures**	No DRR is required
4	**For unlisted companies (other than AIFIs and Banking Companies as specified in Sr. No. 1 above**	
a	**All unlisted NBFCs (registered with RBI under section 45-IA of the RBI (Amendment) Act, 1997) and unlisted HFCs (Housing Finance Companies registered with National Housing Bank) for privately placed debentures**	No DRR is required
b	**Other unlisted companies**	DRR shall be 10% of the value of the outstanding debentures issued

Investment of Debenture Redemption Reserve (DRR) Amount

As per Rule 18 (7) of the Companies (Share Capital and Debentures) Amendment Rules, 2019, all listed NBFCs; all listed HFCs; all other listed companies (other than AIFIs, Banking Companies and Other FIs); and all unlisted companies which are not NBFCs and HFCs shall on or before the 30th day of April in each year, in respect of debentures issued, deposit or invest, as the case may be, a sum which should not be less than 15% of the amount of its debentures maturing during the year ending on the 31st day of March of next year, in any one or more of the following methods, namely:

(a) in deposits with any scheduled bank, free from charge or lien;

(b) in unencumbered securities of the Central Government or of any State Government;

(c) in unencumbered securities mentioned in clauses (a) to (d) and (ee) of Section 20 of the Indian Trusts Act, 1882;

(d) in unencumbered bonds issued by any other company which is notified under clause (f) of Section 20 of the Indian Trusts Act, 1882.

The amount deposited or invested, as the case may be, above should not be utilised for any purpose other than for the redemption of debentures maturing during the year referred to above.

Provided that the amount remaining deposited or invested, as the case may be, shall not at any time fall below 15% of the amount of debentures maturing during the 31st day of March of that year.

In case of partly convertible debentures, DRR shall be created in respect of non-convertible portion of debentures issued.

The amount credited to DRR shall not be utilised by the company except for the purpose of redemption of debentures.

Journal Entries

The necessary journal entries passed in the books of a company are given below:

1. After allotment of debentures

(a)	For setting aside the fixed amount of profit for redemption	
	Profit and Loss A/c	Dr.
	To Debenture Redemption Reserve A/c	
(b)	For investing the amount set aside for redemption	
	Debenture Redemption Reserve Investment A/c	Dr.
	To Bank A/c	
(c)	For receipt of interest on Debenture Redemption Reserve Investments (DRRI)	
	Bank A/c	Dr.
	To Interest on Debenture Redemption Reserve Investment A/c	
(d)	For transfer of interest on Debenture Redemption Reserve Investments (DRRI)	
	Interest on Debenture Redemption Reserve Investment A/c	Dr.
	To Profit and loss A/c*	

** Considering the fact that interest is received each year through cash/ bank account.*

2. At the time of redemption of debentures

(a)	For encashment of Debenture Redemption Reserve Investments	
	Bank A/c	Dr.
	To Debenture Redemption Reserve Investment A/c	
(b)	For amount due to debentureholders on redemption	
	Debentures A/c	Dr.
	To Debentureholders A/c	
(c)	For payment to debentureholders	
	Debentureholders A/c	Dr.
	To Bank A/c	
(d)	After redemption of debentures, Debenture Redemption Reserve A/c should be transferred to general reserve	
	Debenture Redemption Reserve A/c	Dr.
	To General Reserve	

CHAPTER 12: DEPARTMENTAL ACCOUNTS

Introduction

If a business consists of several independent activities, or is divided into several departments, for carrying on separate functions, its management is usually interested in finding out the working results of each department to ascertain their relative efficiencies. This can be made possible only if departmental accounts are prepared. Departmental accounts are of great help and assistance to the managements as they provide necessary information for controlling the business more intelligently and effectively

Type of Departments

- Dependent
  - Have inter-department transfers
- Independent
  - Work independently, have negligible transfers

Advantages of Departmental Accounting

The main advantages of departmental accounting are:

- ***Evaluation of performance:*** The performance of each department can be evaluated separately on the basis of trading results. An endeavour may be made to push up the sales of that department which is earning maximum profit.
- ***Growth potential of each department:*** The growth potential of a department as compared to others can be evaluated.
- ***Justification of capital outlay:*** It helps the management to determine the justification of capital outlay in each department.
- ***Judgement of efficiency:*** It helps to calculate stock turnover ratio of each department separately, and thus the efficiency of each department can be revealed.
- ***Planning and control:*** Availability of separate cost and profit figures for each department facilitates better control. Thus effective planning and control can be achieved on the basis of departmental accounting information.

Methods of Departmental Accounting

Methods of keeping departmental accounts

- **Accounts of all departments are kept in one book only**
  - This may be done by having columnar subsidiary books and a columnar ledger having information of each department.
- **Separate set of books are kept for each department**
  - A separate set of books may be kept for each department, including complete stock accounts of goods received from or transferred to other departments and also sales.

Basis of Allocation of Common Expenditure among Different Departments

Basis of Allocation of Common Expenditure among different Departments

- Expenses incurred specially for each department are charged to the specific department.
- Common expenses allocated among the departments on suitable basis.

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

Note: *There are certain expenses and income, of financial nature, which cannot be apportioned on a suitable basis; therefore they are recognised in the combined Profit and Loss Account, for example, interest on loan, profit/loss on sale of investment, etc.*

Inter-Departmental Transfers

Inter-department transfers (forming part of closing inventory)

- Cost
  - No unrealised Profit exists
- Market Price
- Cost plus agreed percentage of profit

The situation of unrealised profit will arise only if the transfers are made at market price which is more than cost or when the goods are transferred at cost plus percentage of profit.

Stock Reserve

Unrealised profit included in unsold stock at the end of accounting period is eliminated by creating an appropriate stock reserve by debiting the combined Profit and Loss Account. The amount of stock reserve will be calculated as:

$$\frac{\text{Transfer price of unsold stock} \times \text{Profit included in transfer price}}{\text{Transfer price}}$$

Journal Entry

At the end of the accounting year, this journal entry will be passed for elimination of unrealised profit (creation of stock reserve):	• Profit and Loss Account Dr. To Stock Reserve • (Being a provision made for unrealised profit included in closing stock)
In the beginning of the next accounting year, the aforesaid journal entry will be reversed as :	• Stock Reserve Dr. To Profit and Loss Account • (Being provision for unrealised profit reversed.)

CA INTERMEDIATE - PAPER 1 - ACCOUNTING

In a pursuit to provide quality academic inputs to the students to help them in grasping the intricate aspects of the subject, Board of Studies has decided to bring forth a crisp and concise capsule on Paper 1 'Accounting' at Intermediate level. The significant points of the topic "Accounting for Branches Including Foreign Branches" has been covered in this Capsule through pictorial presentations. This capsule, though, facilitates the students in undergoing quick revision, under no circumstances, such revisions can substitute the detailed study of the material provided by the Board of Studies.

Chapter 13: Accounting for Branches (including Foreign Branches)

A branch can be described as any establishment carrying on either the same or substantially the same activity as that carried on by head office of the company. It must also be noted that the concept of a branch means existence of a head office; for there can be no branch without a head office - the principal place of business. Branch offices are of a great utility in the sense that they allow business to expand closer to the clients and hence they facilitate face to face interaction with customers. Branch accounting provides better accountability and control since profitability and efficiency can be closely tracked for each location.

For finding out the trading results of branch, it is assumed that the branch is an entity separate from the head office.

On this basis, a Branch Account is stated in the head office books to which the price of goods or services provided or expenses paid out are debited and correspondingly, the value of benefits and cash received from the branch are credited.

Distinction Between Branch Accounts and Departmental Accounts

	Basis of distinction	Branch Accounts	Departmental Accounts
1.	Maintenance of accounts	Branch accounts may be maintained either at branch or at head office.	Departmental accounts are maintained at one place only.
2.	Apportionment of common expenses	As expenses in respect of each branch can be identified, so the apportionment problem never arises.	Common expenses are distributed among the departments concerned on some equitable basis considered suitable in the case.
3.	Reconciliation	Reconciliation of head office and branch accounts is necessary in case of Branches maintaining independent accounting records at the end of the accounting year.	Such problem never arises.
4.	Conversion of foreign currency figures	At the time of finalisation of accounts, conversion of figures of foreign branch is necessary.	Such problem never arises.

Classification of Branches

From the accounting point of view, branches may be classified as follows:

Classification of Branches

- Inland Branches
  - Dependent Branches for which whole accounting records are kept at Head Office
  - Independent Branches which maintain independent accounting records
- Foreign Branches

Dependent Branches

When the business policies and the administration of a branch are wholly controlled by the head office and its accounts also are maintained by it, the branch is described as Dependent branch.

Branch accounts, in such a case, are maintained at the head office out of reports and returns received from the branch.

Some of the significant types of branches that are operated in this manner are described below:

- A branch set up merely for booking orders that are executed by the head office. Such a branch only transmits orders to the head office.
- A branch established at a commercial center for the sale of goods supplied by the head office, and under its direction all collections are made by the H.O.
- A branch for the retail sale of goods, supplied by the head office.

Accounting in the case of first two types is simple. Only a record of expenses incurred at the branch has to be maintained.

But however, a retail branch is essentially a sale agency that principally sells goods supplied by the head office for cash and, if so authorised, also on credit to approved customers.

Generally, cash collected is deposited into a local bank to the credit of the head office and the head office issues cheques or transfers funds thereon for meeting the expenses of the branch.

In addition, the Branch Manager is provided with a 'float' for petty expenses which is replenished from time to time on an imprest basis.

If, however, the branch also sells certain lines of goods, directly purchased by it, the branch retains a part of the sale proceeds to pay for the goods so purchased.

Methods of Charging Goods to Branches

Goods may be invoiced to branches

At cost

At selling price

In case of retail branches, at wholesale price

Where the goods would be sold at a fixed price by the branch.

Suitable for dealers in tea, petrol, ghee, etc.

In this way, greater control can be exercised over the working of a branch in as much as that the branch balance in the head office books would always be composed of the value of unsold stock at the branch and remittances or goods in transit.

Accounting for Dependent Branches

Dependent branch does not maintain a complete record of its transactions. The Head office may maintain accounts of dependent branches by any of the following methods:

Methods of maintaining accounts of Dependent Branches

- Goods invoiced at cost or selling price
  - Debtors Method
  - Stock and Debtors Method
  - Trading and profit and loss account method (Final Accounts method)
- Goods invoiced at wholesale price
  - Whole sale branch method

When goods are invoiced at cost

(i) **Debtor method**

It is suitable for small sized branches.

Separate branch account is maintained for each branch to compute profit or loss made by each branch.

If the branch is allowed to make small purchases of goods locally as well as to incur expenses out of its cash receipts, it will be necessary for the branch to supply to the head office a copy of the Cash Account, showing details of cash collections and disbursements.

To illustrate the various entries which are made in the Branch Account, the proforma of a Branch Account is shown below:

Proforma Branch Account

To Balance b/d Cash Stock Debtors Petty Cash Fixed Assets Prepaid Expenses To Goods sent to Branch To Bank A/c Salaries Rent Sundry Expenses To Profit & Loss A/c—Profit (if credit side is larger)	By Bank A/c (Cash remitted) By Return to H.O. By Balance c/d Cash Stock Debtors Petty Cash Fixed Assets Prepaid Expenses By Profit and Loss A/c—Loss (if debit side is larger)

Note

Having credited the Branch Account by the actual cash received from debtors, it would be incorrect to debit the Branch Account, in respect of discount or allowances to debtors.

The accuracy of the trading results as disclosed by the Branch Account, so maintained, if considered necessary, can be proved by preparing a Memorandum Branch Trading and Profit & Loss Account, in the usual way, from the balances of various items of income and expenses contained in the Branch Account.

(ii) **Stock and Debtors method:**

The accounts of the branch are maintained under this method

- to exercise a more detailed control over the working of a branch.

Accounts maintained by the Head Office:

	Account	Purpose
1.	**Branch Stock Account (or Branch Trading Account)**	Ascertainment of shortage or surplus
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 (eg: where branch is allowed to incur expenses locally)
6.	**Branch Fixed Asset Account**	Control over branch Fixed Assets
7.	**Branch Profit and Loss Account**	Calculation of net profit or loss

The manner in which entries are recorded in the above method is shown below:

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

Closing Stock: Credit the Branch Stock Account with the value of closing stock at cost.
It will be carried down as opening balance (debit) for the next accounting period. The Balance of the Branch Stock Account, (after adjustment therein the value of closing stock), if in credit, will represent the gross profit on sales and vice versa.

Other Steps

- Balance of Branch Stock Account will be transferred to the Branch Profit and Loss Account.
- Balance of Branch Expenses Account will be transferred to the debit of Branch Profit & Loss Account.
- The balance in the Branch P&L A/c will be transferred to the (H.O.) Profit & Loss Account.
- The credit balance in the Goods sent to Branch Account is afterwards transferred to the Head Office Purchase Account or Trading Account (in case of manufacturing concerns), it being the value of goods transferred to the Branch.

(iii) Trading and Profit and Loss Account (Final Accounts Method)

- Trading and Profit and Loss accounts are prepared
  - considering each branch as a separate entity.
- The main advantage
  - It is easy to prepare and understand.
  - It also gives complete information of all transactions which are ignored in the other methods.
- It is merely a memorandum account and therefore,
  - the entries made do not have double entry effect.

When goods are invoiced at selling price

Whenever, goods sent to branch are invoiced at selling price:	**(a)** It would be obvious that, if Branch Account is debited with the sales price of goods and subsequent to the debit being raised there is a change in the sale price, the amount of debit either has to be increased or reduced on a consideration of the quantity of unsold stock that was there at the branch at the time the change took place. Such an adjustment will be necessary as often as the change in sale price occurs.
	(b) Moreover, the amount of anticipatory or unrealised profit, included in the value of unsold stock with the branch at the close of the year will have to be **eliminated** before the accounts of the branch are incorporated with that of the head office. This will be done by creating a reserve.
	(c) It may also be necessary to adjust the value of closing stock on account of the physical losses of stock due to either pilferage or wastages which may have occurred during the year. This adjustment is made by debiting the cost of such goods to Goods Lost Account and the amount of loading (included in the lost goods), to the Branch Adjustment Account.

The three different methods that are usually adopted for maintaining accounts on this basis are described below:

(i) Debtor method

Under this method, the principal accounts that will be maintained are:

- The Branch Account;
- The Goods Sent to Branch Account; and
- The Stock Reserve Account.

Entries in these accounts will be made in the following manner:

	Transaction	Account debited	Account credited
(a)	Goods sent to Branch at selling price	Branch A/c	Goods Sent to Branch A/c
(b)	'Loading being the difference between selling price and cost of goods	Goods Sent to Branch A/c	Branch A/c
(c)	Returns to H.O. at selling price	Goods Sent to Branch A/c	Branch A/c
(d)	'Loading' in respect of goods returned to H.O.	Branch A/c	Goods Sent to Branch A/c
(e)	'Loading' included in the opening stock to reduce it	Stock Reserve A/c	Branch A/c
(f)	Closing stock at selling price	Branch Stock A/c	Branch A/c
(g)	'Loading' included in closing stock to reduce it to cost	Branch A/c	Stock Reserve A/c

Hence, the Branch Account will not correctly show the trading profit of the Branch unless these amounts are adjusted to cost. Such an adjustment is affected by making contra entries in 'Goods Sent to Branch A/c' and 'Stock Reserve Account'.
In respect of closing stock at branch for the purpose of disclosure in the Balance Sheet, the credit balance in the 'Stock Reserve Account' at the end of the year will be deducted from the value of the closing stock, so as to reduce it to its cost; it will be carried forward as a separate balance to the following year, for being transferred to the credit of the Branch Account.

(ii) Stock and Debtors Method

One additional account i.e. 'Branch Adjustment account' is also prepared

in addition to all the accounts which are maintained under stock and debtors method on cost basis.

Journal Entries

	Transaction	Account debited	Account 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 Branch A/c at cost. (ii) Branch Adjustment A/c (with the loading i.e., difference between the selling price 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). (ii) Branch Adjustment A/c (with the loading)	Branch Stock A/c
(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 customers	Branch Stock A/c	Branch Debtors A/c (at selling price)
(f)	Goods lost in transit or stolen	(i) Goods Lost in Transit A/c or Goods Stolen A/c (with cost of the goods) (ii) Branch Adjustment A/c (with the loading)	Branch Stock A/c

Closing Stock

The balance in the Branch Stock Account at the close of the year normally should be equal to the unsold stock at the Branch valued at sale price.

But quite often the value of stock actually held at the branch is either more or less than the balance of the Branch Stock Account.

In that event balance in the Branch Stock Account is increased or reduced by debit or credit to Goods Lost Account (at cost price of goods) and Branch Adjustment Account (with the loading).

The Stock Account at selling price, thus reveals loss of stock (or surplus) and serves as a check on the branch in this respect.

The discrepancy in the amount of balance in the Branch Stock Account and the value of stock actually in hand, valued at sale price, may be the result of one or more of the under-mentioned factors:				
An error in applying the percentage of loading.	Goods having been sold either below or above the established selling price.	A Commission to adjust returns or allowances.	Physical loss of stock due to natural causes or pilferage.	Errors in Stock-taking.

Rebates and allowances

Rebates and allowances allowed to customers debited to P&L A/c & credited to debtors A/c.

In the Goods Sent to Branch Account, the cost of the goods sent out to a branch for sale is credited by debiting Branch Stock Account.

Conversely, the cost of goods returned by the branch is debited to this account. As such the balance in the account at the end of the year will be the cost of goods sent to the branch; therefore, it will be transferred either to the Trading Account or to Purchases Account of the head office.

The amount of profit anticipated on sale of goods sent to the branch is credited to the Branch Adjustment Account and conversely, the amount of profit not realised in respect of goods returned by the branch to head office or that in respect to stock remaining unsold with the branch at the close of the year is debited to Branch Adjustment Account.

The balance in this account, at the end of year thus will consist of the amount of Gross Profit earned on sale by the branch.

On that account, it will be transferred to the Branch Profit and Loss Account.

Elimination of unrealised profit in the closing stock

The balance in the Branch Stock account would be at the **sale price**; therefore, it would be necessary to eliminate the element of profit included in such closing stock.

This is done by creating a reserve against unrealised profit, by debiting the Branch Adjustment Account and crediting Stock Reserve Account with an amount equal to the difference in the cost and selling price of unsold stock.

Sometimes instead of opening a separate account in respect of the reserve, the amount of the difference is credited to Branch Stock Account. In that case, the credited balance of such a reserve is also carried forward separately, along with the debit balance in the Branch Stock Account; the difference between the two would be the value of stock at cost. In either case, the credit balance will be deducted out of the value of closing stock for the purpose of disclosure in the balance sheet, so that the stock is shown at cost.

An Alternative method of elimination of unrealised profit in closing stock

Where the gross profit of each branch is not required to be ascertained separately, although the selling price is uniform, the amount of goods sent to the branch is recorded only in two accounts namely - Branch Stock Account and Goods Sent to Branch A/c.

In this method, at the end of the year the Branch Stock Account is closed by transfer of the balance representing the value of closing stock, at sale price, to the **Goods Sent to Branch Account**.

This has the effect of altogether eliminating from the books the value of stock at the branch. The balance of Goods sent to Branch Account is afterwards transferred to the **Trading Account** representing the net sale price of goods sold at the branch. In that case, the value of closing stock at the branch at cost will be subsequently introduced in the Trading Account together with that of closing stock at the head office.

(iii) Trading and Profit and Loss Account (Final Accounts) Method:

All items of memorandum Branch Trading and Profit and Loss Account are to be converted into cost price if the goods are invoiced to branch at selling price.

Other points will remain same as already discussed under this method when goods are invoiced at cost.

Goods invoiced at wholesale price to retail branches

Under this method, the Head Office (particularly, the manufacturing concern) supplies goods to its retail branches at wholesale price which is cost plus wholesale profit.

Profit of branch = Sale proceeds at shop - wholesale price of the goods sold.

For this purpose, it is assumed that Manufacturer would always be able to sell the goods on wholesale terms thereby Manufacturer profit = Wholesale price - Cost.

Many concerns, therefore, invoice goods to such shops at wholesale price and determine profit or loss on sale of goods on this basis.

Branch Stock Account or the Trading Account

- It is debited with
  - The value of opening stock at the Branch; and
  - Price of goods sent during the year at wholesale price.
- It is credited by
  - Sales effected at the shop; and
  - Closing stock of goods valued at wholesale price.

The value of goods lost due to accident, theft etc., also is credited to the Branch Stock Account or Trading Account calculated at the **wholesale price.** At this stage, the Branch Stock or Trading Account will reveal the amount of gross profit (or loss). It is transferred to the Branch Profit and Loss Account. On further being debited with the expenses incurred at the shop and the wholesale price of goods lost, the Branch Profit and Loss Account will disclose the net profit (or loss) at the shop.

Since the closing stock at the branch has to be valued at wholesale price, it would be necessary to create a stock reserve equal to the difference between its wholesale price and its cost (to the head office) by debiting the amount in the Head Office Profit and Loss Account. This Stock Reserve is carried forward to the next year and then transferred to the credit of the (Head Office) Profit and Loss Account.

Accounting for Independent Branches

Salient features of accounting system of an Independent Branch are as follows

- Branch maintains its entire books of account under double entry system.
- Branch opens in its books a Head Office account to record all transactions that take place between Head Office and branch. The Head Office maintains a Branch account to record these transactions.
- Branch prepares its Trial Balance, Trading and profit and loss Account at the end of the accounting period and sends copies of these statements to Head Office for incorporation.
- After receiving the final statements from branch, Head Office reconciles between the two – Branch account in Head Office books and Head Office account in Branch books.
- Head office passes necessary journal entries to incorporate branch trial balance in its books.

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

(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 A/c	**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 A/c	**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 A/c	**Dr.**	Depreciation A/c To Head Office A/c	**Dr.**
(xii)	Remittance of funds by H.O. to Branch	Branch A/c To Bank A/c	**Dr.**	Bank A/c To Head Office A/c	**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.**	Supplying Branch H.O. A/c To Goods sent to H.O. A/c	**Dr.**
				Recipient Branch Goods Received from H.O. A/c To Head Office A/c	**Dr.**

The final result of these adjustments will be that so far as the Head Office is concerned, the branch will be looked upon either as a debtor or creditor, as a debtor if the amount of its assets is in excess of its liabilities and as a creditor if the position is reverse.

A debit balance in the Branch Account should always be equal to the net assets at the branch.

Adjustment and Reconciliation of Branch and Head Office Accounts

If the branch and the head office accounts, converse of each other, do not tally, these must be reconciled before the preparation of the final accounts of the concern as a whole.

Reasons for Disagreement

Following are the possible reasons for the disagreement between Branch A/c in Head office books and Head office A/c in Branch books on the closing date:

- Goods dispatched by the Head office not received by the branch. These goods may be in transit or loss in transit.
- Goods returned by the branch to Head Office not received by the H.O. Again, these goods may be in transit or lost in transit.
- Amount remitted by Head office to branch or vice versa remaining in transit on the closing date.
- Receipt of income or payment or expenses relating to the Branch transacted directly by the head office or vice versa, hence not recorded at the respective ends wherein they are normally to be recorded.

Important Points to be noted:

(i) The balance of Head Office A/c in Branch books and Branch A/c in Head Office books have tallied.

(ii) Adjustment are made only at the point:
- Where the recording has been omitted, and
- Other than the point where action has already been effected.

Other points

Inter-Branch Transactions

- Inter-branch transactions (i.e. transaction between two branches) are usually adjusted as if they were entered into only with the head office. It is a very convenient method of treating such transaction especially where the number of branches are large.

Fixed Assets

- Often the accounts of fixed assets of a branch are kept in the head office books; in such a case, at the end of the year, the amount of depreciation on the assets is debited to the branch concerned by recording the following entry by head office:
  - Branch Account Dr.
    To Branch Asset Account

The branch will pass the following entry:
  - Depreciation Account Dr.
    To Head Office Account

Head office Expenses charged to Branch

- Usually the head office devotes considerable time in attending the affairs of the branch; on that account, it may decide to raise a charge against the branch in respect of the cost of such time. In such a case the amount is debited to the branch (being receivable from branch) and is credited to appropriate expense head such as Salaries Accounts, General Charges Account, Entertainment Account, etc. (i.e. reducing the expense in head office books). The branch credits the H.O. Account and debits Expenses Account.

Incorporation of Branch Balance in 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 desirable 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 and is transferred to H.O. in Branch books & converse entry is passed in H.O. Books as:
- 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

Individual balances of all the revenue accounts would be separately transferred to the H.O. by debit or credit in the branch books and the converse entries would be passed in the H.O. books.

↓

Amount of net profit or loss of the branch having been transferred since it would be composed of the balances that have been transferred.

↓

In case it is also desired that consolidated balance sheet of the branch and the head office should be prepared, it will also be necessary to transfer the balance of assets and liabilities of the branch to the head office.

The adjusting entries that would be passed in this respect in the books of branch are shown below:

(a) Head Office Account Dr.
    To Asset (Individual) Account

(b) (Individual) Liability Account Dr.
    To Head Office Account

Converse entries are passed in the head office books.

It is obvious that after aforementioned 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 the 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)

Incomplete Information In Branch Books

If it is desired that profitability of the branch should be kept secret from the branch staff, the head office would hold back some key information from the branch, e.g., amount of opening stock, cost of goods sent to the branch, etc. The head office, in such a case would maintain a record of goods sent to the branch by passing the entry:

↓

Goods Supplied to the Branch Account Dr.
- To Purchases Account

The value of the closing stock will also be adjusted only in head office books.

↓

In such a case, for closing its books at the end of the year, the branch will simply transfer various revenue accounts to the head office without drawing up a Trading and Profit & Loss Account.

↓

On that basis, supplemented by the record of transactions maintained at the head office, it will be possible to construct the Trading and Profit & Loss Account of the branch.

FOREIGN BRANCHES

Foreign branches generally maintain independent and complete record of business transacted by them in currency of the country in which they operate.

Thus, problems of incorporating balances of foreign branches relate mainly to translation of foreign currency into Indian rupees.

This is because exchange rate of Indian rupee is not stable in relation to foreign currencies due to international demand and supply effects on various currencies.

The accounting principles which apply to inland branches also apply to a foreign branch after converting the trial balance of the foreign branch in the Indian currency.

ACCOUNTING FOR FOREIGN BRANCHES

For the purpose of accounting, AS 11 (revised 2003) classifies the foreign branches may be classified into two types:

- Integral Foreign Operation;
- Non- Integral Foreign Operation.

Two types of foreign branches

- **Integral Foreign Operation (IFO)**
  It is a foreign operation, the activities of which are an integral part of those of the reporting enterprise. The business of IFO is carried on as if it were an extension of the reporting enterprise's operations. For example, sale of goods imported from the reporting enterprise and remittance of proceeds to the reporting enterprise.
- **Non-Integral Foreign Operation (NFO)**
  It is a foreign operation that is not an Integral Foreign Operation. The business of a NFO is carried on in a substantially independent way by accumulating cash and other monetary items, incurring expenses, generating income and arranging borrowing in its local currency. An NFO may also enter into transactions in foreign currencies, including transactions in the reporting currency. An example of NFO may be production in a foreign currency out of the resources available in such country independent of the reporting enterprise.

The following are the indicators of Non- Integral Foreign Operation-

- Control by reporting enterprises - While the reporting enterprise may control the foreign operation, the activities of foreign operation are carried independently without much dependence on reporting enterprise.

- Transactions with the reporting enterprises are not a high proportion of the foreign operation's activities.

- Activities of foreign operation are mainly financed by its operations or from local borrowings. In other words, it raises finance independently and is in no way dependent on reporting enterprises.

- Foreign operation sales are mainly in currencies other than reporting currency.

- All the expenses by foreign operations are primarily paid in local currency, not in the reporting currency.

- Day-to-day cash flow of the reporting enterprises is independent of the foreign enterprises cash flows.

- Sales prices of the foreign enterprises are not affected by the day-to-day changes in exchange rate of the reporting currency of the foreign operation.

- There is an active sales market for the foreign operation product.

These are only indicators and not decisive/conclusive factors to classify the foreign operations as non-integral, much will depend on factual information, situations of the particular case and, therefore, judgment is necessary to determine the appropriate classification.

TECHNIQUES FOR FOREIGN CURRENCY TRANSLATION

Items	Integral Foreign Operations	Non-Integral Foreign Operations
Monetary Items (Cash, Bank Balance, Debtor, Creditor, Loans, Bills receivable, Bills Payable)	Closing rate	Closing rate
Non-Monetary Items (Fixed Assets)	Rate on date of purchase	Closing rate
Inventory	Generally, closing rate (but if rate on the date of purchase of inventory is available, then that rate)	Closing rate
Profit and Loss items (revenue items)	Average rate (but if rate on the date of transaction is available, then that rate)	Average rate (but if rate on the date of transaction is available, then that rate)
Exchange Difference	Charge to P&L account.	Accumulated in Foreign Currency Translation reserve.

CHANGE IN CLASSIFICATION

When there is a change in classification, accounting treatment is as under-	
Integral to Non-Integral (i) Translation procedure applicable to non-integral shall be followed from the date of change. (ii) Exchange difference arising on the translation of non-monetary assets at the date of re-classification is accumulated in foreign currency translation reserve.	Non-Integral to Integral (i) Translation procedure as applicable to integral should be applied from the date of change. (ii) Translated amount of non-monetary items at the date of change is treated as historical cost. (iii) Exchange difference lying in foreign currency translation reserve is not to be recognised as income or expense till the disposal of the operation even if the foreign operation becomes integral.

CA INTERMEDIATE - PAPER 2 - CORPORATE AND OTHER LAWS

At Intermediate level, the Company Law portion of the subject 'Corporate and Other Laws' largely involves knowledge and comprehension, analysis and application of provisions of the Companies Act, 2013 to solve situation based and application-oriented issues. In the capsule, an attempt has been made to capture the significant provisions from sections 128 to 148 of the Companies Act, 2013. You are advised to read and understand the September 2021 edition of the Study Material and relevant RTP for a thorough understanding of the relevant provisions of the Companies Act, 2013. This capsule is intended to assist you in the process of revision of concepts discussed in the Study Material.

CHAPTER 9 - ACCOUNTS OF COMPANIES

I. FINANCIAL STATEMENT (FS)

(1) Financial statement is defined under section 2 (40), to include

Financial Statement:
- Balance Sheet
- Profit and Loss account or Income and Expenditure account
- Cash flow Statement
- Statement of change in equity, if applicable
- any explanatory notes annexed to or forming part of financial statements

In case of OPC, Small Co., Dormant Co. and Pvt Co. (Start UP): May not include Cash Flow statement

(2) Financial statement shall

- Give True & Fair view of state of affairs of the Co.
- Comply with AS
- Be in form as provided for different classes of Co.s in Schedule III

If FS do not comply with AS- → reasons for such deviation → along with financial effects → need to be disclosed.

(3) Laying of Financial statement

At each AGM, the Board of Directors (BOD) shall lay the FS for the FY

- If the Co. has subsidiary or associate or Joint Venture, Consolidated Financial Statement (CFS) is also to be laid before AGM

(4) Maintenance of Books of Accounts

Company shall prepare
- Books of accounts
- Books and papers
- Financial statement

↓

Keep at its registered office/any other place in India as the Board of Directors (BOD) may decide

Open for inspection by directors
- Books of accounts inspection of the subsidiary by a person – Only on authorisation by BOD's resolution
- Other financial information outside India- on written request by director himself

Preserved for 8 years

Failure in compliance

Fine (Rs. 50,000- 5 lac)

II. PERIODICAL FINANCIAL RESULTS

The Central Government may, require prescribed unlisted companies → to prepare the financial results of the company on periodical basis → to obtain approval of the BODs and complete audit / limited review of such periodical financial results; and → file a copy with the Registrar within a period of 30 days of completion of the relevant period on payment of fees

III. RE- OPENING OF ACCOUNTS

Application to be made by:

- Central Govt.
- SEBI
- Any other person
- Income Tax authorities
- Statutory regulatory body

Application made to Court/ Tribunal

Court/Tribunal passes an order to the effect that

- Earlier accounts prepared in fraudulent manner
- Affairs of company were mis-managed related to accounts

Notice to be served to applicants

Take Representation into consideration, if any

Pass order to revise/ recast the accounts

Time limit for reopening: No order in respect of re-opening of books of account relating to a period earlier than eight financial years immediately preceding the current financial year, shall be made. Except on direction of the Central Government BOA's may be kept for a period longer than eight years and accordingly may be ordered of re-opening for such period.

IV. VOLUNTARY REVISION OF FINANCIAL STATEMENTS OR BOARD'S REPORT

If it appears to the Directors of the Co.

FS and Board report not in compliance with section 129 or 134

On approval and order of tribunal

- Prepare revised FS
- Revise report

Copy of order of revised FS & Report to be filed with Regsitrar

V. AUTHENTICATION OF FINANCIAL STATEMENTS

FINANCIAL STATEMENT

signed by

- chairperson (authorised by the Board)/ two directors (1 shall be MD,if any)
- Chief Executive Officer(if he is director)
- Chief Financial Officer (if appointed)
- Company secretary (if appointed)

Significant points: Signed copy of every FS, shall be including consolidated financial statement, if any. It shall be issued, circulated or published along with a copy of any notes annexed to or forming part of such financial statement; the auditor's report; and the Board's report.

VI. CONTENTS OF BOARD REPORT

Board of Directors Report

Following information

- the web address, if any, where annual return has been placed
- No. of meetings of Board
- Directors' responsibility statement
- Details of fraud reported by auditors
- Declaration by ID's
- Companies policy on directors' appointment and remuneration
- Comments by board on remarks made by Auditor and CS
- Particulars of loans, guarantees or investments
- Particulars of contracts or arrangements
- State of company's affairs
- Amounts carrying reserves or paid by way of dividend
- Material change affecting on financial position
- Conservation of energy, technology absorption, foreign exchange
- Development and implementation of risk management policy
- CSR policy and initiatives
- Other precribed matters

Listed /other public companies (paid up share capital of 25 cr or more) shall contain statement indicating the manner in which format of annual evaluation of the performance of the Board, its Committees and of individual directors has been made.

Significant points: The Board's Report shall be prepared based on the stand alone financial statements of the company and shall report on the highlights of performance of subsidiaries, associates and joint venture companies and their contribution to the overall performance of the company during the period under report.

The Board's report and any annexures under this section, shall be signed by its chairperson, if he is authorised by the Board.

Where chairperson is not so authorised, shall be signed by at least two directors, one of whom shall be a managing director, or by the director where there is one director.

Directors' Responsibility Statement shall state-

the applicable Accounting Standards that have been followed in the preparation of the annual accounts	Director's selection of such accounting policies and applying them consistently to give a true and fair view of the state of affairs of the company and of the profit and loss of the company	directors had taken care for the maintenance of adequate accounting records for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;	the directors had prepared the annual accounts on a going concern basis; and	the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company effectively.	the directors had devised proper systems to ensure compliance with the provisions of all applicable laws operating effectively.

VII. CORPORATE SOCIAL RESPONSIBILITY (CSR)

(1) Meaning and activities which are specifically excluded:

CSR means-

the activities undertaken by a Company

in pursuance of its statutory obligation

laid down in section 135 of the Act in accordance with the provisions contained in the CSR Policy Rules, 2014.

CSR shall not include the following activities:-

(i) activities undertaken in pursuance of normal course of business of the company:

Provided that any company engaged in research and development activity of new vaccine, drugs and medical devices in their normal course of business related to COVID-19 for financial years 2020-21, 2021-22, 2022-23 subject to the conditions that-

(a) such research and development activities shall be carried out in collaboration with any of the institutes or organisations mentioned in item (ix) of Schedule VII to the Act;

(b) details of such activity shall be disclosed separately in the Annual report on CSR;

(ii) any activity undertaken by the company outside India except for training of Indian sports personnel

(iii) Contribution of any amount directly or indirectly to any political party;

(iv) activities benefitting employees of the company the Code on Wages, 2019

(v) activities supported by the companies on sponsorship basis;

(vi) activities carried out for fulfilment of any other statutory obligations under any law in India;

(2) Companies required to constitute CSR committee

Every company shall constitute a Corporate Social Responsibility Committee of the Board , having-

- net worth of Rs. 500 crore or more, or
- turnover of Rs. 1000 crore or more or
- a net profit of Rs. 5 crore or more
- during the immediately preceding financial year

Comprising of -

three or more directors, out of which at least one director shall be an independent director:

- Provided that where a company is not required to appoint an independent director under section 149 (4),-

  it shall have in its Corporate Social Responsibility Committee two or more directors.

(3) Duties of CSR Committee

formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company in areas or subject, specified in Schedule VII;

recommend the amount of expenditure to be incurred on the referred activities and

monitor the Corporate Social Responsibility Policy of the company from time to time.

(4) Amount of contribution towards CSR

The Board shall ensure that the company spends, in every financial year,
- at least 2% of the average net profits of the co. during the three immediately P.F.Ys

Where the company has not completed the period of 3 F.Ys, since its incorporation,
- atleast 2% during such immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy

in its report shall specify the reasons for not spending the amount.
- and, where the unspent amount relates to any ongoing project, transfer such unspent amount to a Fund specified in Schedule VII,

Where the company spends an amount in excess of the requirements
- such company may set off such excess amount against the requirement to spend for such number of succeeding financial years and in such manner, as may be prescribed.

(5) Transfer of unspent CSR amount to special account

Any amount remaining unspent pursuant to any ongoing project undertaken by a company in pursuance of its CSR Policy

shall be transferred within a period of 30 days from the end of the financial year

to a special account to be opened by the company in that behalf for that financial year

in any scheduled bank to be called the Unspent Corporate Social Responsibility Account, and

such amount shall be spent by the company in pursuance of its obligation towards the CSR Policy

within a period of 3 FYs from the date of such transfer,

failing which, the company shall transfer the same to a Fund specified in Schedule VII,

within a period of 30 days from the date of completion of the third financial year.

(6) When it is not necessary to constitute CSR Committee

Where the amount to be spent by a company does not exceed fifty lakh rupees

the requirement for constitution of the Corporate Social Responsibility Committee

shall not be applicable, and

the functions of such Committee shall, in such cases, be discharged by the Board of Directors.

VIII. ENTITLEMENT OF MEMBERS TO RECEIVE FINANCIAL STATEMENT

(1) Time period for serving of copies of audited financial statement

Copies of audited FS +CFS (if any) + Audit Report+ other document required by law

Sent to

- Every member
- Every trustee for the debenture-holder
- Other persons, being entitled so

At least 21 days before GM

(2) Circumstances when a period can be less than prescribed period

Circumstances when a period of less than 21 days be deemed to have been duly sent if it is so agreed by members—

- In the case of Co. having **share capital**
  - holding majority in number entitled to vote, and
  - who represent not less than 95% of such part of the paid-up share capital of the company as gives a right to vote at the meeting;
- Co. having **no share capital**
  - At least 95% of the total voting power exercisable at the meeting

(3) In case of listed companies:

Copies of the FS and other documents shall be deemed to be served, if

copies of documents are made available for inspection at its **RO**

during **Working Hours**

for a period of **21 days** before the meeting

+

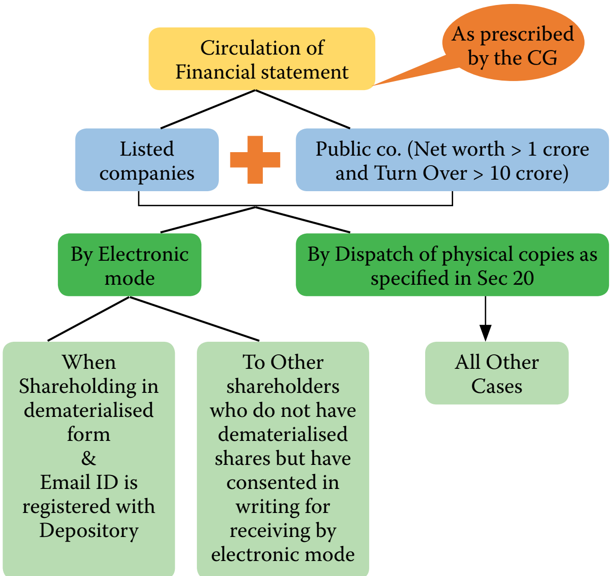
Statement containing salient features of documents is sent to

members

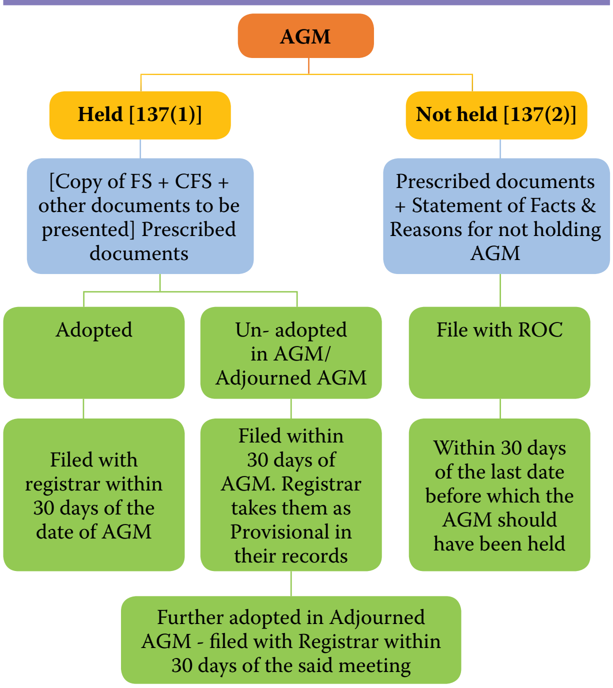
trustee for debenture holders

atleast for 21 days before meeting

IX. MANNER OF CIRCULATION OF FINANCIAL STATEMENTS



X. FINANCIAL STATEMENT TO BE FILED WITH REGISTRAR

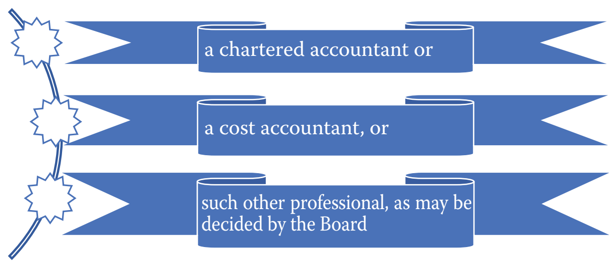


- **In case of a OPC**, it shall file a copy of the financial statements duly adopted by its member, along with the required documents attached to such financial statements, within one **hundred eighty days from the closure of the financial year**.
- **In case of companies having subsidiary/s:** A company shall, along with its financial statements to be filed with the Registrar, attach the accounts of its subsidiary/s which have been incorporated outside India and which have not established their place of business in India.

- In the case of a subsidiary which has been incorporated outside India ("foreign subsidiary"), which is not required to get its financial statement audited under any law of the country of its incorporation and which does not get such financial statement audited, the requirements of the fourth proviso (above point) shall be met if the holding Indian company files such unaudited financial statement along with a declaration to this effect and where such financial statement is in a language other than English, along with a translated copy of the financial statement in English.

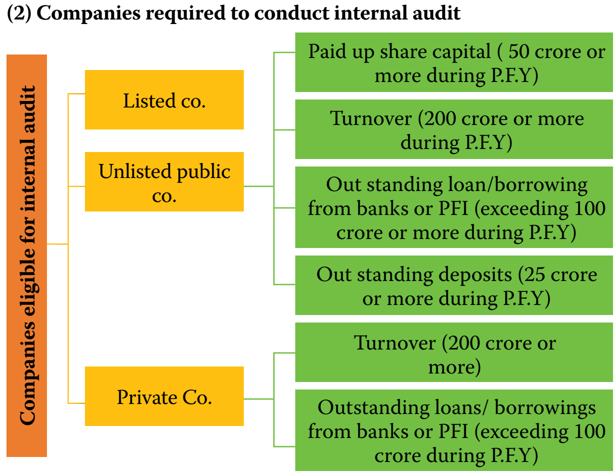
XI. INTERNAL AUDIT

(1) Who can be internal auditor?

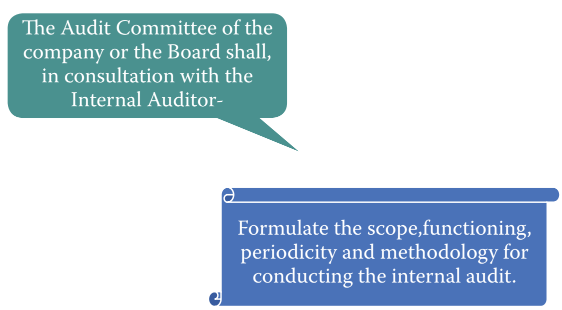


Significant point: Internal auditor may be either an individual or a partnership firm or a body corporate. Internal auditor may or may not be an employee of the company.

(2) Companies required to conduct internal audit



(3) Function of Internal Auditor



CHAPTER 10 - AUDIT AND AUDITORS

I. WHO CAN BE APPOINTED AS AN AUDITOR?

- Individual
- Firm

II. APPOINTMENT OF FIRST AUDITOR

First Auditor

In case of Government Co.*
- C & AG shall appoint auditor
- Within 60 days from date of Registration of Co.
- If C & AG does not appoint 1st Auditor in said 60 days
- BOD shall appoint auditor, within next 30 days
- If BOD does not appoint auditor in 30 these days
- BOD shall inform the members of Co.
- Now, members of Co. shall appoint 1st auditor
- Within 60 days at EGM
- Tenure- Till the conclusion of 1st AGM.

In any Other Co.
- BOD shall appoint auditor
- Within 30 days of Registration of Co.
- If BOD does not appoint auditor
- BOD shall inform members regarding such failure
- Member shall appoint auditor
- Within 90 days at AGM
- Tenure - till the conclusion of 1st AGM.

*Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments.

III. APPOINTMENT OF SUBSEQUENT AUDITOR

Subsequent Auditor

In case of Government Co.*
- Appointed by C & AG
- In respect of a Financial Year
- Within 180 days from Commencement of Financial Year
- Tenure- Till the conclusion of AGM.

In Other Companies
- Appointed by Co. in AGM
- Tenure- Auditor shall hold office from the conclusion of that AGM (in which he is appointed) till the conclusion of 6th AGM.

Here, 'appointment' includes re-appointment.

*Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments.

IV. CASUAL VACANCY OF AUDITOR

Co. whose Accounts are subject to audit by auditor appointed by CAG
- Casual vacancy to be filled by CAG within 30 days
- If CAG does not fill vacancy in 30 days: To be filled by BOD within next 30 days

Other Co.
- Filling the casual vacancy by Board within 30 days
- If vacancy is caused by Resignation-appointment by Board shall also be approved by company at GM convened within 3 months of recommendation of Board
- The Auditor so appointed shall hold office till the conclusion of next AGM.

V. RE- APPOINTMENT OF RETIRING AUDITOR

A retiring auditor may be re-appointed at an AGM if—
- he is not disqualified for re-appointment;
- he has not given Co. notice in writing of his unwillingness to be re-appointed; and
- a SR has not been passed at that meeting, appointing some other auditor or providing expressly that he shall not be re-appointed

Where at any AGM, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company

VI. TERM OF AUDITOR

(1)

Listed companies and prescribed class of companies (except OPC and Small Co.) — Appoint or re- appoint as Auditor

- Individual
  - One Term of 5 consecutive years
  - Cooling Period: On completion of term (one term of 5 consecutive years)- 5 years from the completion of his term
- Audit Firm
  - Two terms of five consecutive years
  - Cooling Period: On completion of term (two term of 5 consecutive years)- 5 years from the completion of his term

(2)

#Specified/ Prescribed Class of Companies

(a) **unlisted public** companies having paid up share capital of rupees 10 crore or more
(b) **Pvt Ltd.** companies having paid up share capital of rupees **fifty** crore or more
(c) companies having paid up share capital of below threshold limit mentioned in (a) and (b) above, but having **public borrowings** from **financial institutions, banks** or **public deposits** of rupees 50 crores or more.

VII. DISQUALIFICATION OF AUDITORS [SECTION 141(3) ALONG WITH RULE 10]

Body Corporate

- Except LLP

Officer or employee of Co.

a person who is a partner, or who is in the employment, of an officer or employee of the company

a person who, or his relative or partner—

- is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. (Relative may hold security or interest in the company of face value not exceeding Rs. 1 lac)
- is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of Rs. 5 lac; or
- has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of Rs. 1 lac

a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company

- 'business relationship' shall be construed as any transaction entered into for a commercial purpose, except–
  (A) commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts;
  (B) commercial transactions which are in the ordinary course of business of the company at arm's length price like sale of products or services to the auditor as customer by the companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses

a person whose relative is a director or is in the employment of the company as a director or key managerial personnel

a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than 20 companies other than one person companies, small companies and private companies having paid-up share capital less than 100 crore rupees

a person who has been convicted by a court of an offence involving fraud and a period of 10 years has not elapsed from the date of such conviction

a person who, directly or indirectly, renders any service referred to in section 144 to the company or its holding company or its subsidiary company

VIII. STEPS FOR REMOVAL OF AUDITOR

A **Special Notice** is received for Removal of auditor

A board meeting will be held

(To decide about removal and then authorising the filing of application to CG)

Application to CG (To be made in ADT-2), within 30 days of Board meeting

Approval of CG received

After approval from CG, **Special Notice** to be sent for AGM

Auditor shall be given a reasonable opportunity of being heard

Auditor removal can be done only through **Special Resolution**

Auditor will be removed

IX. RESIGNATION BY AUDITOR

Resignation by auditor of Government company or company controlled by CG or SG	Form ADT-3	within 30 days of resignation	with Company, Registrar & CAG, indicating the reasons for his resignation
Resignation by auditor of Other Co.	Form ADT-3	within 30 days of resignation	with Company and Registrar

X. PUNISHMENT UNDER SECTION 147

(1) In case of company and officer of company

Contravention of sec 139 to 146
- **In case of Co.** → Rs. 25,000 to 5 lac
- **In case of Officer in default** → Fine: Rs. 10,000 to 1 lac

(2) In case of auditor

Contravention by Auditor of Sec 139, 144 or 145

- If default is **Not Wilful** → Fine: Rs. 25,000 to 5 lac, or four times the remuneration of the auditor, whichever is less
- If default is **Wilful** (with the intention to deceive the company or its shareholders or creditors or tax authorities) → Fine: Rs. 50,000 to 25 lac or 8 times the remuneration of the auditor, whichever is less; Imprisonment: May extend to 1 Year

If the Auditor has been convicted, he shall also be liable to:
- Refund the remuneration
- Pay for the damages to the Co., statutory bodies, authorities or to members or creditors of the company for loss arising out of incorrect statements in Audit Report

(3) In case of audit of a co. conducted by an audit firm

Where the partner/s of the audit firm has / have acted in a-
fraudulent manner / abetted / colluded in any fraud by, or

↓

in relation to or by-
the company / its directors / officers,

↓

the liability (whether civil /criminal) under this Act or in any other law in force,

↓

for such act shall be of the
partner / partners concerned of the audit firm | of the firm jointly and severally

↓

in case of criminal liability of an audit firm (in respect of liability other than fine)-
the concerned partner/s, who acted in a fraudulent manner/ abetted / as the case may be colluded in any fraud-

↓

shall only be liable

CA INTERMEDIATE - PAPER 2: CORPORATE AND OTHER LAWS

THE INDIAN CONTRACT ACT, 1872

At Intermediate level, for the Other Laws portion of the subject "Corporate and Other Laws" involves that the students should understand the laws enshrined in this portion. They are required to apply the knowledge acquired to address application oriented issues.
In this capsule for students, an attempt has been made to capture the significant provisions of the Indian Contract Act, 1872 (only specific contracts from section 123 onwards). You are advised to read the September 2021 edition of the Study Material for a thorough understanding of the relevant provisions of the Indian Contract Act, 1872 and solve the illustrations and exercise questions given therein to hone your application skills. This capsule on Intermediate Paper 2: Corporate and Other Laws is intended to assist you in the process of revision of concepts discussed in the specified portion of Study Material.

UNIT – 1: CONTRACT OF INDEMNITY AND GUARANTEE

Unit Overview

Contract of Indemnity and Guarantee [Section 124-147]

- Contract of Indemnity
- Contract of Guarantee
- Nature of Surety's Liability
- Continuing Guarantee
- Discharge of Surety
- Rights of Surety

1. Meaning of Contract of Indemnity [Section 124]

CONTRACT OF INDEMNITY – a contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person

Indemnity
- Security against loss
- to make good the loss
- to compensate the party who has suffered some loss

To indemnify means to compensate or make good the loss. Thus, under a contract of indemnity the **"existence of loss"** is essential. Unless the promisee has suffered a loss, he cannot hold the promisor liable on the contract of indemnity

2. Parties to Contract of Indemnity

- **Indemnifier** – promises to indemnify/save the other party from loss
- **Indemnified** – who is promised to be saved against the loss

Example: Vishal may contract to indemnify Vibha against the consequences of any proceedings which Karan may take against Vibha in respect of a sum of ₹5000/- advanced by Karan to Vibha. In consequence, when Vibha who is called upon to pay the sum of money to Karan fails to do so, Karan would be able to recover the amount from Vishal as provided in section 124 of the Indian Contract Act, 1872.

3. Scope of Contract of Indemnity

Loss caused by the conduct of the promisor himself

Loss caused by the conduct of any other person

Loss occasioned by an accident not caused by any person, or an act of God/ natural event, is not covered.

4. Mode of Contract of Indemnity

A contract of indemnity is said to be express

- when a person expressly promises to compensate the other from loss.

A contract of indemnity is said to be implied

- when it is to be inferred from the conduct of the parties or from the circumstances of the case

5. Rights of Indemnity Holder when Sued [Section 125]

The promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor/indemnifier—

- all damages which he may be compelled to pay in any suit
- all costs which he may have been compelled to pay in bringing/ defending the suit and
- all sums which he may have paid under the terms of any compromise of suit.

Commencement of liability of an indemnifier- as soon as the liability of the indemnity holder becomes absolute and certain (as per various judicial pronouncements)

Example: Vishal may contract to indemnify Vibha against the consequences of any proceedings which Karan may take against Vibha in respect of a sum of ₹5000/- advanced by Karan to Vibha. In consequence, when Vibha who is called upon to pay the sum of money to Karan fails to do so, Karan would be able to recover the amount from Vishal as provided in section 124 of the Indian Contract Act, 1872.
Thus, as soon as Vibha is called upon to pay the sum of money to Karan (i.e the loss has become certain), the liability of Vishal arises.

6. Meaning of Contract of Guarantee [Section 126]

Contract of Guarantee

CONTRACT OF GUARANTEE – a contract to perform the promise made or discharge the liability, of a third person in case of his default

Parties to Contract of Guarantee

Three parties are involved in a contract of guarantee

- **Surety**- person who gives the guarantee
- **Principal debtor**- person in respect of whose default the guarantee is given
- **Creditor**- person to whom the gurantee is given

Contract of Guarantee (Tripartite Agreement)

- **Principal Contract**: Principal Debtor – Creditor
- **Secondary Contract**: Creditor – Surety
- **Implied Contract**: Surety – Principal Debtor

7. Essential Features of a Guarantee

Principal Debt

- there should be someone liable as a principal debtor and the surety undertakes to be liable on his default. If there is no principal debt, there can be no valid guarantee

Consideration

- A guarantee without consideration is void, but there is no need for a direct consideration between the surety and the creditor
  - consideration received by the principal debtor is sufficient consideration to the surety for giving the guarantee
  - past consideration is no consideration for the contract of guarantee
  - even if the principal debtor is incompetent to contract, the guarantee is valid. But, if surety is incompetent to contract, the guarantee is void

Existence of a liability

- There must be an existing liability or a promise whose performance is guaranteed. The liability must be legally enforceable and not time barred

No misrepresentation or concealment [Section 142 and 143]

- Any guarantee which has been obtained by the means of misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction, is invalid (section 142)
- Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances, is invalid (section 143)

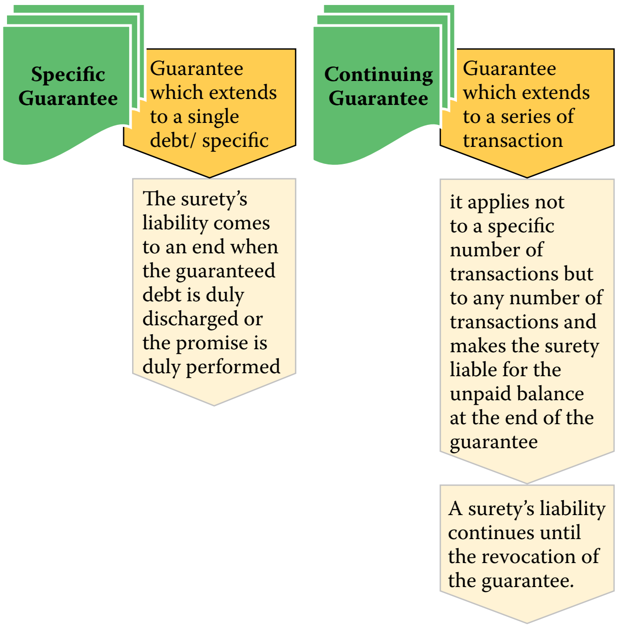
Writing not necessary [Section 126]

- a guarantee may be either oral or written

Joining of the other co-sureties [Section 144]

- Where a person gives a guarantee upon a contract that the creditor shall not act upon it until another person has joined in it as co-surety, the guarantee is not valid if that other person does not join

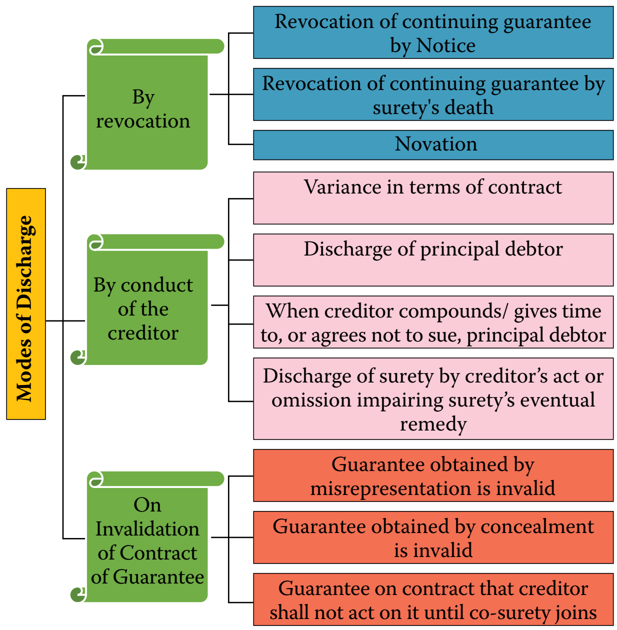
8. Types of Guarantees



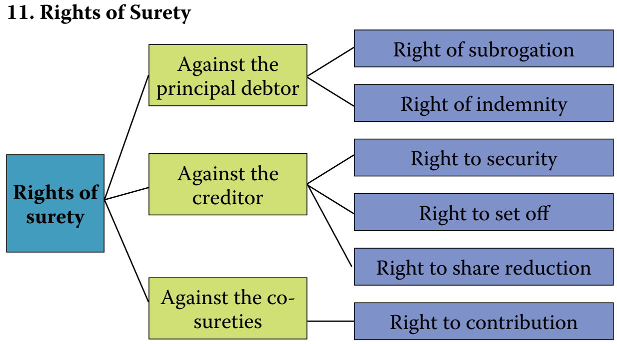
9. Distinction between a Contract of Indemnity and Contract of Guarantee

S. No	Point of distinction	Contract of Indemnity	Contract of Guarantee
1.	**Number of parties to the contract**	There are only **two parties-** indemnifier [promisor] and indemnified [promisee]	There are **three parties-** creditor, principal debtor and surety.
2.	**Nature of liability**	The liability of the indemnifier is primary and unconditional	The liability of the surety is secondary and conditional as the primary liability is that of the principal debtor.
3.	**Time of liability**	The liability of the indemnifier arises only on the happening of a contingency.	The liability arises only on the non-performance of an existing promise or non-payment of an existing debt.
4.	**Time to Act**	The indemnifier need not act at the request of indemnity holder.	The surety acts at the request of principal debtor.
5.	**Right to sue third party**	Indemnifier cannot sue a third party for loss in his own name as there is no privity of contract. Such a right would arise only if there is an assignment in his favour.	Surety can proceed against principal debtor in his own right because he gets all the right of a creditor after discharging the debts.
6.	**Purpose**	Reimbursement of loss	For the security of the creditor
7.	**Competency to contract**	All parties must be competent to contract	In the case of a contract of guarantee, where a minor is a principal debtor, the contract is still valid.

10. Discharge of Surety



11. Rights of Surety



Example 1: Asha and Vidushi are very good friends. During the pandemic time, Vidushi started facing financial difficulties. Both Asha and Vidushi used to buy groceries from Alpha stores. Asha promises to pay Alpha stores for all groceries bought by Vidushi for a period of 12 months if Vidushi fails to pay. In the next three months, Vidushi buys ₹2000/- worth of groceries. After 3 months, Asha revokes the guarantee by giving a notice to Alpha stores. Vidushi further purchases ₹1000 of groceries. Vidushi fails to pay. Asha is not liable for ₹1000/- of purchase that was made after the notice but she is liable for ₹2000/- of purchase made before the notice.
2: Ayush, Bikram and Chandra, as sureties for Devinder, enter into three several bonds, each in a different penalty, namely, Ayush in the penalty of ₹1,00,000, Bikram in that of ₹2,00,000, Chandra in that of ₹4,00,000, conditioned for Devinder's duly accounting to Vishal. Devinder makes default to the extent of ₹3,00,000. Ayush, Bikram and Chandra are each liable to pay ₹1,00,000.

UNIT 2: BAILMENT AND PLEDGE

Unit Overview

Bailment and Pledge [Section 148-181]

- Bailment [Section 148-171]
  - Duties and Rights of Bailor
  - Duties and Rights of Bailee
  - Finder of Goods
  - General lien and particular lien
- Pledge [Section 172-181]
  - Pawnee Rights
  - Pawnor Rights
  - Pledge by Mercantile Agent

1. Meaning of Bailment [Section 148]

Bailment

delivery of goods

↓

by one person to another

↓

for some purpose

↓

upon a contract, that the goods shall, when the purpose is accomplished, be returned or otherwise disposed

Parties to Bailment

Bailor – The person delivering the goods

Bailee – The person to whom the goods are delivered

Example: Mr. Pankaj delivers his car to Mr. Yash's garage for repair. Here, Mr. Pankaj is the bailor and Mr. Yash is the bailee.

2. Essential Elements of Bailment

Contract
- express or implied
- no consideration is necessary to create a valid contract of bailment

Delivery of goods
- delivery of goods from one person to another
- may be Actual Delivery or Constructive Delivery

Purpose
- goods are delivered for some purpose
- purpose may be express or implied

Possession
- possession of goods changes
- change of possession does not lead to change of ownership

Return of goods
- Bailee is obliged to return the goods

Deposit of money in a bank is not bailment since the money returned by the bank would not be identical currency notes.

Depositing ornaments in a bank locker is not bailment, because ornaments are kept in a locker whose key are still with the owner and not with the bank.

3. Examples of types of Bailment

- Delivery of goods by one person to another to be held for the bailor's use
- Goods given to a friend for his own use without any charge
- Hiring of goods
- Delivering goods to a creditor to serve as security for a loan
- Delivering goods for repair with or without remuneration
- Delivering goods for carriage

Bailment (on the basis of reward)
- **Gratuitous** bailment
  - for the exclusive benefit of bailor
  - for the exclusive benefit of the baillee
- **Non Gratuitous** bailment
  - for the benefit of the bailor and the bailee

4. Duties of Bailor

Disclose known facts	• GRB- bailor is bound to disclose faults which he is aware of • NGB-if goods are bailed for hire, bailor is responsible for such damage, whether he was or was not aware of the fault
Bear necessary expenses	• GRB-bailor shall repay to the bailee the necessary and extraordinary expenses incurred by him • NGB- bailor is liable to pay extraordinary expenses incurred by the bailee
Indemnify bailee	When goods are lent gratuitously and bailor terminates the bailment before the expiry of the period of bailment, he must compensate the bailee for the loss suffered by the bailee that is in excess of the benefit received
Defective title	Indemnify for loss which the bailee may sustain by reason that the bailor was not entitled to make the bailment
Bound to accept the goods	When the bailee return goods after the time of bailment has expired or the purpose of bailment has been accomplished

Here, GRB stands for Gratuitous bailment and NGB stands for Non gratuitous bailment

5. Duties of Bailee

Take reasonable care of the goods [Section 151 & 152]

- As a man of ordinary prudence would

No unauthorized use of goods [Section 153 & 154]

- If bailee use the goods bailed, which is not according with terms and conditions of the bailment, (i) he is liable to compensate the bailor for any loss of goods, (ii) the contract of bailment is voidable at the option of the bailor

No mixing of bailor's goods with his own [Section 155, 156 & 157]

- Mixing with consent - both parties shall have an interest in proportion to their respective shares in the mixture thus produced
- Mixing without consent- if goods can be separated, the property in the goods remain in the parties respectively; but the bailee is bound to bear the expense of separation and any damage arising from the mixture
- Mixing without consent- if goods cant be separated, bailor is entitled to be compensated by the bailee for loss of the goods

To return any extra profit accruing from goods bailed [Section 163]

- Bailee has to deliver to the bailor any increase or profit which may have accrued from the goods bailed

No adverse title

- Bailee must hold the goods on behalf of and for the bailor. He cannot deny the title of the bailor

6. Rights of Bailor

- Right to terminate the bailment
- Right to demand back the goods at any time
- Right to file a suit against any wrong doer
- Right to file a suit for enforcement of duties imposed upon a bailee
- Right to claim compensation

7. Rights of Bailee

Right to deliver the goods to any one of the joint bailors

If several joint owners bailed the goods, the bailee can deliver goods to any one of the joint owners

Right to indemnity

Bailee is entitled to be indemnified by the bailor for any loss arising to him by reasons that the bailor was not entitled to make the bailment

Right to indemnity

Bailee is entitled to receive compensation for loss caused to him due to the failure of the bailor to disclose any faults in the goods known to him.

If the bailment is for hire, the bailor will be liable to compensate even though he was not aware of the existence of such faults

Right to claim necessary expenses

In case of gratuitous bailment, the bailor shall repay to the bailee the necessary expenses incurred by him and any extraordinary expenses incurred by him for the purpose of the bailment.

Right to apply to court to decide the title to the goods

If the goods bailed are claimed by the person other than the bailor, the bailee may apply to the court to stop its delivery and to decide the title to the goods

Right of particular lien for payment of services

In case bailee has rendered service involving the exercise of labour or skill, he has a right to retain such goods until he receives due remuneration for the services

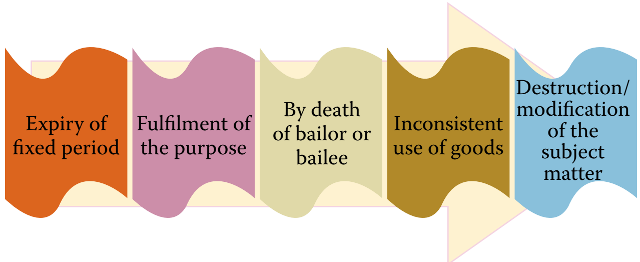
Right of general lien

Bankers, factors, wharfingers, attorneys of a High Court and policy brokers may, in the absence of a contract to the contrary, retain, as a security for a general balance of account any goods bailed to them No other persons have a right to retain, as a security for such balance, goods bailed to them, unless there is an express contract to the effect

Example 1: Mrs. Smita has inherited a huge diamond from her grandmother. She delivers the rough diamond to Panna Laal Jewellers to be cut and polished, which is accordingly done. The jewellers are entitled to retain the stone till it is paid for the services they have rendered.

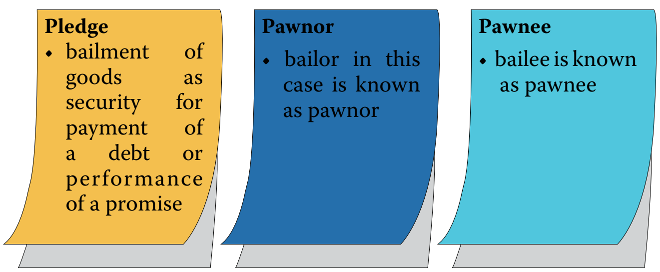
2: Smita borrows ₹ 50,000/- from the bank without security and subsequently again borrows another ₹ 10,000/- but with security of say certain jewellery. In this illustration, even where Smita has returned ₹10,000/- being the second loan, the banker can retain the jewellery given as security to the second loan towards the first loan which is yet to be repaid.

8. Termination of bailment



9. Meaning of Pledge

Pledge



Essentials of contract of Pledge

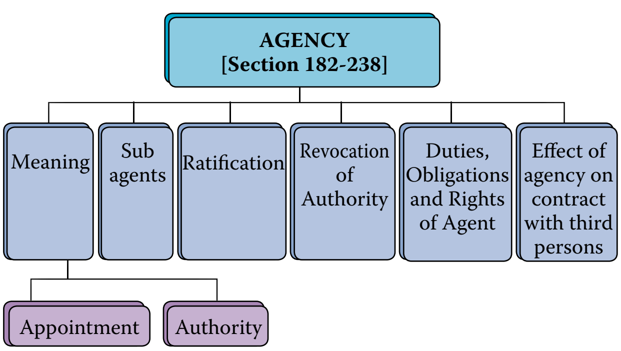
- There shall be a bailment for security against payment or performance of the promise
- The subject matter of pledge is goods
- Goods pledged for shall be in existence
- There shall be the delivery of goods from pledger to pledgee

10. Distinction between Bailment and Pledge

S.No	Basis of Distinction	Bailment	Pledge
1.	**Meaning**	Transfer of goods by one person to another for some specific purpose is known as bailment.	Transfer of goods from one person to another as security for repayment of debt is known as the pledge.
2.	**Terms Applicable**	The person delivering the goods under a contract of bailment is called as "Bailor". The person to whom the goods are delivered under a contract of bailment is called as "Bailee".	The person who delivers the good as security is called the "Pawnor". The person to whom the goods are delivered as security is called the "pawnee".
3.	**Purpose**	Bailment may be made for any purpose (as specified in the contract of bailment, eg: for safe custody, for repairs, for processing of goods).	Pledge is made for the purpose of delivering the goods as security for payment of a debt, or performance of a promise
4.	**Consideration**	The bailment may be made for consideration or without consideration.	Pledge is always made for a consideration.
5.	**Right to sell the goods**	The bailee has no right to sell the goods even if the charges of bailment are not paid to him. The bailee's rights are limited to suing the bailor for his dues or to exercise lien on the goods bailed.	The pawnee has right to sell the goods if the pawnor fails to redeem the goods.
6.	**Right to use of goods**	Bailee can use the goods only for a purpose specified in the contract of bailment and not otherwise.	Pledgee or Pawnee cannot use the goods pledged.

UNIT–3: AGENCY

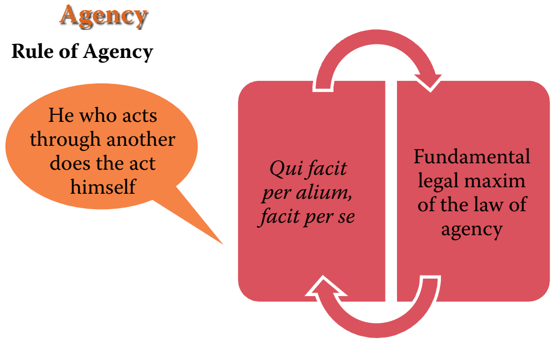
Unit Overview



1. Meaning

Agency

Rule of Agency



Relevant Terms

Agency :
Not defined in the Act. Its used to describe the relationship between one person and another. The first mentioned person brings the second mentioned person into legal relation with others

Agent :
A person employed to do any act for another or to represent another in dealing with the third persons [Section 182]

Principal:
A person for whom such act is done or who is so represented [Section 182]

Test of Agency

There is a relationship of agency, if the answer is in affirmative (Yes)

Where he can establish privity of contract between the principal and third parties.

Where the person has the capacity to bind the principal and make him answerable to the third party

2. Who may employ an agent [Section 183]

Person qualified to appoint agent must be
- major
- sound mind

3. Who may be an agent [Section 184]

- any person
- even a minor or a person of unsound mind
- his act shall bound the principle

As a rule of caution, a minor or a person of unsound mind should not be appointed as an agent because he is incompetent to contract and in case of his misconduct or negligence, the principal shall not be able to proceed against him.

Example: Ajay appoints Bijay who is a minor, to sell his bike for not less than ₹60,000. However, Bijay sells it for ₹40,000. Ajay will be held bound by the transaction and further shall have no right against Bijay for claiming the compensation for having not obeyed the instructions, since Bijay is a minor and a contract with a minor is 'void-ab-initio'.

4. Requirement of Consideration [Section 185]

Consideration for creation of Agency — not necessary

The acceptance of the office of an agent is regarded as a sufficient consideration for the appointment

5. Creation of Agency

Modes of Creation of Agency
- Express appointment
  - words
    - Spoken
    - written
- Implied appointment
- Necessity
- Estoppel/ holding out
- Agency by ratification

6. The authority may be express or implied [Section 186]

Authority of an agent may be-
- express or
- implied

Definitions of express and implied authority [Section 187]

Express Authority: Given by words, spoken or written

Implied Authority: inferred from the circumstances of the case, conduct of the parties and things spoken or written, or in the ordinary course of dealing.

Example 1: A is residing in Delhi and he has a house in Kolkata. A authorizes B under a power of attorney, as caretaker of his house. Agency is created by express agreement.

2 : If a person realizes rent and gives it to the landlord, he impliedly acts for the landlord as an agent.

3: Mr. A owns a shop in Laxmi Nagar, East Delhi, living himself in Gurugram and so visiting the shop occasionally. The shop is managed by F, and he is in the habit of ordering goods from C in the name of A for the purposes of the shop, and of paying for them out of A's funds with A's knowledge. F has an implied authority from A to order goods from C in the name of A for the purposes of the shop.

7. Necessity

An agency of necessity

arises due to some emergent circumstances

In such case, a person is authorised to do what he cannot do in ordinary circumstances

For that he acquires an extra-ordinary or special authority to prevent his principal from loss

Example: Rajkumar has a farm in which Sevakram is the security guard. During visit of Rajkumar to USA, huge fire was caught in the farm. Sevakram becomes an agent of necessity for Rajkumar so as to save the property from being destroyed by fire. Rajkumar (the principal) will be bear up all the expenses, which Sevakram (his agent of necessity) incurred to put out the fire and save the farm from destruction during Rajkumar's absence from the country.

8. Agency by Estoppel [Section 237]

When an agent has without authority -
- done acts
- or incurred obligations

to third persons on behalf of his principal

the principal is bound by such
- acts or
- obligations

if he has by his words / conduct induced such third persons to believe that such acts and obligations were within the scope of the agent's authority

Example: Mr. P (the principal) for several months made Sukhdev, to buy goods on credit from a nearest provision store on his behalf and has paid for the goods bought by Sukhdev. Here P cannot later refuse to pay for the goods purchased from the provision store, who had supplied goods on credit to Sukhdev in the belief that he was P's agent and was buying the goods on behalf of P. In the given case, P is estopped from now asserting that Sukhdev is not his agent because on earlier occasions he permitted provision dealer to believe that Sukhdev was his agent and so he had acted in that belief.

9. Agency by Ratification [Section 196]

Meaning of ratification and manner

Meaning
- approving a previous act / transaction

Manner
- express or implied by the conduct of the person on whose behalf the act was done

Agency by ratification

Where acts are done by one person on behalf of another

but without his knowledge / authority,

he may elect

to ratify, or

to disown such acts

If he ratifies them,

shall have effect as if they had been performed by his authority.

Example: X is Y's agent. He (X) on 10th January 2021 purchased goods from Z on credit without seeking Y's permission. After that, on 20th January 2021, Y tells X that he (Y) will accept responsibility to pay for the purchases although at the time of purchase X had no authority to buy on credit. Y's subsequent statement on 20th January 2021 amounts to a ratification of the agent's (X's) purchase of goods on 10th January 2021.

Essentials of Ratification

- Ratification may be expressed or Implied [Section 197]
- Knowledge requisite for valid ratification [Section 198]
- Effect of ratifying unauthorized act forming part of a transaction [Section 199]
- Ratification of unauthorized act cannot injure third person [Section 200]
- Ratification of unauthorized act cannot injure third person [Section 200]
- Ratification within reasonable time
- Communication of Ratification

Example: 1. Abhi, without B's authority, lends B's money to Mr. C. Afterwards B accepts interests on the money from C. B's conduct implies a ratification of the loan.

2. Abhi has an authority from Mr. Puri to buy certain goods at the market rate. He buys at a higher rate but Mr. Puri accepts the such transaction. Afterwards, Mr. Puri comes to know that the goods purchased by Abhi for him belonged to Abhi himself. The ratification is not binding on Mr. Puri. If, however the alleged principal (Mr. Puri) is prepared to take the risk of what the purported agent, Abhi has done, he can choose to ratify without full knowledge of facts.

3. Abhi, not being authorized thereto by B, demands on behalf of B, the delivery of a chattel, the property of B, from C, who is in possession of it. This demand cannot be ratified by B, so as to make C liable for damages for his refusal to deliver.

10. Extent of agent's authority [Section188-189]

The agent can bind the principal-

only if he acts within the scope of his authority

The extent of an agent's authority, expressed or implied is determined by-

the nature of the act / the business he is appointed to do things which are incidental to the business / are usually done in the course of such business, the usage of trade / business.

nature or extent of the agent's authority, will include-

every lawful thing necessary for the purpose of carrying it out, every lawful thing justified by various customs of trades, in an emergency, such acts for the purpose of protecting the principal from loss, will be done by a person of ordinary prudence in his own case under similar circumstances.

agent's authority is governed by two principles,-

in normal circumstances, and in emergency

* An agent who has authority for sale of goods, may repair it if necessary.

Example: 1. A is employed by B, residing in UK, to recover at Mumbai a debt due to B. A may adopt any legal process necessary for the purpose of recovering the debt and may give a valid discharge for the same.

2. A consigns perishable goods to B at Srinagar, with directions to send them immediately to C, at Tamil Nadu. B may sell the good if they begin to perish before reaching its destination.

11. Provisions related to Sub- Agent [Section 190-193]

Sub-agent [Section 191]

PRINCIPAL
- delegates act/ work

AGENT
- further delegates

SUB- AGENT

Appointment of Sub-agent

based on the Latin principle *delegatus non potest delegare*

Appointment

General principle → An agent cannot lawfully employ another to perform acts which he has expressly or impliedly undertaken to perform personally.

unless by the ordinary custom of trade a sub-agent may, or from the nature of the agency, → a sub-agent must, be employed.

Exception where an agent can appoint sub-agent

If the terms of appointment originally contemplated it

Customs of the trade may provide for such appointment

Where in the course of the agent's employment, unforeseen emergency arise which leads to delegate the authority given to him by the principal.

In both these cases the sub agent would be treated as the agent of the principal.

Representation of principal by sub-agent properly appointed [Section 192]

Where a sub-agent is properly appointed,

- the principal is, w.r.t third persons, is bound and responsible for the acts of sub-agent
  - as if he were an agent originally appointed by the principal
- Agents responsibility for sub agents
  - The agent is responsible to the principal for the acts of the sub-agent.
- Sub-agents liability to principal
  - The sub-agent is responsible for his acts to the agent, but not to the principal,
    - except in case of fraud or willful wrong.

Agent's responsibility for sub-agent appointed without authority [Section 193]

Where an agent, without having authority to do so, appointed a person to act as a sub-agent-

the agent stands towards such person in the relation of a principal to an agent,
- is responsible for his acts both to the principal and to third persons;

the principal is not represented by or responsible for the acts of the sub agent,
- the sub agent is not responsible to the principal at all.
- He is answerable only to the agent.

Example: Mr. A, a carrier, agreed to carry 60 bags of cotton waste from Morvi to Bhavnagar by a truck. Mr. A asked Mr. B, another carrier, to carry the goods. The goods were damaged in transit. Held, Mr. A was liable even though it was proved that Mr. B was the carrier.

12. Provision related to Substituted Agents [Section 194-195]

Substituted Agent

person appointed by the agent-
- to act for the principal

in the business of agency-
- with the knowledge and consent of the principal

Substituted agents are not-
- sub agents

Substituted agents are-
- agents of the principal

Relation between principal and person duly appointed by agent to act in business of agency

Where an agent,
- holding an express /implied authority
- to name another person
- to act for the principal
- in the business of the agency

named another person accordingly,

such person is
- not a sub-agent,
- but an agent of the principal
- for such part of the business of the agency as is entrusted to him

Example: Amir directs Badrinath, his lawyer, to sell his estate by auction, and to employ an auctioneer for the purpose. Badrinath names Chaman, an auctioneer, to conduct the sale. Chaman is not a sub-agent, but is A's agent for the conduct of the sale.

Agent's duty in naming such person

In selecting substituted agent for his principal

an agent is bound to exercise the same amount of discretion as a man of ordinary prudence would exercise in his own case;

and, if he does this,
- he is not responsible to the principal for the acts or negligence of the agent so selected.

Example: Ansh instructs Bijay, a merchant, to buy a ship for him. Bijay hires a ship surveyor of good reputation to choose a ship for Ansh. The surveyor makes the choice casually and the ship turns out to be unseaworthy and is lost. Bijay is not, but the surveyor is, responsible to Ansh.

13. Difference between a sub-agent and a substituted agent

S. No	Point of distinction	Sub Agent	Substituted Agent
1.	**On the basis of assigned work**	does his work under the control and directions of agent.	works under the instructions of the principal.
2.	**Delegation of duties**	The agent not only appoints a sub-agent but also delegates to him a part of his own duties.	The agent does not delegate any part of his task to a substituted agent.
3.	**Relation with the principal**	No privity of contract between the principal and the sub-agent.	Privity of contract is established between a principal and a substituted agent.
4.	**Liability towards agents**	The sub-agent is responsible to the agent alone and is not generally responsible to the principal.	A substituted agent is responsible to the principal and not to the original agent who appointed him

S. No	Point of distinction	Sub Agent	Substituted Agent
5.	**Liability towards principle**	The agent is responsible to the principal for the acts of the sub-agent.	The agent is not responsible to the principal for the acts of the substituted agent.
6.	**Right of action for receiving remuneration**	The sub-agent has no right of action against the principal for remuneration due to him.	The substituted agent can sue the principal for remuneration due to him.
7.	**Improper appointment**	Sub-agents may be improperly appointed.	Substituted agents can never be improperly appointed.
8.	**Liability of agent on their appointments**	The agent remains liable for the acts of the sub-agent as long as the sub-agency continues.	The agent's duty ends once he has named the substituted agent.

14. Duties and Obligations of an Agent

- Duty to execute Mandate order of principle
- Conduct business in accordance with the directions given by the principal
- Duty of resonable care and skill
- Duty to communicate with the principal
- Duty to avoid conflict of interest
- Duty not to make secret profit
- Duty to remit sums

Example: 1. Ajeet, an agent is engaged for managing the business of B, in which it is a custom to invest money at hand for interest. If Ajeet omits to make such investment he must indemnify B for the losses i.e. for the interest B would have obtained for such investment.

2. Ajeet, an agent for the sale of goods, having authority to sell on credit, sells to B on credit, without making proper and usual enquiries as to the solvency of B. B, at the time of such sale is insolvent. Ajeet must compensate his principal for the loss sustained by him.

3. Ajeet directs B to sell his estate. B buys the estate for himself in the name of C. Ajeet, on discovering that B has bought the estate for himself, may repudiate the sale if he can show that B has dishonestly concealed any material fact, or that the sale has been disadvantageous to him.

4. Ajeet directs B, his agent, to buy a certain house for him. B tells Ajeet it cannot be bought, and buys the house for himself. Ajeet may, on discovering that B has bought the house, compel him to sell it to Ajeet at the price he gave for it.

15. Rights of an Agent

Rights of an Agent

- Right to retain out of sums received on principal's account
- Right to remuneration
- Agent's lien on principal's property
- Right of indemnification for lawful acts
- Right of indemnification against acts done in good faith

Example: 1. Ashu employs B to recover ₹ 1,00,000 from C. Because of B's misconduct the money is not recovered. B is entitled to no remuneration for his services, and must make good the loss.

2. Ashu residing in Delhi, appoints 'B' from Mumbai as an agent to sell his merchandise. As a result 'B' contracts to deliver the merchandise to various parties. But Ashu fails to send the merchandise to B and B faces litigations for non- performance. Here, Ashu is bound to protect B against the litigations and all costs, expenses arising of that.

3. Where P appoints Ashu as his agent and directs him to sell certain goods which in fact turned out to be not those belonging to P and if third parties sue Ashu for this act, Ashu is entitled for reimbursement and indemnification for such act done in good faith.

4. Ashu employs B to beat C, and agrees to indemnify him against all consequences of the act. B thereupon beats C, and has to pay damages to C for so doing. Ashu is not liable to indemnify B for those damages.

5. Ashu employs B as a bricklayer in building a house, and puts up the scaffolding himself. The scaffolding is unskillfully put up, and B is in consequence hurt. Ashu must compensate B.

16. Principal's Liability to Third Parties [Section 226-229]

General rule

As there is no privity of contract and passing of consideration between the agent and third party → therefore,

- liability remains that of the principal and not of agents
- An agent also cannot personally enforce contracts entered into by him on behalf of the principal

Conditions when principal is liable for the acts of the agents

- Principal liable for the acts of agents which are within the scope of his authority.
- When an agent does more than he is authorised to do, so much only of what he does as is within his authority is binding as between him and his principal.
- Principal not bound when excess of agent's authority is not separable
- Any notice given / information obtained by the agent, provided it be given or obtained in the course of the business for the principal, shall, as between the principal and third parties, have the same legal consequence as if it had been given to or obtained by the principal.
- Misrepresentations or frauds committed, by agents acting in the course of their business for their principals, have the same effect as if such misrepresentations or frauds had been made, or committed, by the principals.

Example: 1. Anu, being B's agent with authority to receive money on his behalf, receives from C, a sum of money due to B. C is discharged of his obligation to pay the sum in question to B.

2. Anu, being owner of a ship and cargo, authorizes B to procure an insurance for ₹4,00,000 on the ship. B procures a policy for ₹4,00,000 on the ship, and another for the like sum on the cargo. Anu is bound to pay the premium for the policy on the ship, but not the premium for the policy on the cargo.

3. Anu is employed by B to buy from C certain goods of which C is the apparent owner, and buys them accordingly. In the course of the treaty for the sale, Anu learns that the goods really belonged to D, but B is ignorant of that fact. B is not entitled to set off a debt owing to him from C against the price of the goods. Thus, the knowledge of the agent is treated as the knowledge of the principal.

4. Anu, being B's agent for the sale of goods, induces C to buy them by a misrepresentation, which he was not authorized by B to make. The contract is voidable, as between B and C, at the option of C.

17. Personal liability of agent to third parties [Section 230]

General Rule

In the absence of any contract to that effect → an agent cannot personally enforce contracts entered into by him / behalf of his principal, nor is he personally bound by them

Availability of rights to third parties in a contract entered by agent [Section 231-234]

Rights to a contract made by undisclosed agent- the same right as he would have had as against the agent if the agent had been the principal.

Performance of contract with agent supposed to be principal- Where one man makes a contract with another, the principal, if he requires the performance of the contract, can only obtain such performance subject to the rights and obligations subsisting between the agent and the other party to the contract

Option to Third Person- sue the Agent or the Principal-

- **Right of person dealing with agent personally liable-** a person dealing with him may hold either him or his principal, or both of them, liable.
- **Consequence of inducing agent or principal to act on belief that principal or agent will be held exclusively liable-** the agent only will be held liable, he cannot afterwards hold liable the agent or principal respectively.

Examples

S bought a ticket of IPL match at Wankehde Stadium through AB for himself because on personal grounds Stadium management would not have issued the ticket to S. Stadium management may repudiate the contract and refuse S to enter the stadium.

A, who owes 50,000 rupees to B, sells 1,00,000 rupees worth of rice to B. A is acting as agent for C in the transaction, but B has no knowledge nor reasonable ground of suspicion that such is the case. C cannot compel B to take the rice without allowing him to set off A's debt.

A enters into a contract with B to sell him 100 bales of cotton, and afterwards discovers that B was acting as agent for C. A may sue either B or C, or both, for the price of the cotton.

Exceptions:

In the following cases, the agent is presumed to have agreed to be personally bound

- Where the contract is made by an agent for the sale or purchase of goods for a **merchant resident abroad/ foreign principal**
- Where the agent **does not disclose the name of his principal or undisclosed principal**
- **Non-existent or incompetent principal**
- **Pretended agent**
- **When agent exceeds authority**

18. Termination of agency [Section 201]

Termination of agency - putting an end to the legal relationship between principal and agent

Modes of termination:

- Revocation
- Renunciation by agents
- Completion of business
- Death of Principal or the agent
- Principal or agent becoming of unsound mind
- Insolvency of principal
- Expiry of time

Example: 1. Amit authorizes Bhim to buy 1,000 bales of cotton on account of Amit, and to pay for it out of A's money remaining in B's hands. B buys 1,000 bales of cotton in his own name, so as to make himself personally liable for the price. A cannot revoke B's authority so far as regards payment for the cotton.

2. A empowers B to let out A's house. Afterwards A lets it himself. This is an implied revocation of B's authority.

When the agency is irrevocable [Section 202]

where the agent has himself an interest in the property

which forms the subject matter of the agency,

the agency cannot, be terminated to the prejudice of such interest

Unless there is an express contract for the revocation

Example: Arun gives authority to Bharti to sell Arun's land, and to pay himself, out of the proceeds, the debts due to him from Arun. Arun cannot revoke this authority, nor can it be terminated by his insanity or death.

Effects of Termination [Section 208]

The termination of the authority

so far as regards the agent,

so far as regards third persons,

of an agent does not-

take effect before it becomes known to him, or

before it becomes known to them.

Example: 1. Asim directs Biharilal to sell goods for him. Asim agrees to give Biharilal 5% commission on the price fetched by the goods. Asim afterwards, by letter, revokes his authority. Biharilal, after the letter is sent, but before he receives it sells the goods for ₹1,00,000. The sale is binding on Asim, and Biharilal is entitled to ₹5,000 as his commission.

2. Asim directs Biharilal, his agent, to pay certain money to Chamanlal. Asim dies, and Mr. Dhanush takes out probate to his will. Biharilal, after Asim's death, but before hearing of it, pays the money to Chamanlal. The payment is good as against Dhanush, the executor.

Agent's duty on termination of agency by principal's death or insanity [Section 209]

When an agency is terminated-

by the principal dying, or

becoming of unsound mind,

the agent is bound to take, on behalf of the representatives of his late principal,

all reasonable steps for the protection and preservation of the interests entrusted to him.

Termination of sub-agent's authority [Section 210]

termination of the authority of an agent

causes the termination of the authority of all sub-agents appointed by him

subject to the rules regarding the termination of an agent's authority

In this capsule on Intermediate, Paper 2: Corporate and Other Laws, an attempt has been made to capture the significant Rules related to Interpretation/ Construction of Statutes. You are advised to read the September 2021 edition of the Study Material for detailed knowledge and understanding of the said topic. This capsule is intended to assist you in the process of revision of concepts discussed in the Study Material.

CHAPTER 4 - INTERPRETATION OF STATUTES

I. CHAPTER OVERVIEW

Interpretation of statutes, deeds and documents
- Introduction of relevant terms
- Importance of interpretation of statutes
- Rules of Interpretation
  - Primary Rules
  - Secondary Rules
- Aids to interpretation
  - Internal aids
  - External aids

II. BASIC TERMS

1. Statute

Written law, as against unwritten law

- laws and regulations of various kinds irrespective of the source from which they emanate

- Enacted law i.e. the law either enacted by the Parliament or by the State Legislature

2. Document

A paper or other material thing giving information, proof or evidence of anything

The Indian Evidence Act, 1872
- any matter expressed or described upon any substance by means of letters, figures or marks or by more than one of those means,
- intended to be used, or which may be used, for the purpose of recording that matter

The General Clauses Act, 1897
- include any matter written, expressed or described upon any substance by means of letters, figures or marks, or by more than one of those means
- intended to be used, or which may be used, for the purpose of recording this matter

Elements of Documents

Matter
- Its usage with the word "any" shows that the definition of document is comprehensive.

Record
- It must be certain mutual or mechanical device employed on the substance.
- It must be by writing, expression or description.

Substance
- Mental or intellectual elements comes to find a permanent form.

Means
- A permanent form is acquired and those can be letters, any figures, marks, symbols which can be used to communicate between two persons.

3. Instrument

Formal legal document which creates or confirms a right or records a fact

Instrument	• formal writing of any kind • having legal effect, either as creating a right or liability or as affording evidence of it
The Indian Stamp Act, 1899	• 'instrument' includes every document by which any right or liability is or purports to be created, transferred, extended, extinguished or recorded
Example	• an agreement, deed, charter or record, drawn up and executed in a technical form

4. Deed

an instrument in writing (or other legible representation or words on parchment or paper) purporting to effect some legal disposition

- In India- no distinction is made between instruments and deeds
- deeds are instruments though all instruments may not be deeds

5. Interpretation

process by which the Courts seek to ascertain the meaning of the legislature through the medium of the words in which it is expressed

Need for interpretation

- process by which the real meaning of an Act (or a document) and the intention of the legislature in enacting it is ascertained
- to resolve any ambiguity in the statute.
- It is the art of finding out the true sense of words -sense in which their author intended to convey the subject matter.

Importance of interpretation

- Interpretation serves as the bridge of understanding between the process of statute making and the process of interpretation of statutes

Classification of Interpretation:

General Classification of Interpretation

- **Legal**
  - Authentic: when rule of interpretation is derived from the legislator himself
  - Usual: when rule of interpretation is derived from some other source such as custom or case law
- **Doctrinal**
  - Grammatical: when the court applies only the ordinary rules of speech
  - Logical: when the court goes beyond the words and tries to discover the intention of the statute in some other way

III. HOW TO INTERPRET LAW APPLYING THE RULES OF INTERPRETATIONS

When a question arises as to what interpretation to be placed on an enactment, what the court has to do is to ascertain 'the intent of them that make it' and that must be gathered from—

- Literal Rule- The words actually used in the statute, in their grammatical and ordinary sense
- Golden Rule- The modified words if the ordinary and grammatical use leads to obscurity or inconsistency
- Mischief Rule- The history of the legislation, purpose thereof, the mischief it intended to suppress
- Internal aids to Construction- The definitions, exceptions, explanations, fictions, deeming provisions, headings, marginal notes, preamble, provisos, punctuations, saving clause, non obstante clause, etc.
- External aids to Construction- Parliamentary debates, reports of the Committees and Commissions, etc.

These rules are only aids to ascertain what the Parliament meant by using the language of the statute.

IV. RULES OF INTERPRETATION/CONSTRUCTION

Primary Rules

- Rule of Literal Construction
- Rule of Reasonable Construction
- Rule of Harmonious Construction
- The Rule in Heydon's Case or Mischief Rule
- Rule of Beneficial Construction
- Rule of Exceptional Construction
- Rule of Ejusdem Generis

Secondary Rules

- Doctrine of *Noscitur a Sociis*
- Doctrine of *Contemporanea Expositio*

1. Rule of Literal Construction

a statute must be construed literally and grammatically giving the words their ordinary and natural meaning

interpret the words used in legislation according to their ordinary grammatical meaning in the absence of any ambiguity or doubt

where the words of a statute are in themselves clear and unambiguous, then these words should be construed in their natural and ordinary sense and it is not open to the court to adopt any other hypothetical construction

This Rule of literal interpretation can be read and understood under the following headings:

Natural and grammatical meaning

- Statutes are to be understood in their natural, ordinary, or popular sense
- Must be construed according to their plain, literal and grammatical meaning.
- If there is an inconsistency with any express intention or declared purpose of the statute, or it involves any absurdity, repugnancy, inconsistency, the grammatical sense must then be modified, extended or abridged only to avoid such an inconvenience, but no further.

Technical words are to be understood in technical sense

- technical words are understood in the technical sense only

2. Rule of Reasonable Construction

words of statute must be construed so as to lead to a sensible meaning or to avoid absurdity

If a statute is having two interpretations, where one is completely vague and absurd and other is perfectly making sense then that meaningful interpretation should be used

Interpretation, which furthers the object, can be preferred to that which is likely to defeat or impair the policy or object.

Golden Rule of Interpretation

- When the grammatical interpretation leads to absurdity then the courts shall interpret the statute so as to resolve the inconsistency and make the enactment a consistent whole.
- This departure from the grammatical construction is permissible only to the extent it avoids such absurdity and no further.

3. Rule of Harmonious Construction

expressions used in a statute should ordinarily be understood in a sense in which they best harmonize with the object of the statute or to avoid absurdity

This Rule is used when there is a conflict between two or more statutes or between two provisions of the same statute

The provisions of a statute should be construed to give them the most effect and to make justice to the situation at hand

The statute must be read as a whole and every provision in the statute must be construed with reference to the context and other clauses in the statute so as to make the statute a consistent enactment and not reduce it to a futility

But where it is not possible to give effect to both the provisions harmoniously, conflict may be avoided by holding that one section which is in conflict with another merely provides for an exception or a specific rule different from the general rule contained in the other

In some cases, the statute may give a clear indication as to which provision is subservient and which overrides.
This is done by the use of the terms “subject to”, “notwithstanding” and “without prejudice”

4. The Rule in Heydon's Case or Mischief Rule

To make such construction as shall suppress the mischief and advance the remedy according to the true intention of the legislation.

Where the language used in a statute is capable of more than one interpretation

Mischief rule can be applied only if there is any ambiguity in the present law

Points to be considered while interpreting statute through this Rule

1. What was the law before the making of the Act?
2. What was the defect, mischief, hardship caused by the earlier law?
3. How does the Act of Parliament seek to resolve or cure the mischief or deficiency?
4. What are the true reasons for the remedy?

5. Rule of Beneficial Construction

Give the widest meaning to the statute in order to protect the interest of the parties

Whenever there is an ambiguity or when the interpretation would take the benefit away from effected parties, an interpretation that would benefit the parties should be adopted.

In such cases it is permissible to give an extended meaning to words or clauses in enactments.

This method can only be used when two constructions are reasonably possible and not when the words in a statute are quite clear.

This Rule ought to be used to interpret the provisions that were brought into effect for improving the conditions of certain classes of people who are under privileged or who have not been treated fairly in the past.

6. Rule of Exceptional Construction

The rule of exceptional construction stands for the elimination of statutes and words in a statute which defeat the real objective of the statute or make no sense.

The question as to whether a statute is mandatory depends upon the intent of the legislature and not upon the language in which the intent is clothed.

Majorly this Rule is used for the construction of words- 'and, or', 'may, must and shall.'

7. Rule of Ejusdem Generis

of the same kind or species

Specific words pertaining to a class or category or genus are followed by general words

the general words shall be construed as limited to the things of the same kind as those specified.

Rule of Ejusdem Generis Applies when-

- Statute contains an enumeration of specific words
- The subject of enumeration constitutes a class or category
- That class or category is not exhausted by the enumeration
- The general terms follow enumeration, and
- There is no indication of a different legislative intent

V. AIDS TO INTERPRETATION AND CONSTRUCTION

Where language of the statute is not clear

there is need to resort to aids of construction-

- such aids can be either-
  - internal or
  - external

VI. INTERNAL AIDS TO INTERPRETATION/ CONSTRUCTION

Internal aids to construction

- Long Title
- Preamble
- Heading
- Marginal Notes
- Definitional Sections
- Illustrations
- Proviso
- Explanation
- Schedules
- Saving clauses
- Non obstante clauses
- Read the Statute as a Whole

1. Long Title

An enactment would be known by a	Relevance of short titles	Relevance of Long Title
• 'Short Title' and • 'Long Title'	• merely identifies the enactment and • is chosen merely for convenience	• describes the enactment • is a part of the Act • referred to ascertain the object, scope and purpose of the Act

2. Preamble

Relevance

- expresses the scope, object and purpose of the Act comprehensively
- the Preamble of a Statute is a part of the enactment

Significance

- can legitimately be used for construing
- does not over-ride the plain provision of the Act
- Where, if the wording of the statute gives rise to doubts as to its proper construction, the Preamble can and ought to be referred to in order to arrive at the proper construction.

3. Heading and Title of a Chapter

Relevance

- Heading and Titles prefixed to sections/ groups of sections can legitimately be referred
  - for the purpose of construing the enactment / its parts
- The headings of different portions of a Statute can be referred-
  - to determine the sense of any doubtful expression in a section ranged under any particular heading

4. Marginal notes

Summaries and side notes often found at the side of a section / group of sections in an Act

They are not a part of the enactment

They were not present when the Act was passed in Parliament, but inserted after the Act has been so passed.

Relevance
- purporting to sum up the effect of that section or sections.

5. Definitional Sections/Interpretation Clauses

Meaning -When a word / phrase is defined as having a particular meaning in the enactment

- It is an **exhaustive definition**
  - it is that meaning alone which must be given to it in interpreting a Section of the Act
- **Purpose**
  - to provide a key to the proper interpretation of the enactment
  - to shorten the language of the enacting part by avoiding repetition of the same words contained in the definition part.
- **Types**
  - **Restrictive and extensive definitions**
    - definition of a word / expression in the definition section may restricting of its ordinary meaning or may be extensive of the same
  - **Ambiguous definitions**
    - sometimes the definition section may itself be ambiguous, and
    - so have to be interpreted in the light of other provisions of the Act
    - having regard to the ordinary meaning of the word defined.
    - Such type of definition is not to be read in isolation.
    - It must be read in the context of the phrase which it defines, to give accuracy and certainty to a word or phrase
  - **Definitions subject to a contrary context**
  - When a word is defined to bear a number of inclusive meanings
  - then the sense in which the word is used in a particular provision-
    - must be ascertained from the context of the scheme of the Act,
    - the language of the provision and
    - the object intended to be served thereby

6. Illustrations

Follow the text of the Sections	Do not form a part of the Sections.	Not all sections have illustrations appended to them
It cannot have the effect of modifying the language of the section	Neither can curtail nor expand the ambit of the section.	Relevance • Illustrations do form a part of the statute • considered to be of relevance and value in construing the text of the sections.

7. Proviso

Proviso is to except something out of the enactment or to qualify something stated in the enactment	Effect	As a general rule
• which would be within its purview if the proviso were not there. • Usually, a proviso is embedded in the main body of the section and becomes an integral part of it	• to qualify the preceding enactment which is expressed in terms which are too general.	• a proviso is added to an enactment to qualify or create an exception to what is in the enactment

8. Difference with related terms

Distinction between Proviso, exception and saving Clause		
'Exception' is intended to restrain the enacting clause to particular cases	'Proviso' is used to remove special cases from general enactment and provide for them specially	'Saving clause' is used to preserve from destruction certain rights, remedies or privileges already existing

9. Explanation

Appended to a section to explain the meaning of certain words or phrases used in the section or of the purport of the section.

Relevance

- An Explanation may be added to include something within the section or to exclude something from it.
- Normally be so read as to harmonise with and clear up any ambiguity in the main section.
- It should not be so construed as to widen the ambit of the section

10. Schedules

Form part of an Act

They must be read together with the Act for all purposes of construction

Relevance
- If there appears any inconsistency between the schedule and the enactment, the enactment shall always prevail.

They often contain details and forms for working out the policy underlying the sections of the statute

11. Read the Statute as a Whole

Elementary principle
- Construction of a statute is to be made of all its parts taken together and not of one part only.

Relevance
- Must be read as a whole in order to ascertain the true meaning of its several clauses, and the words of each clause should be so interpreted as to bring them into harmony with other provisions

VII. EXTERNAL AIDS TO INTERPRETATION/ CONSTRUCTION

External Aids					
Historical Setting	Consolidating Statutes & Previous Law	Usage	Earlier & Later Acts and Analogous Acts	Dictionary Definitions	Use of Foreign Decisions

1. Historical Setting

History of the external circumstances which led to the enactment	• is of much significance in construing any enactment
Purpose	• necessary in the understanding and comprehension of the subject matter and the scope and object of the enactment. • History in general (Parliamentary History in particular), ancient statutes, contemporary or other authentic works and writings are helpful in interpreting and construing an Act

2. Consolidating Statutes & Previous Law

- The Preambles to many statutes contain expressions such as "An Act to consolidate" the previous law, etc. In such a case, the Courts may stick to the presumption that it is not intended to alter the law.
- They may solve doubtful points in the statute with the aid of such presumption in intention, rejecting the literal construction

3. Usage

Relevance
- Where the meaning of the language in a statute is doubtful, usage helps in how that language has been interpreted and acted upon over a long period
- May determine its true meaning.
- When a legislative measure of doubtful meaning has, for several years, received an interpretation which has generally been acted upon by the public,
  - the Courts should be very unwilling to change that interpretation,
  - unless they see cogent reasons for doing so

4. Earlier & Later Acts and Analogous Acts

Reference to Analogous Act:
- Different statutes (that are in similar nature), may shall be construed together as one system and as explanatory of each other
- They can be used even though they may be made at different times, or may have repealed and may not referring to each other

5. Dictionary Definitions

- **First** refer to the Act in question to find out if any particular word or expression is defined in it.
- If word is **not defined in the Act** itself, **refer dictionaries** to find out the general sense in which that word is commonly understood
- In selecting one out of the several meanings of a word, always consider the context in which it is used in the Act
- For technical terms refer **technical dictionaries**
- **judicial decisions** laying down the meaning of words will have greater weight than the meaning furnished by dictionaries

6. Use of Foreign Decisions

- Foreign decisions of countries following the **same system of jurisprudence** as ours and given on laws similar to ours, can be used for interpretation
- Prime importance is always to be given to the language of the Indian statute

VIII. MAJOR LATIN MAXIMS

Rule of Literal Construction
absoluta sententia expositore non indiget

- an absolute sentence or preposition needs not an expositor
- plain words require no explanation

Rule of Reasonable Construction and **Rule of Exceptional Construction**
ut res magis valeat quam pereat

- words of statute must be construed so as to lead to a sensible meaning

Rule of Reasonable Construction
Interpretatio fienda est ut res magis valeat quam pereat

- words of a statute must be construed reasonably so as to give effect to the enactment rather than reduce it to a futility

Rule of Harmonious Construction
generalia specialibus non derogant

- A specific rule will override a general rule.

Doctrine of Noscitur a Sociis
Noscitur a Sociis

- Meaning of doubtful word may be ascertained by reference to word associated with it

Doctrine of Contemporanea Expositio
Contemporanea Expositio est optima et fortissinia in lege

- law should be understood in the sense in which it was understood at the time when it was passed

Doctrine of Contemporanea Expositio
optima legum interpres est consuetude

- Custom is the best interpreter of law

***Non-obstante* clause**

- notwithstanding anything contained

Earlier Act Explained by the Later Act
pari materia

- in a similar case

Cost and Management Accounting - A Capsule for Quick Revision

In contemporary business environment, existence of an entity depends on the way it tackles the challenges posed by the competitive market conditions. Cost leadership being one of the competitive strategies, gives an added advantage to the entity. Cost being an important aspect for survival and growth in business, requires a mandatory awareness about the cost control and cost reduction. Fourth industrial revolution, also known as Industry 4.0, puts more emphasis on the digitization of information for effective decision-making, which enables an entity in keeping ahead in competition. Cost and Management accounting, a discipline of accounting, capacitates an entity in taking timely decisions by provisions of cost, profitability and other relevant information.

Chartered Accountants, as a global business solution provider, play an important role in business, have an onus by helping an entity to achieve its long-term objectives. In this direction, Cost and Management Accounting helps Chartered Accountants in taking timely and informed business decisions. In view of nobility of the objective to provide quality academic inputs to the students of CA course, the Board of Studies (BoS) of ICAI has decided to bring forth a capsule module of Cost and Management Accounting. Although, the capsule has been prepared keeping in view the new and revised Scheme of Education and Training of ICAI, the students of earlier Scheme may also be benefitted from it.

In the beginning, a chapter overview has been provided to present a holistic viewpoint on the topic's coverage. This capsule, though, facilitates the students in undergoing quick revision, under no circumstances; such revisions can substitute the detailed study of the material provided by the BoS.

Remember, "The expert in anything was once a beginner". Now, let us begin.

Introduction to Cost and Management Accounting

Chapter Overview

Objectives of Cost and Management Accounting → Scope of Cost and Management Accounting → Role & Functions of Cost and Management Accounting → Users of Cost and Management Accounting → Relationship of Cost and Management Accounting with other accounting disciplines → Cost Accounting using IT → Cost Object → Responsibility Centres → Cost Classification

Meaning of Terms used in Cost and Management Accounting

First of all, let us discuss the meaning of various terminologies used in Cost and Management Accounting to have a clear understanding about the subject.

Cost	Costing	Cost Accounting	Cost Accountancy	Management Accounting	Cost Management
The amount of expenditure incurred on or attributable to a specified article, product or activity.	Costing is defined as the technique and process of ascertaining costs.	It is the process of accounting for cost.	Cost Accountancy has been defined as the application of costing and cost accounting principles, methods and techniques.	Management accounting is the application of the principles of accounting and financial management.	It is an application of management accounting concepts, methods of collections, analysis and presentation of data.

Objectives of Cost Accounting

There are many objectives of cost accounting. The main objectives are explained as below. We also need to keep our focus on understanding the difference between Cost Control and Cost Reduction.

Objectives of Cost Accounting

- **Ascertainment of Cost:** The main objective of cost and management accounting is accumulation and ascertainment of cost. Costs are accumulated, assigned and ascertained for each cost object.
- **Determination of Selling Price and Profitability:** The cost and management accounting system helps in determination of selling price and thus profitability of a cost object.
- **Cost Control:** Maintaining discipline in expenditure is one of the main objectives of a good cost and management accounting system. It ensures that expenditures are in consonance with predetermined set standard and any variation from these set standards is noted and reported on continuous basis.
- **Cost Reduction:** It may be defined "as the achievement of real and permanent reduction in the unit cost of goods manufactured or services rendered without impairing their suitability for the use intended or diminution in the quality of the product."
- **Assisting management in decision making:** Cost and Management accounting by providing relevant information, assist management in planning, implementing, measuring, controlling and evaluation of various activities.

Scope of Cost Accounting

We also need to know various scopes of cost accounting. Cost ascertainment and the process of cost accounting are the major scopes. The other scopes are presented.

Role and Functions of Cost and Management Accounting

Role of a Cost and Management Accounting system

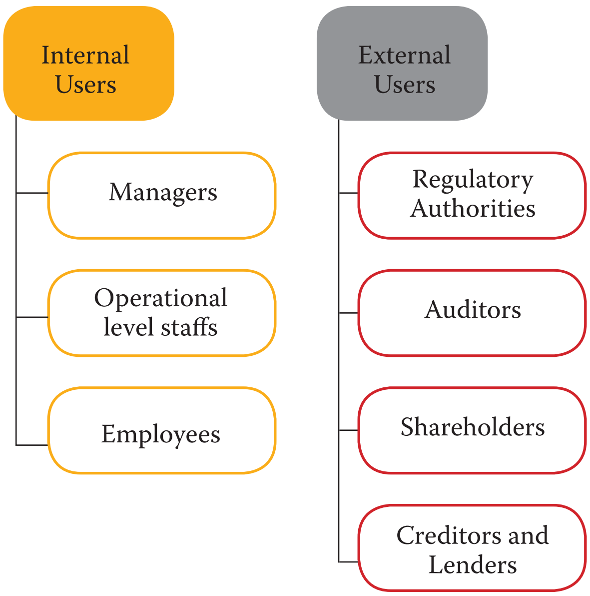
- Provide relevant information to management for decision making
- Assist management for planning, measurement, evaluation and controlling of business activities
- Help in allocation of cost to products and inventories for both external and internal users.

Functions of Cost and Management Accounting System

- Collection and accumulation of cost for each element of cost
- Assigning costs to cost objects to ascertain cost.
- Sets budget and standards for a particular period or activity beforehand and these are compared with the assigned and ascertained cost.
- Provision of relevant information to the management for decision making.
- To gather data like time taken, wastages, process idleness etc., analyse the data, prepare reports and take necessary actions

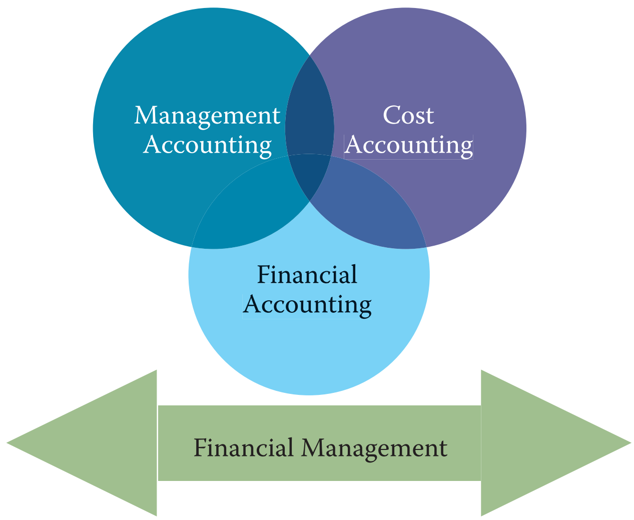
Users of Cost and Management Accounting

Cost and Management Accounting information which are generated or collected are used by various stakeholders. The users of the information can be broadly categorized as below:



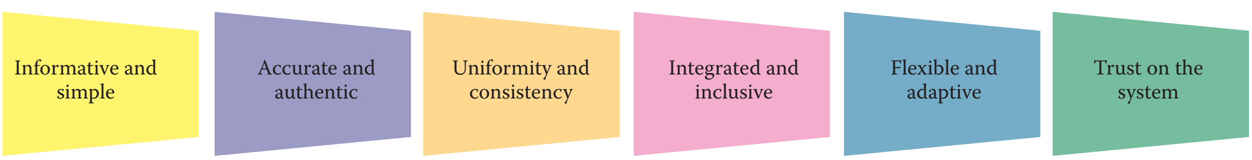
Relationship of Cost Accounting, Management Accounting, Financial Accounting and Financial Management

There is a close relationship between various disciplines like Cost Accounting, Management Accounting, Financial Accounting and Financial Management. Sometimes these disciplines are interrelated and dependent on each other also.



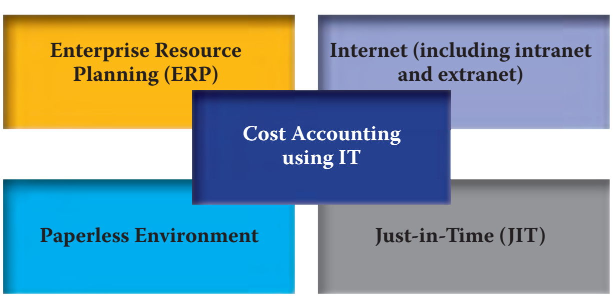
Essentials of a good Cost Accounting System

The essential features which a cost accounting system should possess are depicted as below:



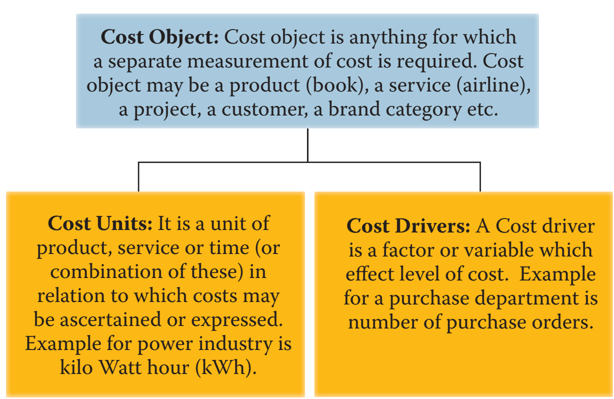
Cost Accounting using Information Technology

With the use of information technology, the cost accounting system gets integrated and automated. The basic features are depicted as below:



Cost Objects

It is very important to understand the meaning of cost object, cost unit and cost driver. Their meaning alongwith examples are illustrated below.



Responsibility Centres

To have a better control over the organisation, management delegates its responsibilities and authorities to various departments or persons, which are known as responsibility centres. There are four types of responsibility centres as discussed below:

Responsibility Centres

- **Cost Centres:** The responsibility centre which is held accountable for incurrence of costs which are under its control.
  - **Standard Cost Centre:** Cost Centre where output is measurable and input required for the output can be specified.
  - **Discretionary Cost Centre:** The cost centre whose output cannot be measured in financial terms.
- **Revenue Centres:** Which are accountable for generation of revenue for the entity. Example- Sales Department.
- **Profit Centres:** Which have both responsibility of generation of revenue and incurrence of expenditures. Example- Decentralised branches of an organisation.
- **Investment Centres:** Which are not only responsible for profitability but also has the authority to make capital investment decisions. Example- Maharatna, Navratna and Miniratna.

Classification of Cost

Classification of cost basically means grouping of cost according to their common features. The important ways of classification of cost are illustrated as below:

Classification of Cost

- By Nature or Element
- By Functions
- By Variability or Behaviour
- By Controllability
- By Normality
- By Costs for Managerial Decision Making

(i) By Nature or Element

ELEMENTS OF COST

- Material Cost
  - Direct Material Cost
  - Indirect Material Cost
- Labour Cost
  - Direct Labour Cost
  - Indirect Labour Cost
- Other Expenses
  - Direct Expenses
  - Indirect Expenses

Indirect Material Cost + Indirect Labour Cost + Indirect Expenses → **Overheads**

- Production Overheads
- Administration Overheads
- Selling and Distribution Overheads

(ii) By Functions

Elements		Classification
Direct Materials Direct Employees (Labours) Direct Expenses		**Prime Cost**
Indirect Material Indirect Labour Indirect Expenses	Factory Overheads	**Factory Cost or Works Cost**
	Administration Overheads	**Cost of Goods Sold**
	Selling and Distribution Overheads	**Cost of Sales**

(iii) By Variability or Behaviour

Fixed Cost | Variable Cost | Semi-variable Cost

(iv) By Controllability

Controllable Costs: Cost that can be controlled

Uncontrollable Costs: Costs which cannot be influenced or controlled

(v) By Normality

Normal Cost - It is the cost which is normally incurred

Abnormal Cost - It is the cost which is not normally incurred

(vi) By Cost for Managerial Decision Making

(a) **Pre determined Cost** – A cost which is computed in advance before production or operations start

(b) **Standard Cost** – A pre-determined cost, which is calculated from managements 'expected standard of efficient operation' and the relevant necessary expenditure

(c) **Marginal Cost** – The amount at any given volume of output by which aggregate costs are changed if the volume of output is increased or decreased by one unit

(d) **Estimated Cost** – The expected cost of manufacture, or acquisition, often in terms of a unit of product computed on the basis of information available in advance of actual production or purchase

(e) **Differential Cost** – It represents the change (increase or decrease) in total cost (variable as well as fixed) due to change in activity level, technology, process or method of production, etc.

(f) **Imputed Costs** – These costs are notional costs which do not involve any cash outlay

(g) **Capitalised Costs** – These are costs which are initially recorded as assets and subsequently treated as expenses.

(h) **Product Costs** – These are the costs which are associated with the purchase and sale of goods (in the case of merchandise inventory).

(i) **Opportunity Cost** – This cost refers to the value of sacrifice made or benefit of opportunity foregone in accepting an alternative course of action

(j) **Out-of-pocket Cost** – It is that portion of total cost, which involves cash outflow

(k) **Shut down Costs** – Those costs, which continue to be incurred even when a plant is temporarily shut-down e.g. rent, rates, depreciation, etc

(l) **Sunk Costs** – Historical costs incurred in the past are known as sunk costs. They play no role in decision making in the current period.

(m) **Absolute Cost** – These costs refer to the cost of any product, process or unit in its totality.

(n) **Discretionary Costs** – Such costs are not tied to a clear cause and effect relationship between inputs and outputs.

(o) **Period Costs** – These are the costs, which are not assigned to the products but are charged as expenses against the revenue of the period in which they are incurred.

(p) **Engineered Costs** – These are costs that result specifically from a clear cause and effect relationship between inputs and outputs.

(q) **Explicit Costs** – These costs are also known as out of pocket costs and refer to costs involving immediate payment of cash. Salaries, wages, postage and telegram, printing and stationery, interest on loan etc.

(r) **Implicit Costs** – These costs do not involve any immediate cash payment.

Material Cost

Chapter Overview

Material Procurement:
- Bill of Materials
- Material Requisition Note
- Purchase Requisition
- Goods Received Note
- Material Returned Note etc.

Valuation of Materials Received

Material Storage & Records:
- Bin Cards
- Stores Ledger
- Stock Control Cards etc.

Inventory Control:
- Setting of various stock levels
- Economic Order Quantity (EOQ)
- Techniques of Inventory Control etc.

Valuation of Material Issues:
- Cost Price methods (FIFO, LIFO etc)
- Average Price methods
- Market Price methods
- Notional Price methods

Accounting & Control of:
- Waste, Scrap, Spoilage, Defectives etc.

Consumption of Materials

Value at Which Materials are Recorded in Stores Ledger

From the following table we can understand the procedure of calculating total value at which materials are to be recorded in stores ledger.

Particulars	Amount	Amount
Purchase Price		XXX
Additions/ Inclusions:		
Insurance charges	XXX	
Commission or brokerage	XXX	
Freight inward	XXX	
Cost of containers	XXX	
Wastage due to normal reasons	XXX	
Duties and Taxes for which no credit or refund is available	XXX	XXX
Deduction/ Exclusions:		
Discount, Rebate and Subsidy	XXX	
Duties and Taxes for which credit or refund is available	XXX	
Penalties and charges	XXX	
Other expenses not borne	XXX	(XXX)
		XXX

How Material is Procured?

Material requirement procedure can be understood with the help of the following diagram. We should focus on various documents in general required and also should keep in mind the departments who initiate these documents.

Bill of Materials- It is the basic document which is prepared by experts specifying the quality and quantity of materials required to make final goods.

Material Requisition Note- It is prepared by the department which require materials for processing.

Purchase Requisition Note- It is the document which authorise purchase department to purchase the requisitioned materials. Based on this document the purchase department invites proposals or quotations from the vendors.

Purchase Order- After selection of vendor for the materials, the purchase department initiates purchase order for the required quality and quantity.

Goods Received Note (GRN)- This document is evidence of the receipt of goods from the vendor.

Material Returned Note- This document is prepared when all or any materials are returned back to vendor.

Invoice- This is the bill charged by vendor for the materials. Invoice also shows the duties and taxes to be paid for the purchase of materials. The invoice is the basis for valuation of material in store ledger and books of account.

How Inventory is Controlled?

Inventory control is the function of ensuring that sufficient inventory is retained to meet all requirements. In inventory control, it is essential to balance between overstock and understock. Various techniques of inventory control are illustrated below:

Inventory Control
- By Setting Quantitative Levels
- On the basis of Relative Classification
- Using Ratio Analysis
- Physical Control

(a) Inventory Control- By Setting Quantitative Levels

Re-order Stock Level	When to Order
Re-order Quantiy/ EOQ	How Much to Order
Maximum Stock Level	Upto How much to stock
Minimum Stock Level	Atleast How much to keep
Average Stock Level	Stock normally kept
Danger Stock Level	Kept for emergency requirement
Buffer Stock	To meet sudden demand

(i) Re-order Stock Level (ROL): Maximum Consumption × Maximum Re-order Period
Or, ROL = Minimum Stock Level + (Average Rate of Consumption × Average Re-order period)

(ii) Re-Order Quantity/ Economic Order Quantity (EOQ):

$$EOQ = \sqrt{\frac{2x \text{ Annual Requirement (A) x Cost per order (O)}}{\text{Carrying Cost per unit per annum (C)}}}$$

Just in Time (JIT) Inventory Management

JIT is a system of inventory management with an approach to have a zero inventories in stores. According to this approach material should only be purchased when it is actually required for production.

Demand for final product → Production starts to process the demand for product → Material Requirement is sent to Purchase department → Order for raw materials sent to supplier → Supplier sent the material for production

(iii) Minimum Stock Level:
Minimum Stock Level = Re-order Stock Level - (Average Consumption Rate × Average Re-order Period)

(iv) Maximum Stock Level:
Maximum Stock Level = Re-order Level + Re-order Quantity - (Minimum Consumption Rate × Minimum Re-order Period)

(v) Average Inventory Level:
Average Stock Level = Minimum Stock Level + 1/2 Re-order Quantity
Or
Average Stock Level =

$$\frac{\text{Maximum Stock Level + Minimum Stock Level}}{2}$$

(b) On the basis of Relative Classification

ABC Analysis	On the basis of value and frequency of inventory
Fast, Slow and Non Moving (FSN)	On the basis of inventory turnover
Vital, Essential and Desirable (VED)	On the basis of importance of inventory
High, Medium and Low (HML)	On the basis of price of an item of inventory

(c) Using Ratio Analysis

(i) Input Output Ratio: Input-output ratio is the ratio of the quantity of input of material to production and the standard material content of the actual output.

(ii) Inventory Turnover Ratio:
Inventory Turnover Ratio =

$$\frac{\text{Cost of materials consumed during the period}}{\text{Cost of average stock held during the period}}$$

(d) Physical Control

(i) Two Bin System: Two Bin System is supplemental to the record of respective quantities on the bin card and the stores ledger card.

(ii) Establishment of system of budgets: Based on this, inventories requirement budget can be prepared. Such a budget will discourage the unnecessary investment in inventories.

(iii) Perpetual inventory records and continuous stock verification :
Perpetual inventory represents a system of records maintained by the stores department in the form of Bin cards and Stores ledger.

(iv) Continuous Stock Verification:
The system of continuous stock-taking consists of physical verification of items of inventory.

Valuation of Material Issue

Cost Price Methods
- Specific Price Method
- First-in First-out (FIFO) method
- Last-in-First-out (LIFO) method
- Base Stock Method

Average Price Methods
- Simple Average Price Method
- Weighted Average Price Method

Market Price Methods
- Replacement Price Method
- Realisable Price Method

Notional Price Methods
- Standard Price Method
- Inflated Price Method
- Re-use Price Method

Some of the techniques are discussed as follows:

(i) First-in First-out method (FIFO): The materials received first are to be issued first when material requisition is received. Materials left as closing stock will be at the price of latest purchases.

(ii) Last-in First-out method (LIFO): The materials purchased last are to be issued first when material requisition is received. Closing stock is valued at the oldest stock price.

(Accounting Standard- 2 and Ind AS-2 do not allow LIFO method for inventory valuation, however, for academic knowledge it may be studied).

(iii) Simple Average Method: Material Issue Price=

$$\frac{\text{Total of unit price of each purchase}}{\text{Total Nos of Purchases}}$$

(iv) Weighted Average Price Method: This method gives due weightage to quantities purchased and the purchase price to determine the issue price.

Weighted Average Price =

$$\frac{\text{Total cost of materials in stock}}{\text{Total quantity of materials}}$$

Normal and Abnormal Loss of Materials

Loss of Material

- **Waste:** Portion of basic raw material lost in processing having no recoverable value
- **Scrap:** The incidental material residue coming out of certain manufacturing operations having low recoverable value.
- **Spoilage:** Goods damaged beyond rectification to be sold without further processing.
- **Defectives:** Goods which can be rectified and turned out as good units by the application of additional labour or other services.
- **Obsolescence:** It is the loss in the intrinsic value of an asset due to its supersession.

Treatment of Loss of Material

(i) Treatment of Waste

Normal- Cost of normal waste is absorbed by good production units.

Abnormal- The cost of abnormal loss is transferred to Costing Profit and loss account.

(ii) Treatment of Scrap

Normal- The cost of scrap is borne by good units and income arises on account realisable value is deducted from the cost.

Abnormal- The scrap account should be charged with full cost. The credit is given to the job or process concerned. The profit or loss in the scrap account, on realisation, will be transferred to the Costing Profit and Loss Account.

(iii) Treatment of Spoilage

Normal- Normal spoilage (i.e., which is inherent in the operation) costs are included in costs either charging the loss due to spoilage to the production order or by charging it to production overhead so that it is spread over all products.

Abnormal- The cost of abnormal spoilage (i.e., arising out of causes not inherent in manufacturing process) is charged to the Costing Profit and Loss Account.

(iv) Treatment of Defectives:

Normal- The cost less realisable value on sale of defectives are charged to material cost of good production.

Abnormal- The material cost of abnormal loss is transferred to costing profit and loss account.

(v) Treatment of Obsolescence:

The value of the obsolete material held in stock is a total loss and immediate steps should be taken to dispose it off at the best available price. The loss arising out of obsolete materials on abnormal loss does not form part of the cost of manufacture.

CA INTERMEDIATE - PAPER 3 - COST AND MANAGEMENT ACCOUNTING

In today's business world, Chartered Accountants are very much part of the decision-making team of any organisation. They are rigorously involved in decision-making process with the help of Cost and Management Accounting tools. While being associated with an industry, a Chartered Accountant may also be involved in monitoring, measuring, compensating appropriately to the employees (labour) to achieve economy in cost as well as retain best talent, efficiency in performance and effectiveness in desired output, side by side ascertaining cost for a cost object through elementwise collection of cost, accumulation of the costs into a cost sheet. While this edition of Cost & Management Accounting (CMA) Capsule discusses the topic 'Employee (Labour) Cost' covering Wages and Incentive Payment system to employees, its absorption; efficiency rating procedures; treatment of overtime, idle time; Employee Turnover along with topic 'Cost Sheet' covering its classification, format and advantages, students are advised to thoroughly go through the same to meticulously understand the concepts before attempting questions.

EMPLOYEE (LABOUR) COST

Points of Discussion

- Meaning of Employee (Labour) Cost
- Control of Employee Cost
- Attendance & Payroll Procedures
- Idle Time
- Overtime
- Wage and Incentives Payment System
- Absorption of Wages
- Efficiency Rating Procedures
- Employee (Labour) Turnover

Meaning of Employee (Labour) Cost

EMPLOYEE (LABOUR) COST

- Benefits paid or payable to the employees of an entity, whether permanent, or temporary for the services rendered by them.
- Includes payments made in cash or kind.

Employee cost includes

- Wages and salary
- Allowances and incentives
- Payment for overtimes
- Employer's contribution to PF and other welfare funds;
- Other benefits (leave with pay, free or subsidised food, leave travel concession etc.)

Classification of Employee cost:

- **Direct employee cost**
- **Indirect employee cost**

Direct employee cost	Indirect employee cost
1. **Cost of employees, directly engaged in the production process.**	1. Cost of employees who are **not directly engaged** in the production process.
2. **Easily identifiable and allocable to cost unit.**	2. **Apportioned on** some **appropriate basis.**
3. **Varies with the volume of production and has positive relationship with the volume.**	3. May **not vary with the volume** of production.

Employee Cost Control

EMPLOYEE (LABOUR) COST CONTROL

- **To control over the cost incurred on employees.**
- **To keep the wages per unit of output as low as possible.**
- **To give the employees an appropriate compensation and encourage efficiency.**

Factors for the Control of Employee Cost:

- **Assessment of manpower requirements.**
- **Control over time-keeping and time-booking.**
- **Time and Motion Study.**
- **Control over idle time and overtime.**
- **Control over employee turnover.**
- **Wage and Incentive systems.**
- **Job Evaluation and Merit Rating.**
- **Employee productivity.**

Time-keeping: A record of total time spent by the employees in a factory.

Objectives of Time Keeping:

- (i) For the preparation of payrolls.
- (ii) For calculating overtime.
- (iii) For ascertaining employee cost.
- (iv) For controlling employee cost.
- (v) For ascertaining idle time.
- (vi) For disciplinary purposes.
- (vii) For overhead distribution.

Methods of Time-keeping

Methods of Time-keeping

- **Manual Methods**
  - Attendance Register method
  - Metal Disc/ Token method
- **Mechanical/ Automated Methods**
  - Punch Card Attendance
  - Biometric Attendance system

Time-Booking: A method wherein each activity of an employee is recorded.

Objectives of Time Booking:

- (i) To compute the cost of the job or activity.
- (ii) To measure efficiency.
- (iii) To analyse the variance in time with respect to the standard time.

For the collection of all such data, a separate record, generally known as Time (or Job) card, is kept.

Payroll Procedures of Employees

- Time -keeping Department → 1. Time and Attendance → Payroll Department
- Personnel/ HR Department → 2. Employee Details → Payroll Department
- Payroll Department → 3. Wage and Salary sheet → Cost/ Accounting Department
- Cost/ Accounting Department → 4. Payment after deductions and contributions → Employees
- Cost/ Accounting Department → 5. Deposit of deductions and contributions → Statutory Bodies

Step-1
- **Attendance and Time details:** *Detailed sheet of number of days or hours worked by each employee as reflected by the time keeping methods are sent to the payroll department.*

Step-2
- **List of employees and other details:** *List of employees on roll and the rate at which they will be paid is sent by the personnel/ HR department.*

Step-3
- **Computation of wages and other incentives:** *Payroll department prepares pay slip and forward the same to the cost/ accounting department.*

Step-4
- **Payment to the employees:** *After all deductions (like PF, ESI, TDS), wages/ salary is paid to the employees.*

Step-5
- **Deposit of all statutory liabilities:** *All statutory deduction are paid to the respective statutory bodies & funds.*

Idle Time

The time during which no production is carried-out because the worker remains idle but are paid.

Normal idle time | **Abnormal idle time**

Normal Idle Time: Time which cannot be avoided or reduced in the normal course of business.

Causes:

- *Time lost between factory gate and the place of work,*
- *Interval between one job and another,*
- *Setting up time for the machine,*
- *Normal rest time, break for lunch etc.*

Treatment of Normal Idle Time

- Treated as a **part of cost of production**.
- In the case of **direct workers** an allowance for normal idle time is considered while **setting of standard hours** or standard rate.
- In case of **indirect workers**, normal idle time is considered for the **computation of overhead rate.**

Abnormal Idle Time: Apart from normal idle time, there may be factors which give rise to abnormal idle time.

Causes:

- *Lack of coordination,*
- *Power failure, Breakdown of machines,*
- *Non-availability of raw materials,*
- *Strikes, lockouts, poor supervision, fire, flood etc.*

Causes further analysed into

Controllable abnormal idle time

Time which could have been put to productive use had the management been more alert and efficient.

Uncontrollable abnormal idle time

Time lost which management does not have any control e.g., breakdown of machines, flood etc.

Treatment of Abnormal Idle time

- **Not included in production cost.**
- Shown as a **separate item** in the **Costing Profit and Loss** Account.
- For each category i.e. **controllable and uncontrollable** idle time, the **break-up** of cost due to various factors should be **separately shown.**
- **Management** should aim at **eliminating controllable idle time.**

Overtime

Overtime: Work done beyond normal working hours.

Overtime Payment = Wages paid for overtime at normal rate + Premium (extra) payment for overtime work

Overtime premium: **Extra amount so paid over the normal rate**

CAUSES		TREATMENT
Urgency of work.	↔	**Charged to job directly.**
To make up shortfall in production due to some unexpected development.	↔	**Treated as overhead cost of the particular cost centre which works overtime.**
To make up shortfall in production due to some fault of management.	↔	**If overtime is worked in a department due to the fault of another department, then premium should be charged to the latter department.**
To take advantage of an expanding market or of rising demand.	↔	**Overtime worked on account of abnormal conditions such as flood, etc., should be charged to Costing P/L Account.**

Systems of Wage Payment and Incentives

System of Wages Payment

Time based	Output based	Combination of time and output based	Premium Bonus method	Group bonus scheme	Incentives for indirect workers

Time based (Time Rate System):

Workers are paid on time basis i.e. hour, day, week, or month.

Wages = Time Worked (Hours/ Days/ Months) × Rate for the time

Output Based (Piece Rate System):

Each operation, job or unit of production is termed a piece.
A rate of payment, is fixed for each piece.
The wages of the worker depend upon his output and rate of each unit of output.

Wages = Number of units produced × Rate per unit

Premium Bonus Method:

The worker is guaranteed his daily wages, if output is below and up to standard.
In case the task is completed in less than the standard time, the saved time is shared between the employees and the employer.

HALSEY PREMIUM PLAN

- **A standard time is fixed for each job or process**
- **Worker gets his time rate even if he exceeds the standard time limit, since his day rate is guaranteed.**
- **If job done in less than the standard time, bonus equal to 50 percent of the wages of time saved is paid.**

Wages = Time taken × Time rate + 50% of time saved × Time rate

ADVANTAGES of HALSEY PREMIUM PLAN

- **Time rate** is **guaranteed.**
- Opportunity for **increasing earnings** by increasing production.
- **System is equitable** in as much as the employer gets a **direct return** for his efforts in improving production methods.

DISADVANTAGES of HALSEY PREMIUM PLAN

- **Incentive** is **not so strong** as with piece rate system.
- **Harder the worker works,** the **lesser** he **gets** per piece.
- Sharing principle may **not be liked by employees.**

ROWAN PREMIUM PLAN

- Standard time allowance is fixed for performance of a job.
- Bonus is paid if time is saved.
- Bonus is that proportion of the time wages as time saved bears to the standard time.

$$\text{Time taken} \times \text{Rate per hour} + \frac{\text{Time Saved}}{\text{Time Allowed}} \times \text{Time taken} \times \text{Rate per hour}$$

ADVANTAGES of ROWAN PREMIUM PLAN	DISADVANTAGES of ROWAN PREMIUM PLAN
• A worker can **never double his earnings even if there is bad rate setting**. • Suitable for **encouraging moderately efficient workers**. • Sharing principle **appeals to the employer** as being equitable.	• System is a **bit complicated**. • Incentive is **weak at a high production level where the time saved is more than 50% of the time allowed**. • Sharing principle is **not generally welcomed by employees**.

Absorption of Wages

ELEMENTS OF WAGES

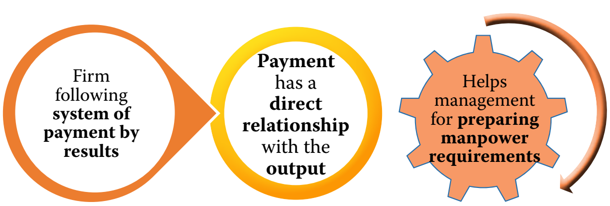
Monetary payment	Non-monetary benefits
• Basic wages, • Dearness allowance, • Overtime wages, • Production bonus, • Employer's contribution to PF, ESI and other funds, • Leave pay, etc.	• Medical facilities; • Educational and training facilities; • Recreational and sports facilities; • Housing and social welfare; and • Cost of subsidised canteen and co-operative societies, etc.

Efficiency Rating Procedures

If the time taken by a worker on a job ≤ the standard time, then he is rated efficient.

$$\text{Efficiency in \%} = \frac{\text{Time allowed as per standard}}{\text{Time Taken}} \times 100$$

Need for Efficiency rating:



Factors for increasing Employee productivity:

- **Employing** who possess **right type of skill.**
- Placing the **right** type of **person** to the **right job**.
- **Training** young and old workers by providing right types of opportunities.
- Taking appropriate measures to **avoid** the situation of **excess or shortage of employees.**
- Carrying **out work study for fixation of wages.**

Employee (Labour) Turnover

EMPLOYEE TURNOVER: **Rate of change in the composition of employee force during a specified period measured against a suitable index.**

Methods to calculate Employee Turnover

- **Replacement Method**: This considers actual replacement of employees irrespective of number of persons leaving the organisation
- **Separation Method**: This considers total number of employees separated
- **Flux Method**: This considers both the number of replacements as well as the number of separations

$$\textbf{Replacement method} = \frac{\text{Number of employees Replaced during the period}}{\text{Average number of employees during the period on roll}} \times 100$$

$$\textbf{Separation method} = \frac{\text{Number of employees Seperated during the period}}{\text{Average number of employees during the period on roll}} \times 100$$

$$\textbf{Flux method} = \frac{\text{Number of employees Seperated + Number of employees Replaced during the period}}{\text{Average number Of employees during the period on roll}} \times 100$$

Or

$$\frac{\text{No. of Separations+No.of Accessions (i.e. No.of Replacements+ No.of New Joinings)}}{\text{Average no.of employees during the period on roll}} \times 100$$

Newly recruited employees are also responsible for changes in the composition or work force, some management accountants feel to take new recruitment for calculating employee turnover. The total number of workers joining, including replacements, is called accessions.

Causes of Employee Turnover:

- **Causes of Employee Turnover**
  - **Personal Causes**
    - Change of jobs for betterment
    - Premature retirement
    - Domestic problems/ Family responsibilities
    - Discontent over the jobs and working environment
  - **Unavoidable Causes**
    - Seasonal nature of the business
    - Shortage of raw material, power, slack market for the product etc.
    - Change in plant location
    - Disability
    - Disciplinary measures
  - **Avoidable Causes**
    - Dissatisfaction with job, remuneration, hours of work, working conditions, etc.
    - Strained relationship with management
    - Lack of training facilities and promotional avenues
    - Lack of recreational and medical facilities
    - Low wages and allowances

Effects of Employee Turnover:

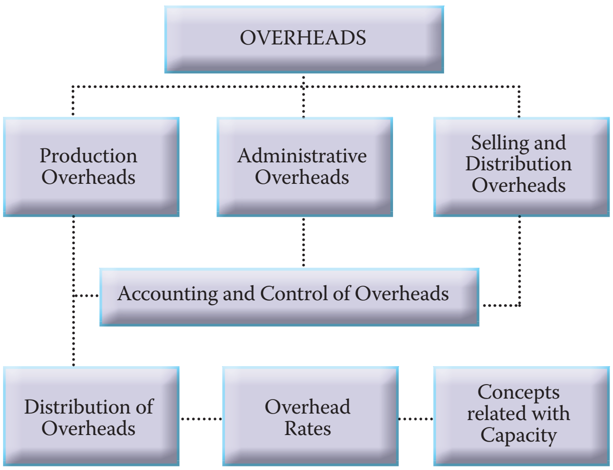
- **Even flow of production is disturbed**
- **Efficiency of new workers is low**
- **Increased cost of training**
- **New workers cause increased breakage of tools**
- **Cost of recruitment**

Cost of Employees Turnover:

- **Cost of Employees Turnover**
  - **Preventive Costs** Costs incurred to prevent employee turnover or keep it as lowest as possible
    - Cost of medical benefit
    - Cost on employees' welfare like pension etc.
    - Cost on other benefits with an objective to retain employees
  - **Replacement Costs** Costs which arise due to employee turnover
    - Cost of recruitment
    - Training and induction
    - Abnormal breakage and scrap
    - Extra wages and overheads due to the inefficiency of new workers

Overheads

Chapter Overview



Classification of Overheads

Overheads are the expenditure which can not be identified with a particular cost unit. Overheads can be classified as under.

By Function	By Nature	By Element	By Control
• Factory or Manufacturing or Production Overhead • Office and Administrative Overheads • Selling and Distribution Overheads	• Fixed Overhead • Variable Overhead • Semi-Variable Overheads	• Indirect materials • Indirect employee cost • Indirect expenses	• Controllable costs • Uncontrollable costs

Functional Classification of Overheads

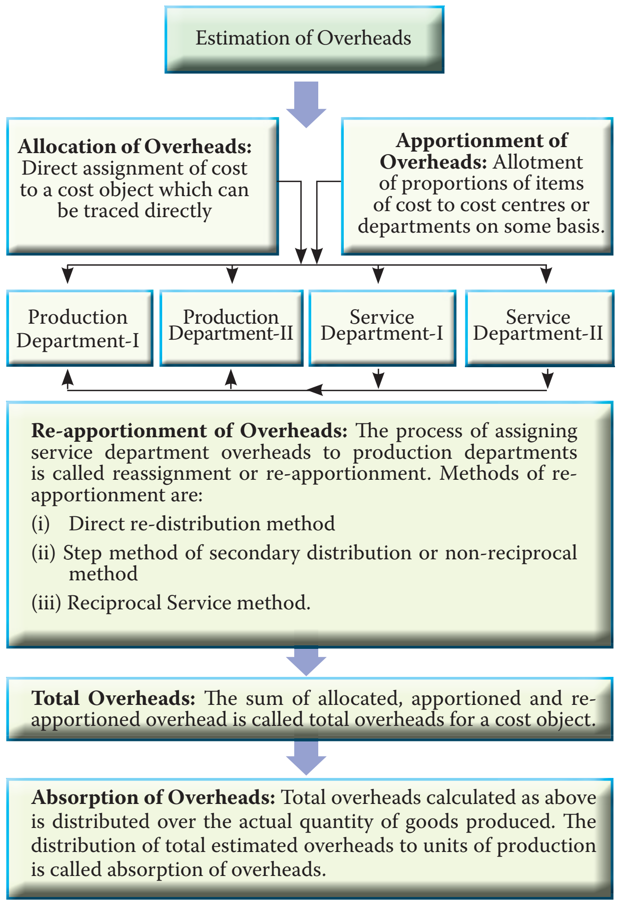
One of the most important ways of classifying overheads is as per their function. As per this classification overheads are classified as under.

Factory or Manufacturing or Production Overhead: Indirect cost incurred for manufacturing or production activity in a factory. Manufacturing overhead includes all expenditures incurred from the procurement of materials to the completion of finished product.

Office and Administrative Overheads: Expenditures incurred on all activities relating to general management and administration of an organisation. It includes formulating the policy, directing the organisation and controlling the operations of an undertaking which is not related directly to production, selling, distribution, research or development activity or function.

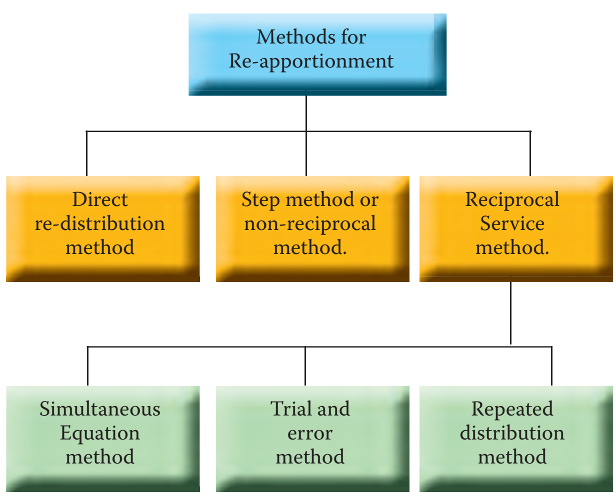
Selling and Distribution Overheads: (i) Selling overhead: expenses related to sale of products and include all indirect expenses in sales management for the organisation.
(ii) Distribution overhead: cost incurred on making product available for sale in the market.

Steps for Distribution of Overheads



Methods for Re-apportionment of Overheads

The re-apportionment of service department expenses over the production departments may be carried out by using any one of the following methods:



Methods of Absorbing Overheads to various Products or Jobs

Several methods are commonly employed either individually or jointly for computing the appropriate overhead rate. The more common of these are:

- Percentage of direct materials
- Percentage of prime cost
- Percentage of direct labour cost
- Labour hour rate
- Machine hour rate
- Rate per unit of Output

Machine hour rate

Machine hour rate implies, cost of running a machine for an hour to produce goods.

The steps involved in determining of Machine hour rate is as follows:

Step1: Calculate total of overheads apportioned to a production department.

↓

Step 2: Apportion further these overheads to machines or group of machines in the department.

↓

Step 3: Allocate machine specific costs (directly identifiable with the machine)

↓

Step 4: Estimate total productive hours for the machine

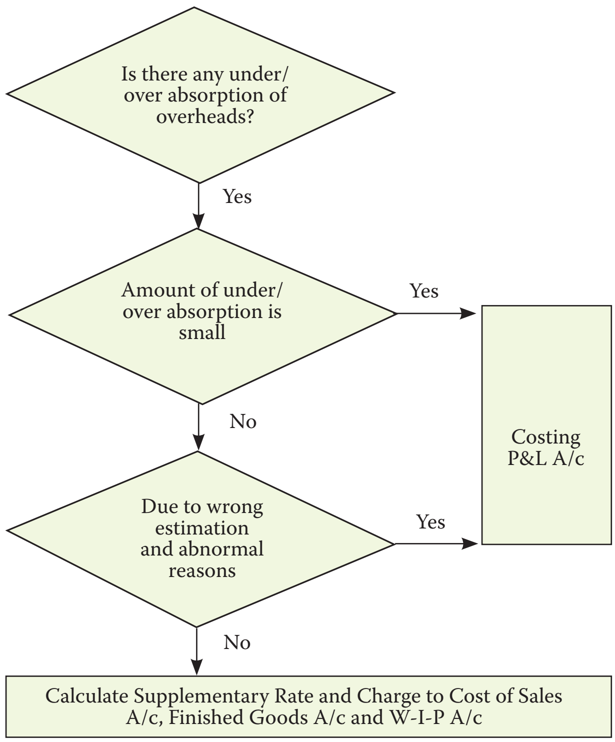
↓

Step 5: Aggregate overheads as apportioned in step-2 and allocated in step-3 and divide it by Estimated total productive hours

↓

The resultant figure is machine hour rate

Treatment of Under-absorption and Over-absorption of overheads in Cost Accounting



Types of Overhead Rates

Normal Rate: This rate is calculated by dividing the actual overheads by actual base. It is also known as actual rate.

Pre-determined Overhead Rate: This rate is determined in advance by estimating the amount of the overhead for the period in which it is to be used.

Blanket Overhead Rate: Blanket overhead rate refers to the computation of one single overhead rate for the whole factory.

Departmental Overhead Rate: It refers to the computation of one single overhead rate for a particular production unit or department.

Concepts related with Capacity

Installed/ Rated capacity: The maximum capacity of producing goods or providing services. It is also known as theoretical capacity.

Practical capacity: It is defined as actually utilised capacity of a plant. It is also known as operating capacity.

Normal capacity: The volume of production or services achieved or achievable on an average over a period under normal circumstances taking into account the reduction in capacity resulting from planned maintenance.

Actual capacity: Capacity actually achieved during a given period.

Idle capacity: It is that part of the capacity of a plant, machine or equipment which cannot be effectively utilised in production.

Treatment of Certain Items in Cost Accounting

Interest and financing charges	It includes any payment in nature of interest for use of non- equity funds and incidental cost that an entity incurs in arranging those funds. Interest and financing charges shall be presented in the cost statement as a separate item of cost of sales.
Packing expenses	Cost of primary packing necessary for protecting the product or for convenient handling, should become a part of cost of production. The cost of packing to facilitate the transportation of the product from the factory to the customer should become a part of the distribution cost.
Fringe benefits	These indirect benefits stand to improve the morale, loyalty and stability of employees towards the organisation. If the amount of fringe benefit is considerably large, it may be recovered as direct charge by means of a supplementary wage or labour rate; otherwise these may be collected as part of production overheads.
Research and Development Expenses	If research is conducted in the methods of production, the research expenses should be charged to the production overhead; while the expenditure becomes a part of the administration overhead if research relates to administration. Similarly, market research expenses are charged to the selling and distribution overhead. Development costs incurred in connection with a particular product should be charged directly to that product. Such expenses are usually treated as "deferred revenue expenses," and recovered as a cost per unit of the product when production is fully established.

ACTIVITY BASED COSTING

POINTS OF DISCUSSION

- Concept
- Usefullness of ABC
- Cost Hierarchy
- Steps

MEANING OF ACTIVITY BASED COSTING

ACTIVITY BASED COSTING (ABC)

- Accounting methodology that assigns costs to activities rather than products or services.
- Costs are assigned based on their use of resources.
- Creates a LINK BETWEEN THE ACTIVITY (resource consumption) and the COST OBJECT.
- Useful to the ORGANIZATION WITH MULTIPLE PRODUCTS.

FACTORS PROMPTING DEVELOPMENT OF ABC

- Growing overhead costs
- Increasing market competition
- Increasing product diversity
- Decreasing costs of information processing

USEFULNESS/SUITABILITY OF ABC

ABC is particularly needed in the following situations:			
High amount of overhead	Wide range of products	Presence of non-volume related activities	Stiff competition

ADVANTAGES AND DISADVANTAGES OF ABC

ADVANTAGES

- More accurate costing.
- Overhead allocation is done on logical basis.
- Enables better pricing policies.
- Utilizes unit cost rather than just total cost.
- Help to identify non-value added activities.
- Helpful to the organizations with multiple products.
- Highlights problem areas which require attention of the management.

DISADVANTAGES

- Expensive.
- Not helpful to the small organizations.
- May not be applied to organizations with limited products.
- Selection of the most suitable cost driver may be difficult or complicated.

TERMS USED

(i) Activity

- Event that incurs cost.

(ii) Cost Object

- An item for which cost measurement is required

(iii) Cost Driver

- Factor that causes a change in the cost of an activity-
  - **Resource cost driver:** Measure of the quantity of resources.
  - **Activity cost driver:** Measure of the frequency and intensity of demand.

Examples of Cost Driver business function wise:

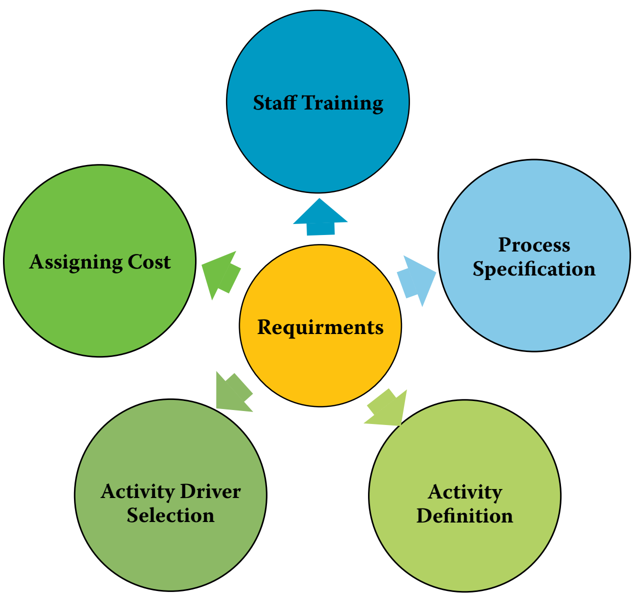
- **Research and Development**
  - Number of research projects
  - Personnel hours on a project
- **Design of products, services and procedures**
  - Number of products in design
  - Number of parts per product
  - Number of engineering hours
- **Customer Service**
  - Number of service calls
  - Number of products serviced
  - Hours spent on servicing products
- **Marketing**
  - Number of advertisements
  - Number of sales personnel
  - Sales revenue
- **Distribution**
  - Number of units distributed
  - Number of customers

(iv) Cost Pool
- Group of various individual cost items.
- Example machine set-up.

COST ALLOCATION

Overhead Costs → Linked through **Resource Cost Drivers** → **Activities** → Linked through **Activity Cost Drivers** → **Cost Objects**

REQUIREMENTS IN ABC IMPLEMENTATION



TRADITIONAL ABSORPTION COSTING VS ABC

Cost Allocation
- **Traditional Costing** – Based on Machine hours, labour Hours, Volume etc.
- **Activity based Costing** – Based on Cost Driver

Activity Based Costing	Traditional Absorption Costing
Related to activities	Related to cost centers
More realistic	Not realistic
Activity–wise cost drivers	Time (hours) - only cost driver
Cost are assigned to cost objects	Costs are assigned to cost units
Aids cost control	Not suitable for cost control.

LEVEL OF ACTIVITIES UNDER ABC METHODOLOGY/COST HIERARCHY

Unit level activities	
Activities which can be identified with the number of units produced.	**- Indirect materials/ consumables - Inspection or testing of every item produced**

Batch level activities	
Activities which are performed each time a batch of goods is produced.	**- Material ordering - Machine set-up costs**

Product level activities	
Activities which are performed to support different products in product line.	**- Designing the product - Producing parts specifications**

Facilities level activities	
Activities which are common and joint to all products manufactured.	**- Maintenance of buildings - Plant security**

STAGES IN ACTIVITY BASED COSTING (ABC)

Identify different activities within the organisation

Break the organisation down into many very small activities.

Relate the overheads to the activities

This creates 'cost pools' or 'cost buckets'.

Support activities are then spread across the primary activities

Where base is the cost driver measuring, how the support activities are used.

Determine the activity cost drivers

To relate the overheads collected in cost pools to the cost objects.

Calculate activity cost driver rates

Calculate activity cost driver rates for each activity

$$\text{Activity cost driver rate} = \frac{\text{Total cost of activity}}{\text{Activity driver}}$$

EXAMPLES OF COST DRIVERS

Overhead Costs

ACTIVITY COST POOL	COST DRIVERS
Ordering and Receiving Materials cost	Number of purchase orders
Setting up machines costs	Number of set-ups
Machining costs	Machine hours
Assembling costs	Number of parts
Inspecting and testing costs	Number of tests
Painting costs	Number of parts
Supervising Costs	Direct labour hours
Delivery cost	Number of deliveries
Shelf-stocking cost	Shelf-stocking hours
Customer Support	Number of items sold

HOW TO CALCULATE COST PER PRODUCT USING ABC?

If it is given that,

Activity	Cost (₹)
Ordering	64,000
Delivery	1,40,000
Shelf stocking	80,000

Particulars	Product 1	Product 2
No. of Purchase Orders	30	50
No. of Deliveries	110	90
Shelf Stocking Hours	220	180

Image source: https://www.dreamstime.com/photos-images/activity-based-costing.html

Then, cost per product as per ABC

Activity	Total Cost (₹)	Cost Driver	Cost Driver Level	Cost Driver Rate (₹)	Product 1 (₹)	Product 2 (₹)
(a)	(b)	(c)	(d)	(e) = (b)/(d)	(f)	(g)
Ordering	64,000	No. of Purchase Orders	80 (30+50)	800	24,000 (800 x 30)	40,000 (800 x 50)
Delivery	1,40,000	No. of Deliveries	200 (110 + 90)	700	77,000 (700 x 110)	63,000 (700 x 90)
Shelf stocking	80,000	Shelf Stocking Hours	400 (220 +180)	200	44,000 (200 x 220)	36,000 (200 x 180)

PRACTICAL APPLICATIONS OF ACTIVITY BASED COSTING

As a Decision-Making Tool

Improve performance and profitability → Decisision w.r.t. introduction of new product or vendor → Decisions related to facility and resource expansion → Decision support for human resources → Helps in determining price based on cost plus markup basis

As Activity Based Management

Activity Based Cost Management (ABM): Using ABC to manage costs at activity level.

- Cost Driver Analysis
- Activity Analysis
  - Value-Added Activities (VA)
  - Non-Value-Added Activities (NVA)
- Performance Analysis
  - Cost Reduction
  - Business Process Re-engineering
  - Benchmarking
  - Performance Measurement

Facilitate Activity Based Budgeting (ABB)

It analyses the resource input or cost for each activity.
It is the reversing of the ABC process to produce financial plans and budgets.

Key Elements

- Type of work to be done
- Quantity of work to be done
- Cost of work to be done

Benefits

- Enhance accuracy of financial forecasts
- Increasing management understanding
- Rapidly and accurately produce financial plans
- Eliminates much of the needless rework

COST SHEET

Points of Discussion

- Functional Classification
- Head of Costs in Cost Sheet
- Format of Cost Sheet
- Advantages of Cost Sheet

Functional Classification of Elements of Cost

- Direct Material Cost
- Direct Employee (labour) Cost
- Direct Expenses
- Production/ Manufacturing Overheads
- Administration Overheads
- Selling Overheads
- Distribution Overheads
- Research and Development costs etc.

Cost Heads in a Cost Sheet

- Prime Cost
- Cost of Production
- Cost of Goods Sold
- Cost of Sales

Prime Cost:

Direct material costs + Direct employee costs + Direct expenses = Prime Cost

Direct Material Cost

Cost of direct material consumed* e.g.
- Cost of material
- Freight inwards
- Insurance
- Trade discounts or rebates (to be deducted)
- Duties & Taxes (if ITC is not available/ availed).

Direct Employee Cost

Payments to the employees engaged in the production of goods and provision of services e.g.
- Wages and salary
- Allowances and incentives
- Payment for overtime
- Bonus/ ex-gratia
- Employer's contribution to PF, ESI & funds
- Other benefits (medical, leave with pay, LTC).

Direct Expenses

Expenses other than direct material cost and direct employee cost e.g.
- Power & fuel
- Royalty paid
- Hire charges
- Fee for technical assistance
- Amortised cost of moulds, patterns, patents
- Other expenses directly related with the production of goods.

*

Opening Stock of Material + Addition/ Purchases − Closing stock of Material = Direct materials consumed

Cost of Production:

Prime cost + Factory related costs and overheads = Cost of Production

Prime Cost	xxxx
Add: Factory Overheads#	xxx
Gross Works Costs	xxxx
Add: Opening stock of Work-in-process	xxx
Less: Closing stock of Work-in-process	(xxx)
Factory or Works Costs	xxxx
Add: Quality Control Cost	xxx
Add: Research & Development cost (Process related)	xxx
Add: Administrative Overheads related with production	xxx
Less: Credit for recoveries (miscellaneous income)	(xxx)
Add: Packing Cost (Primary packing)	xxx
Cost of Production	xxxx

Factory Overheads (Works / production / manufacturing overheads) includes-

- Consumable stores and spares
- Depreciation
- Lease rent of production assets
- Repair and maintenance of plant and machinery, factory building
- Indirect employees cost related with production activities
- Drawing and Designing department cost
- Insurance of plant and machinery, factory building, stock of raw material & WIP
- Amortised cost of jigs, fixtures, tooling
- Service department cost such as Tool Room, Engineering & Maintenance, Pollution Control

Cost of Goods Sold:

Cost of Production + Cost of Opening stock of finished goods − Cost of Closing stock of finished goods = Cost of Goods Sold

Cost of Sales:

Cost of Goods Sold	xxxx
Add: Administrative Overheads (General)	xxx
Add: Selling Overheads	xxx
Add: Packing Cost (secondary)	xxx
Add: Distribution Overheads	xxx
Cost of Sales	xxxx

Examples:

Administrative Overheads (General)
- Depreciation and maintenance of, office building, furniture etc.
- Salary of administrative employees, accountants, etc.
- Rent, rates & taxes
- Insurance, lighting, office expenses
- Indirect materials- printing and stationery, office supplies etc.
- Legal charges, audit fees, meeting expenses etc.

Selling Overheads
- Salary and wages related with sales department
- Rent, depreciation, maintenance related with sales department
- Advertisement, maintenance of website for online sales, market research etc.

Packing Cost (secondary)
- Packing material that enables to store, transport, and make the product marketable.

Distribution Overheads
- Salary and wages of employees engaged in distribution of goods
- Transportation and insurance costs related with distribution
- Depreciation, hire charges, maintenance and other operating costs related with distribution.

Cost Sheet- Specimen Format

	Particulars	**Total Cost (₹)**	**Cost per unit (₹)**
1.	Direct materials consumed:		
	Opening Stock of Raw Material	xxx	
	Add: Additions/ Purchases	xxx	
	Less: Closing stock of Raw Material	(xxx)	
		xxx	**xxx**
2.	Direct employee (labour) cost	xxx	
3.	Direct expenses	xxx	
4.	**Prime Cost (1+2+3)**	**xxx**	**xxx**
5.	**Add:** Works/ Factory Overheads	xxx	
6.	Gross Works Cost (4+5)	xxx	
7.	**Add:** Opening Work in Process	xxx	
8.	**Less:** Closing Work in Process	(xxx)	
9.	**Works/ Factory Cost (6+7-8)**	**xxx**	**xxx**
10.	**Add:** Quality Control Cost	xxx	
11.	**Add:** Research and Development Cost	xxx	
12.	**Add:** Administrative Overheads (relating to production activity)	xxx	
13.	**Less:** Credit for Recoveries/Scrap/By-Products/ misc. income	(xxx)	
14.	**Add:** Packing cost (primary)	xxx	
15.	**Cost of Production (9+10+11+12-13+14)**	**xxx**	**xxx**
16.	**Add:** Opening stock of finished goods	xxx	
17.	**Less:** Closing stock of finished goods	(xxx)	
18.	**Cost of Goods Sold (15+16-17)**	**xxx**	**xxx**
19.	**Add:** Administrative Overheads (General)	xxx	
20.	**Add:** Marketing Overheads :		
	Selling Overheads	xxx	
	Distribution Overheads	xxx	
21.	**Cost of Sales (18+19+20)**	**xxx**	**xxx**

Treatment of various items of cost in Cost Sheet:

Abnormal costs	• Any abnormal cost, where it is material and quantifiable, shall not form part of cost of production or acquisition or supply of goods or provision of service.
Subsidy/ Grant/ Incentives	• Reduced from the cost objects to which such amount pertains.
Penalty, fine, damages, and demurrage	• Does not form part of cost.
Interest and other finance costs	• Not included in cost of production. • Shall be presented in the cost statement as a separate item of cost of sales.

Advantages of Cost Sheet

- **Provides the total cost figure as well as cost per unit of production.**
- **Helps in cost comparison.**
- **Facilitates preparation of cost estimates required for submitting tenders.**
- **Provides sufficient help in arriving at the figure of selling price.**
- **Facilitates cost control by disclosing operational efficiency.**

POINTS OF DISCUSSION

Cost Accounting System

Non-Integral accounting system | Integral accounting system

Reconciliation of Cost and Financial Accounts

Non-integrated Accounting System

SEPARATE LEDGERS are maintained for both cost and financial accounts.

This system is also known as COST LEDGER ACCOUNTING SYSTEM.

This system contain limited ACCOUNTS due to the exclusion of purchases, expenses and also Balance Sheet items like fixed assets, debtors and creditors.

ITEMS OF ACCOUNTS excluded are REPRESENTED BY COST LEDGER CONTROL ACCOUNT.

Integrated Accounting System

COST AND FINANCIAL ACCOUNTS are kept in the SAME SET of books.

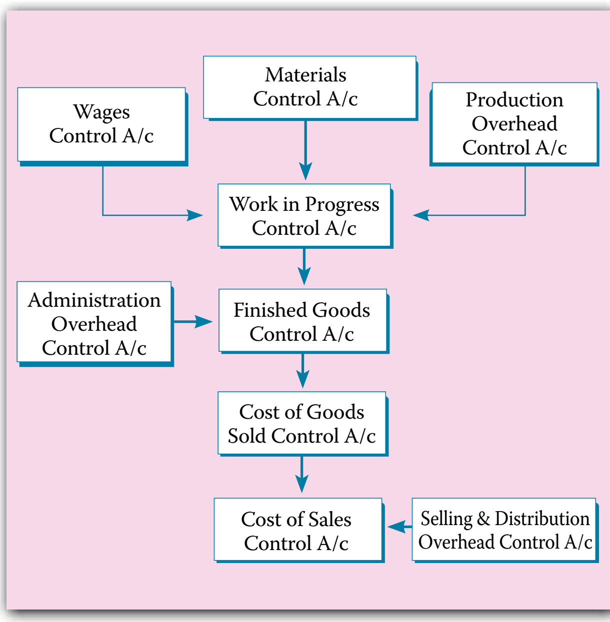
PROVIDES RELEVANT INFORMATION necessary for preparing profit and loss account and the balance sheet.

NON-INTEGRATED ACCOUNTING SYSTEM

MAIN ACCOUNTS usually prepared when a separate Cost Ledger is maintained

- Cost Ledger Control Account
- Stores Ledger Control Account
- Wages Control Account
- Manufacturing/ Production/Works/ Factory Overhead Control Account
- Work-in-Progress Control Account
- Administrative Overhead Control Account
- Finished Goods Control Accounts
- Selling and Distribution Overhead Control Account
- Cost of Sales Account
- Costing Profit & Loss Account
- Overhead Adjustment Account

FLOWCHART



INTEGRATED ACCOUNTING SYSTEM

ADVANTAGES

- No need for reconciliation
- Less efforts
- Less time consuming
- Economical process

In integrated system, all accounts necessary for showing classification of cost will be used but the cost ledger control account of non-integrated accounting is replaced by use of following accounts:

- **Bank account**
- **Receivables (Debtors) account**
- **Payables (Creditors) account**
- **Provision for depreciation account**
- **Fixed assets account**
- **Share capital account**

RECONCILIATION OF COST AND FINANCIAL ACCOUNTS

Reconciliation is done when cost and financial accounts are kept separately

Reconciliation of the balances of two sets of accounts is possible by preparing a MEMORANDUM RECONCILIATION ACCOUNT

Causes of differences in Financial and Cost Accounts

Items included in Financial Accounts only

- **Purely Financial Expenses**
  - Interest on loans
  - Expenses and discounts on issue of shares
  - Loss by fire not covered by insurance
  - Losses on the sales of fixed assets
  - Income tax, donations
- **Purely Financial Income**
  - Interest received on bank deposits
  - Dividends received
  - Profits on the sale of fixed assets
  - Rent receivables

Items included in Cost Accounts only (notional expenses)

- Charges in lieu of rent where premises are owned
- Interest on capital at notional figure though not incurred
- Salary for the proprietor at notional figure
- Notional Depreciation on the assets fully depreciated

Items whose treatment is different in the two sets of accounts

- LIFO may be adopted for cost accounts
- Different method of depreciation may be followed

Varying basis of valuation

- Valuation of stock (at cost in cost accounting)

Procedure for Reconciliation

1. Ascertainment of profit as per financial accounts
2. Ascertainment of profit as per cost accounts
3. Reconciliation of both the profits

Example:

Profit as per Cost Accounts after following adjustment	**₹3,00,000**
Factory overheads absorbed	₹5,00,000
Selling & Distribution Overhead absorbed	₹2,00,000
Valuation of closing stock of finished goods	₹1,23,000
Administrative Overhead absorbed	₹1,93,000
Profit as per financial accounts after following adjustment	**₹1,10,000**
Factory overheads charged	₹4,50,000
Selling & Distribution Overhead charged	₹1,80,000
Valuation of closing stock of finished goods	₹1,50,000
Administrative Overhead charged	₹2,60,000
Interest on loan	₹2,20,000

Now, reconciliation between Financial and Cost Accounts can be done by preparing RECONCILIATION STATEMENT as follows:

	(Rs.)	**(Rs.)**
Profit as per Cost Accounts		**3,00,000**
Add: Factory overheads over-absorbed (₹5,00,000 – ₹4,50,000)	50,000	
Selling & Dist. Overhead over-absorbed (₹2,00,000 – ₹1,80,000)	20,000	
Difference in the valuation of closing stock of finished goods (₹1,50,000 – ₹1,23,000)	27,000	97,000
		3,97,000
Less: Admn. overhead under-absorbed (₹2,60,000 – ₹1,93,000)	67,000	
Interest on loan	2,20,000	2,87,000
Profit as per financial accounts		**1,10,000**

CA INTERMEDIATE (NEW) PAPER 3- COST AND MANAGEMENT ACCOUNTING

Different Industries follow different method of Costing as the nature of their work varies. A Chartered Accountant will be associated with various industries, hence it is of paramount importance that a CA student must be familiar with method of costing followed by these Industries. This edition of Cost and Management Accounting capsule covers the topic Unit & Batch Costing, Job & Contract Costing, Activity Based Costing (ABC), Joint Products & By-products. Brief overview of the topics is given as follows for quick recapitulation: Industries like paper, cement, mining, etc. follows unit costing where output produced is identical and each unit of output requires identical cost, while batch costing is followed where products are manufactured in predetermined lots known as batches like in case of pen manufacturing industry, vaccine manufacturing etc. The job costing method is also applicable to industries in which production is carried out to accomplish a specific Job, while contract costing is followed where job is relatively at larger scale and takes longer than a year to complete like in case of construction of building, setting up plants. ABC is an approach followed while allocating cost to cost object based on cost drivers. The joint product costs are the expenditures incurred up-to the point of separation, however, its apportionment may be done based on different methods like physical units method, net realisable value at split-off point, etc.

UNIT & BATCH COSTING

Points of Discussion

Methods of Costing

- **Unit Costing**
  - Meaning
  - Process of Cost Accumulation and Calculation
- **Batch Costing**
  - Meaning
  - Process of Cost Accumulation and Calculation
  - Determination of Economic Batch Quantity (EBQ)
  - Difference between Job and Batch Costing

UNIT COSTING

Meaning of Unit Costing

UNIT COSTING

- **where the output produced is identical and each unit of output requires identical cost.**
- **also known as single or output costing.**
- **applied in industries like PAPER, CEMENT, STEEL WORKS, MINING, BREWERIES ETC.**

Here, costs are collected and analysed element wise and then total cost per unit is ascertained as follows:

$$\text{Cost per unit} = \frac{\text{Total cost of production}}{\text{No. of units produced}}$$

COST COLLECTION PROCEDURE IN UNIT COSTING

Collection of Materials Cost

↓ It is collected from Material Requisition notes.

↓ Accumulated material cost is then posted in cost accounting system.

Collection of Employees (labour) Cost

↓ **Direct employee cost:** It is collected from job time cards or sheets.

↓ The time booked/ recorded is valued at appropriate rates and entered in the cost accounting system.

↓ **Indirect employee costs:** These are collected from the payrolls books and posted against standing order or expenses code numbers in the overhead expenses ledger.

Collection of Overheads

↓ These are collected under suitable standing orders numbers, and selling and distribution overheads against cost accounts numbers.

↓ Total expenses so collected are apportioned to service and production departments on some suitable basis.

↓ The expenses of service departments are finally transferred to production departments.

↓ The total overhead of production departments is then applied to products on some realistic basis, e.g. machine hour; labour hour etc.

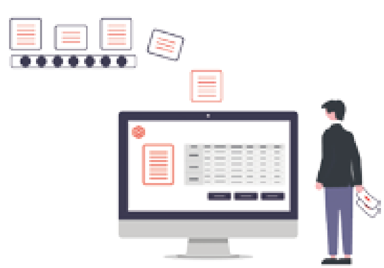


Image source: https://metry.io/en/cost-collection-from-invoices/

TREATMENT OF SPOILED AND DEFECTIVE WORK

Loss due to normal reasons

- Actual number of defectives is **within the normal limit**
  - Cost of rectification or loss will be **charged to the entire output**
- Number of defective units substantially **exceeds the normal limits**
  - Cost of rectification or loss beyond normal limits are **written off in Costing Profit and Loss Account**

Loss due to abnormal reasons

- Cost of rectification and loss is treated as abnormal cost and is **written off as loss in Costing Profit and Loss Account**.

BATCH COSTING

Meaning of Batch Costing

BATCH COSTING

- **is a type of specific order costing where articles are manufactured in predetermined lots, known as batch.**
- **the cost object for cost determination is a batch for production.**
- **example PEN MANUFACTURING INDUSTRY**

A batch consists of certain number of units which are PROCESSED SIMULTANEOUSLY. Under this method of manufacturing, the inputs are accumulated in the assembly line till it reaches minimum batch size. Soon after a batch size is reached, all inputs in a batch is processed for further operations.

COSTING PROCEDURE IN BATCH COSTING

Material cost	On the basis of material requisitions for the batch.
Labour cost	Multiplying the time spent on the batch by direct workers as ascertained from time cards or job tickets.
Overheads	Absorbed on some suitable basis like machine hours, direct labour hours etc.

ECONOMIC BATCH QUANTITY (EBQ)

Primarily, the total production cost under batch production comprises of two main costs, namely,

Machine Set Up Costs + **Inventory holding costs**

Balancing Machine set up cost and Inventory holding cost

Higher lot size

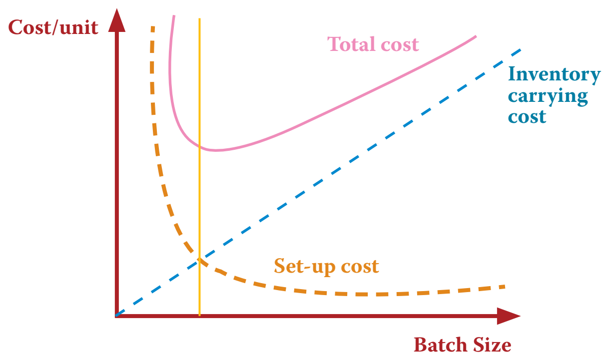
- **Set up cost** may **decline** due to lesser number of set ups.
- But units in inventory will go up leading to **higher holding costs**

Lower lot size

- **Lower inventory holding costs.**
- But **higher set up costs** due to high number of set ups.

ECONOMIC BATCH QUANTITY (EBQ)

- **It is the size of a batch where total cost of set-up and holding costs are at minimum.**



Determination of EBQ

By calculating the total cost for a series of possible batch sizes and checking which batch size gives the minimum cost.

Mathematical formula:

$$EBQ = \sqrt{\frac{2DS}{C}}$$

Where,

D	=	**Annual demand for the product**
S	=	**Setting up cost per batch**
C	=	**Carrying cost per unit of production**

DIFFERENCE BETWEEN JOB AND BATCH COSTING

Sr. No	Job Costing	Batch Costing
1	Used for **non- standard and non- repetitive products** produced as per customer specifications and against specific orders.	**Homogeneous products** produced in a continuous production flow in lots.
2	**Cost determined for each Job.**	**Cost determined in aggregate** for the entire Batch and then arrived at on per unit basis.
3	Jobs are different from each other and independent of each other. **Each Job is unique.**	Products produced in a batch are homogeneous and **lack of individuality**.

JOB AND CONTRACT COSTING

POINTS OF DISCUSSION

Methods of Costing

- **Specific Order Costing**
  - **Job Costing**
  - **Contract Costing**

JOB COSTING

MEANING OF JOB COSTING

JOB COSTING

- **It is applicable where the work consists of separate contracts, jobs or batches, each of which is authorised by specific order or contract.**
- **Industry example: PRINTING; FURNITURE; HARDWARE; SHIP-BUILDING; HEAVY MACHINERY; INTERIOR DECORATION.**

PRINCIPLES OF JOB COSTING

- **Analysis and ascertainment of cost of each unit of production**
- **Control and regulate cost**
- **Determine the profitability**

PROCESS OF JOB COSTING

1. Prepare a **separate cost sheet** for each job
2. Disclose cost of **materials** issued for the job
3. **Employee costs** incurred (on the basis of bill of material and time cards respectively)
4. When job is completed, **overhead charges** are added for ascertaining total expenditure

SUITABILITY OF JOB COSTING

- **When jobs are executed for different customers according to their specifications.**
- **When no two orders are alike and each order/ job needs special treatment.**
- **Where the work-in-progress differs from period to period on the basis of the number of jobs in hand.**

JOB COST CARD/ SHEET

JOB COST CARD/ SHEET

A cost sheet where,
- **quantity of materials issued,**
- **hours spent by different class of employees,**
- **amount of other expenses and share of overheads**

are recorded.

Format of Job Cost Sheet:

JOB COST SHEET

Description: ________	Job No.: ________
Blue Print No.: ________	Quantity: ________
Material No.: ________	Dateofdelivery: ________
Reference No.: ________	Datecommenced: ________
	Datefinished: ________

Date	Reference	Details	Material	Labour	Overhead
		Total			

Summary of costs	*Estimated (₹)*	*Actual (₹)*	
Direct material cost Direct wages Production overhead			For the job ________
PRODUCTION COST			Units produced ________
Administration and Selling & Distribution Overheads			Cost/unit ________
TOTAL COST			Remarks ________
PROFIT/LOSS			Prepared by: ________
SELLING PRICE			Checked by: ________

COLLECTION OF COSTS FOR A JOB

Materials cost

- Traced to and identified with specific job or work order
- Posted to individual job cost sheets or cards in the work-in-progress ledger
- If the surplus material is utilised on some other job, instead of being returned to the stores first, a material transfer note is prepared.

Labour cost

- Booked against specific jobs in the job time cards or sheets
- Posted to the appropriate job cost card or sheet in work-in-progress ledger

Image source: https://www.dreamstime.com/job-costing-text-paper-sheet-chart-dice-spectacles-pen-laptop-blue-yellow-push-pin-wooden-table-business-banking-image197323655

Overheads

- Manufacturing overheads are collected under suitable standing order numbers
- Selling and distribution overheads are collected against cost accounts numbers
- Total overhead expenses are apportioned to service and production departments on some suitable basis.
- The expenses of service departments are finally transferred to production departments.
- The total production overhead is then applied to products on some realistic basis.

SPOILED AND DEFECTIVE WORK

Meaning

Spoiled work – It is the quantity of production that has been totally rejected and cannot be rectified.

Defective work – It refers to production that is not as perfect as the saleable product but is capable of being rectified

Treatment

Where a percentage of defective work is ALLOWED in a particular batch AS IT CANNOT BE AVOIDED.	The cost of rectification will be charged to the whole job and spread over the entire output of the batch
Where defect is DUE TO BAD WORKMANSHIP.	The cost of rectification shall be written off as a loss being an abnormal cost
Where defect is due to the inspection department WRONGLY ACCEPTING INCOMING MATERIAL OF POOR QUALITY.	Cost of rectification will be charged to the department and will not be considered as cost of manufacture of the batch

ACCOUNTING OF COSTS FOR A JOB

1.	**For purchase of materials**	
	Stores Ledger Control A/c	**Dr.**
	To Cost Ledger Control A/c	
2.	**For the value of direct materials issued to jobs**	
	Work-in-Process Control A/c	**Dr.**
	To Stores Ledger Control A/c	
3.	**For return of direct materials from jobs**	
	Stores Ledger Control A/c	**Dr.**
	To Work-in-Process Control A/c	
4.	**For return of materials to suppliers**	
	Cost Ledger Control A/c	**Dr.**
	To Stores Ledger Control A/c	
5.	**For indirect materials**	
	Factory Overhead Control A/c	**Dr.**
	To Stores Ledger Control A/c	
6.	**For wages paid**	
	Wages Control A/c	**Dr.**
	To Cost Ledger Control A/c	

7.	**For direct wages incurred on jobs**	
	Work-in-Process Control A/c	**Dr.**
	To Wages Control A/c	
8.	**For indirect wages**	
	Factory Overhead Control A/c	**Dr.**
	To Wages Control A/c	
9.	**For any indirect expense paid**	
	Factory Overhead Control A/c	**Dr.**
	To Cost Ledger Control A/c	
10.	**For charging overhead to jobs**	
	Work-in-Process Control A/c	**Dr.**
	To Factory Overhead Control A/c	
11.	**For the total cost of jobs completed**	
	Cost of Sales A/c	**Dr.**
	To Work-in-Progress Control A/c	
12.	**The balance of Cost of Sales A/c is transferred to Costing Profit and Loss A/c;** For such transfer	
	Costing Profit and Loss A/c	**Dr.**
	To Cost of Sales A/c	
13.	**For the sales value of jobs completed**	
	Cost Ledger Control A/c	**Dr.**
	To Costing Profit and Loss A/c	

ADVANTAGES AND DISADVANTAGES OF JOB COSTING

Advantages

- **Details of Cost of material, labour and overhead for all job is available to control.**
- **Profitability of each job can be derived.**
- **Facilitates production planning.**
- **Budgetary control and Standard Costing can be applied in job costing.**
- **Spoilage and detective can be identified and responsibilities can be fixed accordingly.**

Dis-advantages

- **It is costly and laborious method.**
- **Chances of error is more as lot of clerical process is involved.**
- **This method not suitable in inflationary condition.**
- **Previous records of costs will be meaningless if there is any change in market condition.**

DIFFERENCE BETWEEN JOB COSTING AND PROCESS COSTING

Job Costing	**Process Costing**
A Job is carried out by specific orders.	Process of producing the product has a continuous flow and the product produced is homogeneous.
Costs determined for each job.	Costs are compiled on time basis i.e., for each process or department.
Each job is separate and independent.	Products lose their individual identity.
Each job has a number and costs are collected against the same job number.	The unit cost of process is an average cost for the period.
Costs are computed when a job is completed.	Costs are calculated at the end of the cost period.
More managerial attention is required for effective control.	Control here is comparatively easier.

CONTRACT COSTING

MEANING OF CONTRACT COSTING

CONTRACT COSTING

- **It is a form of specific order costing where job undertaken is relatively large and normally takes period longer than a year to complete.**
- **Adopted by the contractors engaged in contracts like CONSTRUCTION OF BUILDING, ROAD, BRIDGE, ERECTION OF TOWER ETC.**

FEATURES OF CONTRACT COSTING

Work in contract is ordinarily carried out at the site of the contract.	**Separate account is usually maintained for each contract.**	**Bulk of the expenses incurred are considered as direct.**
Number of contracts undertaken by a contractor at a time is usually few.	**Indirect expenses mostly consist of office expenses, stores and works.**	**Cost unit in contract costing is the contract itself.**

TERMS USED IN CONTRACT COSTING

(i) Work-in-Progress

Work-in-Progress

The contract which is not complete at the reporting date. It includes:

- **Cost of work completed (certified and uncertified)**
- **Cost of work not yet completed**
- **Amount of estimated/ notional profit**

(ii) Cost of Work Certified or Value of Work Certified

Expert, based on his assessment, certifies the work completion in terms of percentage of total work.
Cost or value of certified portion is calculated and is known as Cost of work certified or Value of work certified respectively.

(a) Value of Work Certified = Value of Contract × Work certified (%)
(b) Cost of Work Certified = Cost of work to date – (Cost of work uncertified + Material in hand + Plant at site)

(iii) Cost of Work Uncertified

Cost of the work carried out but not certified by the expert. | **Always shown at cost price.**

The cost of Work Uncertified may be ascertained as follows:

	(₹)	(₹)
Total cost to date		xxx
Less: Cost of work certified	xxx	
Material in hand	xxx	
Plant at site	xxx	xxx
Cost of work uncertified		xxx

(iv) Progress Payment

Progress payment = Value of work certified – Retention money – Payment to date

(v) Retention Money

Retention Money = Value of work certified – Payment actually made

(vi) Cash Received

Cash received = Value of work certified – Retention money

(vii) Notional Profit

Notional profit = Value of work certified – (Cost of work to date – Cost of work not yet certified)

(viii) Estimated Profit

Estimated Profit = Contract price – Estimated total cost

SPECIMEN OF CONTRACT ACCOUNT (with few items)

The cost of Work Uncertified may be ascertained as follows:

	Particulars	(₹)		Particulars	(₹)
To	Materials	xxx	By	Plant at site c/d	xxx
"	Wages	xxx	"	Work-in-progress c/d:	xxx
"	Direct expenses	xxx		- Work certified	xxx
"	Indirect expenses	xxx		- Work uncertified	xxx
"	Plant and Machinery	xxx	"	Costing P&L A/c (b/f) (If Loss)	xxx
"	Cost of Sub-Contract	xxx			
"	Costing P&L A/c (b/f) (If Profit)	xxx			
		XXX			XXX

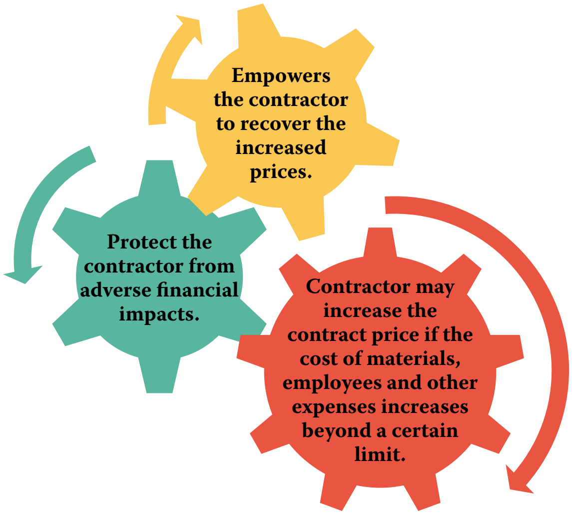
COST PLUS CONTRACT

Cost- Plus Contract: **When the value of the contract is determined by adding an agreed percentage of profit to the total cost.**

ADVANTAGES AND DISADVANTAGES OF COST PLUS CONTRACT

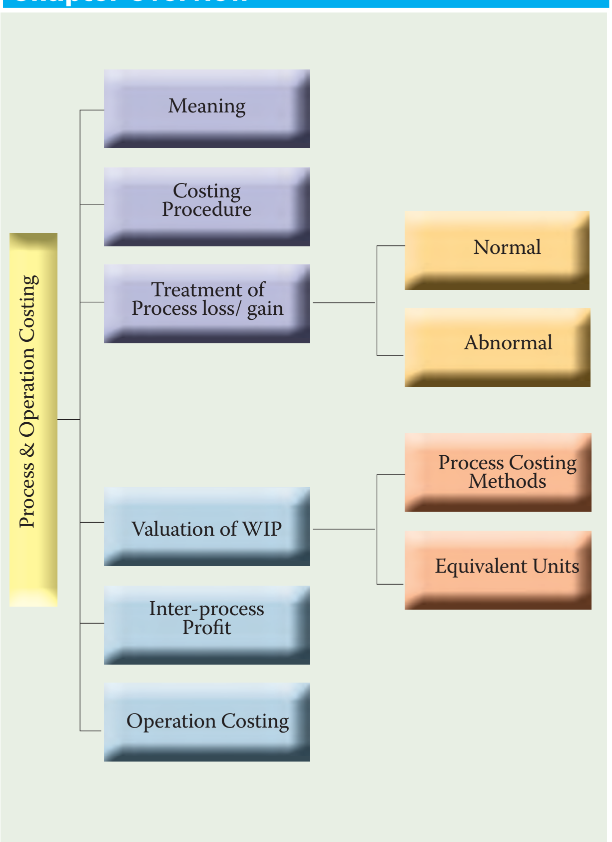
ADVANTAGES	DISADVANTAGES
• Contractor is assured of a fixed percentage of profit. • Useful when work to be done is not definitely fixed at the time of making the estimate. • Contractee can ensure himself about 'the cost of the contract', as he is empowered to examine the books and documents of the contractor.	• Contractor may not have any inducement to avoid wastages and effect economy in production to reduce cost.

ESCALATION CLAUSE



Process and Operation Costing

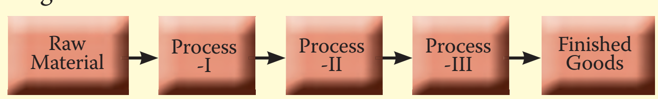
Chapter Overview



Meaning of Process Costing

Process Costing is a method of costing used in industries where the material has to pass through two or more processes for being converted into a final product. It is defined as "a method of Cost Accounting whereby costs are charged to processes or operations and averaged over units produced".

This can be understood with the help of the following diagram:



Costing Procedure in Process Costing

Materials: Each process for which the materials are used, are debited with the cost of materials consumed on the basis of the information received from the Cost Accounting department.

Employee Cost (Labour) - Each process account should be debited with the labour cost or wages paid to labour for carrying out the processing activities. Sometimes the wages paid are apportioned over the different processes after selecting appropriate basis.

Direct expenses - Each process account should be debited with direct expenses like depreciation, repairs, maintenance, insurance etc. associated with it.

Production Overheads- These expenses cannot be allocated to a process. The suitable way out to recover them is to apportion them over different processes by using suitable basis.

Steps in Process Costing

Step-1: Analyse the Physical Flow of Production Units

Step-2: Calculate Equivalent Units for each Cost Elements

Step-3: Determine Total Cost for each Cost Element

Step-4: Compute Cost Per Equivalent Unit for each Cost Element

Step-5: Assign Total Costs to Units Completed and Ending WIP

Treatment of Normal, Abnormal Loss and Abnormal Gain

Normal Process Loss	Abnormal Process Loss	Abnormal Process Gain/ Yield
• The cost of normal process loss in practice is absorbed by good units produced under the process. The amount realised by the sale of normal process loss units should be credited to the process account.	• The cost of an abnormal process loss unit is equal to the cost of a good unit. The total cost of abnormal process loss is credited to the process account from which it arises. • Total cost of abnormal process loss is debited to costing profit and loss account.	• The process account under which abnormal gain arises is debited with the abnormal gain and credited to abnormal gain account which will be closed by transferring to the Costing Profit and Loss account.

Valuation of Work-in-process

The valuation of work-in-process presents a good deal of difficulty because it has units under different stages of completion from those in which work has just begun to those which are only a step short of completion.

(i) **Equivalent Units**

Equivalent units or equivalent production units, means converting the incomplete production units into their equivalent completed units. Under each process, an estimate is made of the percentage completion of work-in-process with regard to different elements of costs, viz., material, labour and overheads.

The formula for computing equivalent completed units is:

$$\text{Equivalent completed units} = \left(\begin{array}{c}\text{Actual number of units in}\\ \text{the process of manufacture}\end{array}\right) \text{X} \left(\begin{array}{c}\text{Percentage of}\\ \text{Work completed}\end{array}\right)$$

Input Details	Units	Output Particulars	Units	Equivalent Units					
				Material		Labour		Overhead	
				%	Units	%	Units	%	Units
			a	b	c= a×b	d	e=a×d	f	g=a×f
Opening W-I-P	xxx	Opening W-I-P*	xxx	xxx	xxx	xxx	xxx	xxx	xxx
Unit Introduced	xxx	Finished output**	xxx	xxx	xxx	xxx	xxx	xxx	xxx
		Normal loss***	xxx	-	-	-	-	-	-
		Abnormal loss/ Gain****	xxx	xxx	xxx	xxx	xxx	xxx	xxx
Total		Closing W-I-P	xxx	xxx	xxx	xxx	xxx	xxx	xxx
	xxx	Total	xxx		xxx		xxx		xxx

* Equivalent units for Opening W-I-P is calculated only under FIFO method. Under the Average method, it is not shown separately.

**Under the FIFO method, Finished Output = Units completed and transferred to next process less Opening WIP. Under Average method, Finished Output = Units completed and transferred.

***For normal loss, no equivalent unit is calculated.

****Abnormal Gain/ Yield is treated as 100% complete in respect of all cost elements irrespective of percentage of completion.

(ii) Methods for valuation of work-in-process

Under this method the units completed and transferred include completed units of opening work-in-process and subsequently introduced units. Proportionate cost to complete the opening work-in-process and that to process the completely processed units during the period are derived separately.

Under this method, the cost of opening work-in-process and cost of the current period are aggregated and the aggregate cost is divided by output in terms of completed units.

Inter Process Profit

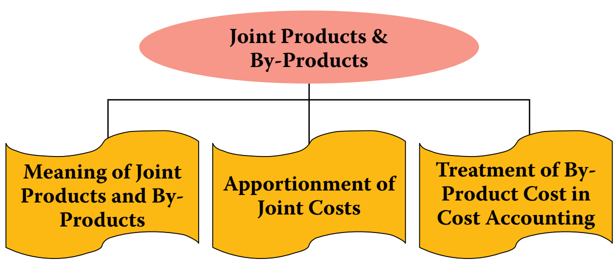
In some process industries the output of one process is transferred to the next process not at cost but at market value or cost plus a percentage of profit. The difference between cost and the transfer price is known as inter-process profits.

Operation Costing

This product costing system is used when an entity produces more than one variant of final product using different materials but with similar conversion activities. Which means conversion activities are similar for all the product variants but materials differ significantly. Operation Costing method is also known as Hybrid product costing system as materials costs are accumulated by job order or batch wise but conversion costs i.e. labour and overheads costs are accumulated by department, and process costing methods are used to assign these costs to products.

JOINT PRODUCTS AND BY PRODUCTS

POINTS OF DISCUSSION

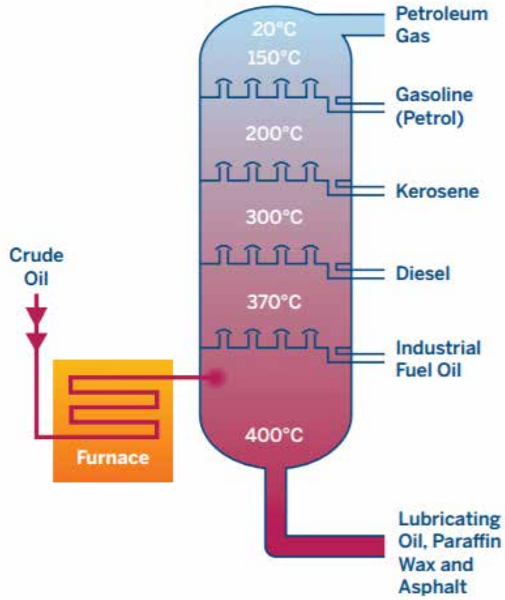


MEANING OF JOINT PRODUCTS AND BY-PRODUCTS

Joint Products* — **Two or more products separated in the course of same processing operation.**

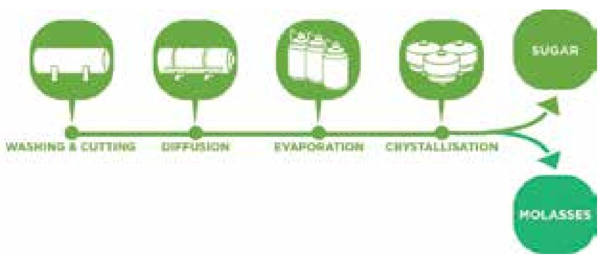
By-Products# — **Products recovered from-**
- **material discarded in main process.**
- **production of some major products.**

*OIL INDUSTRY PRODUCING JOINT PRODUCTS using crude petroleum like gasoline, fuel oil, lubricants, paraffin, asphalt, kerosene etc.



Petroleum Refining Processes[1]

MOLASSES IS PRODUCED AS A BY-PRODUCT in the process of sugar manufacturing



Sugar Manufacturing Process[2]

Point at which products are separated from the main product is known as SPLIT-OFF POINT.

DISTINCTION BETWEEN JOINT PRODUCTS AND BY-PRODUCTS

JOINT PRODUCTS	BY-PRODUCTS
• Equal importance. • Produced simultaneously.	• Small economic value. • Incidental to the main product.

[1] *Image source: https://www.cmegroup.com/education/courses/introduction-to-refined-products/a-look-into-the-refining-process.html*
[2] *Image source: http://www.sustainablesugar.eu/molasses*

CO-PRODUCTS

CO-PRODUCTS

Joint products and co-products are used synonymously, but a **distinction is there**.

Co-products are the two or more products which are **contemporary but** do **not** emerge necessarily **from the same material in the same process**.

For instance,

wheat and gram produced in two separate farms with separate processing of cultivation are co-products.	**Timber boards** made from different trees are co-products.

METHODS OF APPORTIONMENT OF JOINT COST TO JOINT PRODUCTS

Methods for apportioning joint cost

- **Physical Units Method**
- **Net Realisable Value at split-off point**
- **Using Technical Estimates**
- **Other methods**
  - **Market value at the point of separation**
  - **Market value after further processing**
  - **Average unit cost method**
  - **Contribution margin method**

Physical Units Method:

Joint costs here are apportioned on the basis of some **physical base, such as weight, numbers etc.**

Net Realisable Value at Split-off Point Method:

Joint costs here are apportioned on the basis of **Net Realisable Value at Split-off Point.**

NET REALISABLE VALUE AT SPLIT-OFF POINT

sales value of joint products after processing

– **Estimated profit margins**

– **Selling and distribution expenses**

– **Post split- off costs**

Using Technical Estimates:

This method is used WHEN-

Result obtained by above methods does not match with the resources consumed by joint products, or;

Realisable value of the joint products are not readily available.

Other Methods:

(i) Market value at the point of separation

Useful method where further processing costs are incurred disproportionately.

To determine the apportionment of joint costs over joint products, a multiplying factor is determined as follows:

$$\text{Multiplying factor: } \frac{\text{Joint Cost}}{\text{Total Sales Revenue}} \times 100$$

***Alternatively,* joint cost may be apportioned in the ratio of sales values of different joint products.**

(ii) Market value after further processing

Basis of apportionment of joint cost is the total sales value of finished products.

Use of this METHOD IS UNFAIR WHERE-

Further processing costs after the point of separation are disproportionate, or;

All the joint products are not subjected to further processing.

(iii) Average Unit Cost Method

$$\text{Average unit cost} = \frac{\text{Total process cost (up to the point of separation)}}{\text{Total units of joint product produced}}$$

Physical unit method also follows the same steps of calculation as followed under Average unit cost method, ultimately giving the same outcome.

(iv) Contribution Margin Method

Joint costs segregated into two parts
- **Variable**
- **Fixed**

Variable costs

Apportioned on the basis of units produced (average method or physical quantities)	In case products are further processed after point of separation, then all variable cost incurred be added to the variable costs determined earlier.

Total variable cost is arrived which is deducted from their respective sales values to **ascertain their contribution**.

Fixed costs

Thereafter, fixed costs are **apportioned** over the joint products **on the basis of the contribution ratios**.

METHODS OF APPORTIONMENT OF JOINT COST TO BY-PRODUCTS

Methods for apportioning joint cost
- **Net Realisable Value method**
- **Standard cost in Technical Estimates**
- **Comparative price**
- **Re-use basis**

Net Realisable Value method:

No further processing required

Realisation on the disposal of the by-product deducted from the total cost of production.

Further processing required

Additional expenses so incurred be deducted from the total value realised from the sale of the by-product.

Only the net realisations be deducted from the total cost of production to arrive at the cost of production of the main product.

Standard cost in Technical Estimates:

This method may be adopted where by-product is not saleable.

It may be valued at standard costs.

Standard cost may be determined by averaging costs recorded in the past and making technical estimates of the number of units of original raw material going into the main product and the number forming the by-product; or by adopting some other consistent basis.

Comparative price:

Value of by-product is ascertained with reference to the price of -	
Similar material, or;	Alternative material

Re-use basis:

Sometimes, by-product may be of such a nature that it can be reprocessed in the same process as part of the input of the process.	
In that case, **value put on by-product should be same as that of the materials introduced into the process.**	However, **if the by-product can be put into an earlier process only**, the **value** should be the **same as for the materials introduced into the process.**

TREATMENT OF BY-PRODUCT COST IN COST-ACCOUNTING

Treatment of by-product cost in cost-accounting

- **Small total value**
  - **Sales value credited to Costing P & L Account**
  - **Deducted from total costs**
- **Considerable total value**
  - May be **regarded as joint products** rather than as by-products
- **Require further processing**
  - **Net realisable value of the by-product at the split-off point** may be arrived

CA INTERMEDIATE - PAPER 3 - COST AND MANAGEMENT ACCOUNTING

Service sector, being one of the fastest growing areas and making a significant contribution towards the GDP of India, is a very important sector where the role of the cost and management accounting is inevitable. The competitiveness of a service organisation is majorly dependent on a robust cost and management accounting system for competitive pricing and identification of value-added activities. Providers of services like transportation, hotels, financial services & banking, insurance, electricity generation, transmission and distribution etc., are cost conscious and thrive to provide services in a cost-effective manner. Chartered Accountants being global business providers guide the service organisation to continue its operations cost effectively. Students are advised to meticulously go through the concept of service sectors and practice practical questions for better understanding.

SERVICE COSTING

POINTS OF DISCUSSION

Service Costing

- **Application of Service Costing**
- **Service Costing vs Product Costing**
- **Methods of Ascertaining Service cost unit**
  - **Composite Unit**
  - **Equivalent Unit**
- **Service Cost Statement**
- **Costing of Services:**
  - (i) Transport
  - (ii) Hotels & Lodges
  - (iii) Hospitals
  - (iv) Information Technology Enabled Services
  - (v) Toll Roads
  - (vi) Educational Institutes
  - (vii) Insurance
  - (viii) Financial Institutes
  - (ix) Others

WHEN is service costing APPLIED?

Internal application

When service provided by service cost centre to other responsibility centre

Example-
Use of canteen services by hospital staff, operation of fleet of trucks for transport of raw material to factory

External application

When services are offered to outside customers as a profit centre

Example-
Hospitality services provided by a hotel, provision of services by financial institutions

SERVICE COSTING VS. PRODUCT COSTING

Unlike products,

- sevices are intangible.
- sevices cannot be stored.
- there are no inventory for the services.
- employee (labour) cost constitutes a major cost element than material cost.
- Indirect costs like administration overheads have significant proportion in total cost.
- service sector heavily depends on support services.

Composite cost units are used,

- for cost measurement.
- to express the volume of outputs.

WHAT is service cost UNIT?

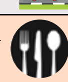
All the costs incurred during a period are-

collected

analyzed

expressed in terms of a cost per unit of service.

LIST of typical cost unit

Service industry	Unit of cost (examples)
Transport Services 	Passenger- km., (In public transportation) Quintal- km., or Ton- km. (In goods carriage)
Electricity Supply service 	Kilowatt- hour (kWh)
Hospital 	Patient per day, room per day or per bed, per operation, etc.
Canteen 	Per item, per meal, etc.
Cinema 	Per ticket

Hotels	Guest Days or Room Days
Bank or Financial Institutions	Per transaction, per services (e.g. per letter of credit, per application, per project, etc.)
Educational Institutes	Per course, per student, per batch, per lecture, etc.
Information Technology Enabled Services	Cost per project, per module, etc.
Insurance	Per policy, per claim, per TPA, etc.

What are the METHODS for ascertaining Service Cost Unit?

Composite Cost Unit

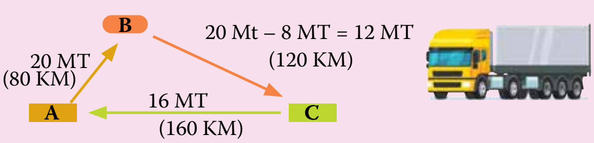
Two measurement units combined together

Example- transportation undertaking measuring operating cost per passenger per kilometre.
Other examples- Ton- km., Quintal- km., Passenger-km., Patient-day etc.

Composite unit may be computed in TWO WAYS

Absolute (Weighted Average) basis	**Commercial (Simple Average) basis**
Summation of the products of qualitative and quantitative factors	Product of average qualitative and total quantitative factors
$\Sigma\{\text{Weight Carried (W)} \times \text{Distance (D)}\}_1 + (W \times D)_2 + ... + (W \times D)_n$	$\Sigma\{\text{Distance } (D_1 + D_2 + ...+ D_n)\} \times [(\text{Weight}_1 + W_2 + ... + W_n)/n]$

Example: A Lorry starts with a load of 20 Metric Ton (MT) of Goods from Station 'A'. It unloads 8 MT in Station 'B' and balance goods in Station 'C'. On return trip, it reaches Station 'A' with a load of 16 MT, loaded at Station 'C'. The distance between A to B, B to C and C to A are 80 Kms, 120 Kms and 160 Kms, respectively.



Weighted Average or Absolute basis – MT – Kilometer would be calculated as follows:

= (20 MT × 80 Kms) + (12 MT × 120 Kms) + (16 MT × 160 Kms)

= 1,600 + 1,440 + 2,560 = 5,600 MT – Kilometer

Simple Average or Commercial basis – MT – Kilometer would be calculated as follows:

= [{(20+12+16) / 3} MT × (80 +120 +160) Kms]

= 16 MT × 360 Kms = 5,760 MT – Kilometer

Equivalent Cost Unit/ Equivalent Service Unit

Each grade of service is assigned a weight and converted into equivalent units

Example- hotel having three types of suites for its customers, viz., Standard, Deluxe and Luxurious and tariff to be decided for one suite being double the rate of other suite.

Example: A hotel may decide tariff to their different type of suites as follows-

Type of suite	Number of rooms	Room Tariff
Standard	100	Amount X
Deluxe	50	2.5 times of the Standard suites
Luxurious	30	Twice of the Deluxe suites

Since, all three types of suites use same amount of overheads but to attach qualitative weight, these rooms are required to be converted into equivalent units.

(i) If Standard suite is taken as base:

Nature of suite	Occupancy (Room-days)	Equivalent single room suites (Room-days)
Standard	36,000 (100 rooms x 360 days)	36,000 (36,000 x 1)
Deluxe	18,000 (50 rooms x 360 days)	45,000 (18,000 x 2.5)
Luxurious	10,800 (30 rooms x 360 days)	54,000 (10,800 x 5)
		1,35,000

Or

(ii) If Luxurious suite is taken as base:

Nature of suite	Occupancy (Room-days)	Equivalent luxurious suites (Room-days)
Standard	36,000 (100 rooms x 360 days)	7,200 (36,000 x 1/5)
Deluxe	18,000 (50 rooms x 360 days)	9,000 (18,000 x ½)
Luxurious	10,800 (30 rooms x 360 days)	10,800 (10,800 x 1)
		27,000

STATEMENT OF COSTS FOR SERVICE SECTORS

Cost sheet on the basis of variability is prepared classifying all the costs into three different heads.

- Fixed costs or Standing charges
- Variable costs or Operating expenses
- Semi-variable costs or Maintenance expenses

COSTING OF TRANSPORT SERVICES

Types of transport services

Goods transport — **Cost unit: Ton– Kilometer**

Passenger transport — **Cost unit: Passenger– Kilometer**

Suggestive heads:

Standing charges or fixed costs (costs that remain constant irrespective of distance travelled)

- Insurance
- License fees
- Salary to Driver, Conductor, Cleaners, etc if paid on monthly basis
- Garage costs, including garage rent
- Depreciation (if related to efflux of time)
- Taxes
- Administration expenses, etc.

Variable costs or Running costs (costs associated with distance travelled)

- Petrol and Diesel
- Lubricant oils,
- Wages to Driver, Conductor, Cleaners, etc. if it is related to operations
- Depreciation (if related to activity)
- Any other variable costs identified.

Semi-variable costs or Maintenance costs

- Repairs and maintenance
- Tyres
- Spares, etc.

COSTING OF HOTELS AND LODGES

Cost unit — **Guest-day or Room-day**

COSTING OF HOSPITALS

A hospital may have different departments such as

- Out - Patient
- In Patient
- Medical services like X-Ray, Scanning, etc.
- General services like Catering, Laundry, Power house, etc.
- Miscellaneous services like Transport, Dispensary, etc.

Unit of Cost

- Out Patient – Per Out-patient
- In Patient – Per Room Day
- Scanning – Per Case
- Laundry – Per 100 items laundered

COSTING OF INFORMATION TECHNOLOGY ENABLED SERVICES

EMPLOYEE COST constitutes SIGNIFICANT portion of total operating costs.

DIRECT EMPLOYEE COST is TRACEABLE to SERVICES RENDERED.

Typical MANPOWER DIRECTLY ENGAGED on a project:

- Software Engineers / Functional Consultants / Business Analysts,
- Project Leaders,
- Project Manager,
- Program Manager, etc.

The COSTS are TRACEABLE with a project and hence forming part of DIRECT COSTS of the project.

SUPPORT MANPOWER ENGAGED on a project:

- Quality Assurance Team,
- Testing team,
- Version Control team,
- Staffing Manager, etc.

If time is NOT TRACEABLE with a single project, then it may either be allocated or apportioned to various projects on some SUITABLE BASIS.

COSTING OF TOLL ROADS

Cost Involved

- **Capital Costs (incurred during construction period)**
  - Preliminary and pre-operative expenses,
  - Land Acquisition,
  - Materials, Labour, Overheads incurred in the course of actual construction,
  - Contingency allowance,
  - Interest during construction period.
- **Operating and Maintenance Costs (incurred once the road is operational)**
  - **Annual operating cost**
    - cost of operating tollbooths,
    - administrative expenses,
    - emergency services,
    - communications and security services.
  - **Routine maintenance**
    - Patching of potholes, sealing of cracks, edge repair,
    - Surface renewal,
    - Periodic maintenance.

To compute the toll rate, following formula may be used: $= \dfrac{\text{Total Cost + Profit}}{\text{Number of Vehicles}}$

COSTING OF EDUCATIONAL INSTITUTIONS

INCOME of the Educational Institutions

One-time fees like Admission fee, Development fee, Annual fee etc

Recurring fees like tuition fee, laboratory, computer and internet fee, library fee, training fee, amenities fee, sports fee, extracurricular activities fee, etc.

Other incomes like transport, hostel, mess and canteen.

EXPENDITURE of the Educational Institutions

Operational Cost like teachers' salary, Building maintenance, Computer maintenance and internet charges.

Research and Development Cost like academic research on various fields of specialisations.

COSTING OF INSURANCE COMPANIES

INCOME of Insurance companies

Premium on policy (periodic or onetime)	Commission on re-insurance	Fund administration fee and return on investment of funds, etc.

EXPENDITURE of Insurance companies

Direct costs like commission paid to agents, claim settlement, cost of valuation, premium for re-insurance, legal and other costs, etc.	**Indirect costs like** actuarial fees, market and product development costs, administration cost, asset management cost, etc.

Method of Costing

Activity Based Costing

- Pre-product development activities
  - Market research, product development like specification of coverage, conditions, amount of premium, etc.
- Post product development activities
  - Selling of policy
    - Appointment of distribution of sales channel, soliciting for policy, processing of applications, etc.
  - Processing of claims
    - Claim inception, claim estimation, claim settlement and legal actions.

COSTING OF FINANCIAL INSTITUTIONS

COSTS TO BE IDENTIFIED with appropriate activities that have caused its occurrence.

Then costs must be REASSIGNED FROM ACTIVITIES TO COST OBJECTS based on identified cost drivers.

The concepts on ACTIVITY BASED COSTING under Costing of Insurance Companies is also applicable to financial institutions.

COSTING OF POWER HOUSES

Cost unit

Cost per kilowatt-hour (kWh)

Suggestive heads:

Standing charges or Fixed costs

(costs that remain constant irrespective of power or stream generated)

- Rent, Rates & Taxes
- Insurance
- Depreciation
- Salaries, if paid on time (Monthly basis)
- Administration expenses, etc.

Variable costs or Running costs

(costs associated with power or stream generated)

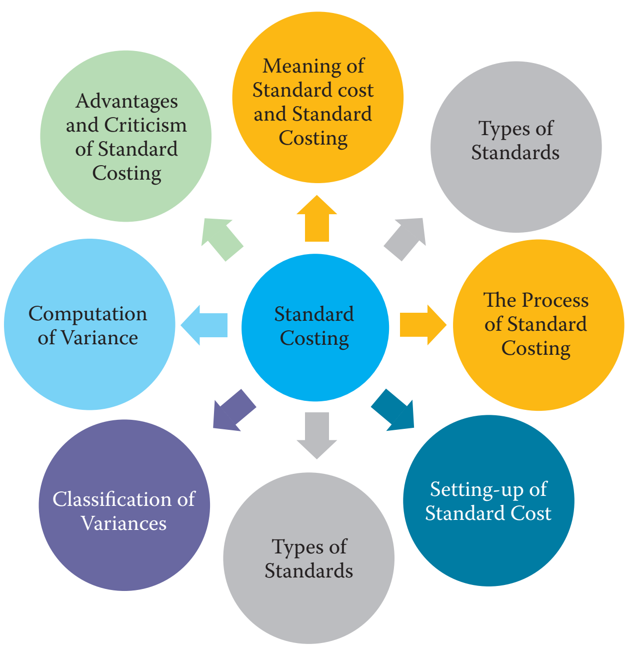
- Fuel Charges
- Water Charges
- Wages / Labour charges, if paid on the basis of production
- Any other variable costs identified.

Semi-variable costs or Maintenance costs

- Meters
- Furnaces
- Service materials
- Tools, etc.

Standard Costing

Chapter Overview



What is a Standard or Standard Cost?

Standard cost is defined in the CIMA Official Terminology as "'the planned unit cost of the product, component or service produced in a period. The standard cost may be determined on a number of bases. The main use of standard costs is in performance measurement, control, stock valuation and in the establishment of selling prices."

Types of standards

There are various types of standard which are illustrated below:

Ideal Standards: The level of performance attainable when prices for material and labour are most favourable, when the highest output is achieved with the best equipment and layout and when the maximum efficiency in utilisation of resources results in maximum output with minimum cost.

Normal Standards: These are standards that may be achieved under normal operating conditions.

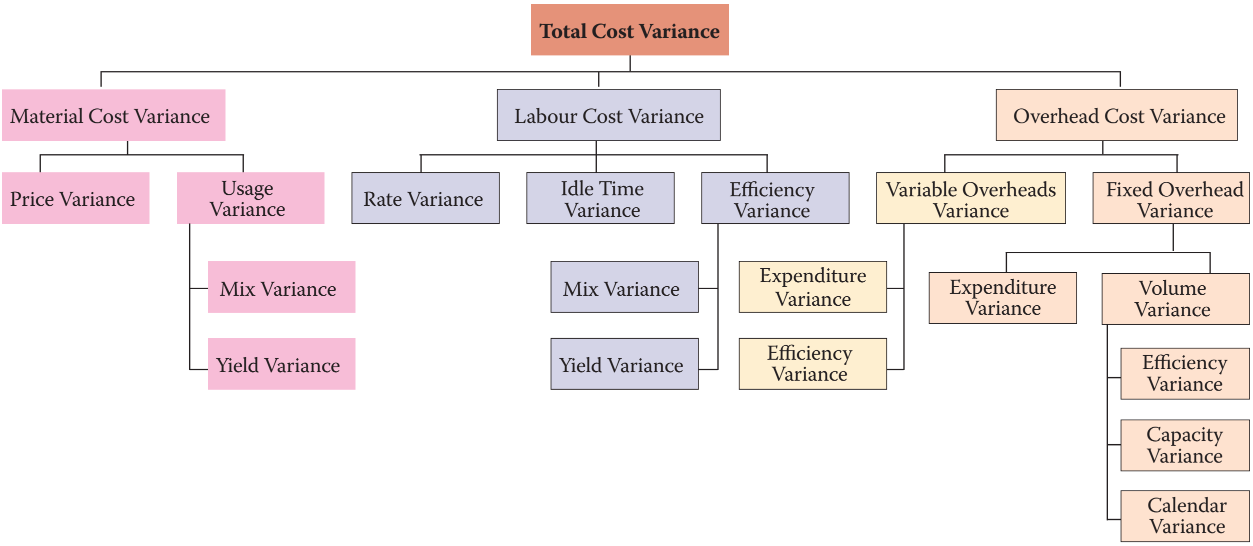
Basic or Bogey Standards: These standards are used only when they are likely to remain constant or unaltered over a long period.

Current Standards: These standards reflect the management's anticipation of what actual costs will be for the current period.

Process followed in Standard Costing

Setting of Standards → Ascertainment of actual costs → Comparison of actual cost with standard cost → Investigate the reasons for variances → Disposition of variances

Variances at a Glance



Variance Analysis

(i) Material Cost Variance

Material Cost Variance

[Standard Cost – Actual Cost]

(The difference between the Standard Material Cost *of the actual production volume* and the Actual Cost of Material)

[(SQ × SP) – (AQ × AP)]

Material Price Variance

[Standard Cost of Actual Quantity – Actual Cost]

(The difference between the Standard Price and Actual Price for the Actual Quantity Purchased)

[(SP – AP) × AQ]

Or

[(SP × AQ) – (AP × AQ)]

Material Usage Variance

[Standard Cost of Standard Quantity for Actual Production – Standard Cost of Actual Quantity]

(The difference between the Standard Quantity *specified for actual production* and the Actual Quantity *used*, at Standard Price)

[(SQ – AQ) × SP]

Or

[(SQ × SP) – (AQ × SP)]

Material Mix Variance

[Standard Cost of Actual Quantity in Standard Proportion – Standard Cost of Actual Quantity]

(The difference between the Actual Quantity *in standard proportion* and Actual Quantity *in actual proportion*, at Standard Price)

[(RSQ – AQ) × SP]

Or

[(RSQ × SP) – (AQ × SP)]

Material Yield Variance

[Standard Cost of Standard Quantity for Actual Production – Standard Cost of Actual Quantity in Standard Proportion]

(The difference between the Standard Quantity *specified for actual production and Actual Quantity in standard proportion*, at Standard Purchase Price)

[(SQ – RSQ) × SP]

Or

[(SQ × SP) – (RSQ × SP)]

(ii) Labour Cost Variances

Labour Cost Variance
[Standard Cost – Actual Cost]
(The difference between the Standard Labour Cost and the Actual Labour Cost *incurred for the production achieved)*
[(SH × SR) – (AH* × AR)]

Labour Rate Variance	Labour Idle Time Variance	Labour Efficiency Variance
[Standard Cost of Actual Time – Actual Cost]	[Standard Rate per Hour x Actual Idle Hours]	[Standard Cost of Standard Time for Actual Production – Standard Cost of Actual Time]
(The difference between the Standard Rate per hour and Actual Rate per hour for the Actual Hours paid)	(The difference between the Actual Hours *paid* and Actual Hours *worked* at Standard Rate)	(The difference between the Standard Hours *specified for actual production* and Actual Hours *worked* at Standard Rate)
[(SR – AR) × AH*] *Or* [(SR × AH*) – (AR × AH*)]	[(AH* – AH#) × SR] *Or* [(AH* × SR) – (AH# × SR)]	[(SH – AH#) × SR] *Or* [(SH × SR) – (AH# × SR)]

Labour Mix Variance Or Gang Variance	Labour Yield Variance Or Sub-Efficiency Variance
[Standard Cost of Actual Time Worked in Standard Proportion – Standard Cost of Actual Time Worked]	[Standard Cost of Standard Time for Actual Production – Standard Cost of Actual Time *Worked* in Standard Proportion]
(The difference between the Actual Hours worked in standard proportion and Actual Hours worked in actual proportion, at Standard Rate)	(The difference between the Standard Hours specified for actual production and Actual Hours worked in standard proportion, at Standard Rate)
[(RSH – AH#) × SR] *Or* [(RSH × SR) – (AH# × SR)]	(SH – RSH) × SR *Or* (SH × SR) – (RSH × SR)

(iii) Variable Overhead Variances

Variable Overhead Cost Variance
(Standard Variable Overheads for Production – Actual Variable Overheads)

Variable Overhead Expenditure (Spending) Variance	Variable Overhead Efficiency Variance
(Standard Variable Overheads for Actual Hours#) *Less* (Actual Variable Overheads) [(SR – AR) × AH#] *Or* [(SR × AH#) – (AR × AH#)]	(Standard Variable Overheads for Production) *Less* (Standard Variable Overheads for Actual Hours#) [(SH – AH#) × SR] *Or* [(SH × SR) – (AH# × SR)]

(iv) Fixed Overhead Variances

Fixed Overhead Cost Variance
(Absorbed Fixed Overheads) *Less* (Actual Fixed Overheads)

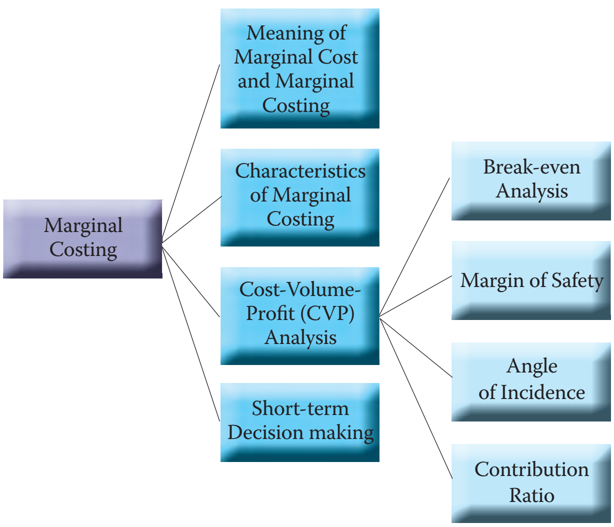
Fixed Overhead Expenditure Variance	Fixed Overhead Volume Variance
(Budgeted Fixed Overheads) *Less* (Actual Fixed Overheads) *Or* (BH × SR) – (AH × AR)	(Absorbed Fixed Overheads) *Less* (Budgeted Fixed Overheads) *Or* (SH × SR) – (BH × SR)

Fixed Overhead Capacity Variance	Fixed Overhead Calendar Variance	Fixed Overhead Efficiency Variance
SR (AH – BH) *Or* (AH × SR) – (BH × SR)	Std. Fixed Overhead rate per day (Actual no. of Working days – Budgeted Working days)	SR (AH – SH) *Or* (AH × SR) – (SH × SR)

AH* - Actual Hours paid
AH# - Actual Hours worked

Marginal Costing

Chapter Overview



Characteristics of Marginal Costing

Characteristics of Marginal Costing

- All elements of cost are classified into fixed and variable components. Semi-variable costs are also analyzed into fixed and variable elements.
- The marginal or variable costs (as direct material, direct labour and variable factory overheads) are treated as the cost of product
- Under marginal costing, the value of finished goods and work–in–progress is also comprised only of marginal costs. Variable selling and distribution overheads are excluded for valuing these inventories.
- Fixed costs are treated as period costs and are charged to profit and loss account for the period for which they are incurred
- Prices are determined with reference to marginal costs and contribution margin
- Profitability of departments and products is determined with reference to their contribution margin

Meaning of Terms

In order to understand the concept of marginal costing, let us first define various terminology associated with marginal costing.

Marginal Cost	Marginal Costing	Direct Costing	Differential Cost
Marginal cost as understood in economics is the incremental cost of production which arises due to one-unit increase in the production quantity.	It is a costing system where products or services and inventories are valued at variable costs only.	Direct costing and Marginal Costing is used synonymously at various places and it is so also.	Differential cost is difference between the costs of two different production levels.

Computation of Contribution and Profit under Marginal Costing

For the determination of cost of a product/ service under marginal costing, costs are classified under variable and fixed. All the variable costs are part of product and fixed costs are charged against contribution margin.

Cost and Profit Statement under Marginal Costing

	Amount (Rs)	Amount (Rs)
Revenue		xxx
Product Cost:		
- Direct Materials	xxx	
- Direct employee (labour)	xxx	
- Direct expenses	xxx	
- Variable manufacturing overheads	xxx	
Product (Inventoriable) Costs	**xxx**	**(xxx)**
Product Contribution Margin		xxx
- Variable Administration overheads	xxx	
- Variable Selling & Distribution overheads	xxx	(xxx)
Contribution Margin		**xxx**
Period Cost:		
Fixed Manufacturing expenses	xxx	
Fixed non-manufacturing expenses	xxx	(xxx)
Profit/ (loss)		xxx

Advantages of Marginal Costing

There are many advantages of marginal costing, some of them are discussed below.

Cost-Volume-Profit (CVP) Analysis

It is a managerial tool showing the relationship between various ingredients of profit planning viz., cost, selling price and volume of activity.

Marginal Cost Equation

Marginal Cost Equation = S -V = C = F ± P

Marginal Cost Statement

	(₹)
Sales (S)	xxxx
Less: Variable Cost (V)	xxxx
Contribution (C)	xxxx
Less: Fixed Cost (F)	xxxx
Profit/ Loss (P)	xxxx

Profit Volume Ratio or P/V ratio

This ratio shows the proportion of sales required to cover fixed cost and profit. P/V ratio is calculated as below:

(a) $\text{P/V Ratio} = \dfrac{\text{Contribution}}{\text{Sales}} \times 100$

(b) When two years' data is given, P/V Ratio

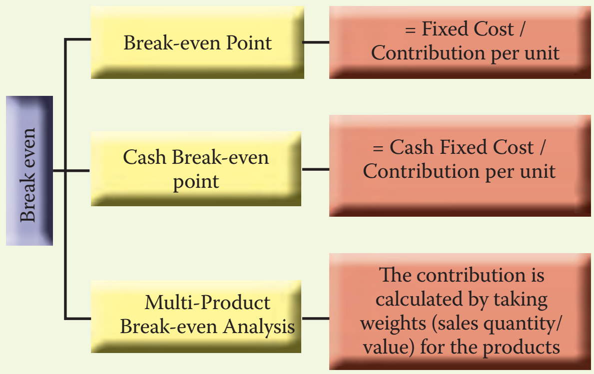
$$= \frac{\text{Change in contribution/ Profit}}{\text{Change in sales}} \times 100$$

Break-Even Analysis

Break-even analysis is a generally used method to study the CVP analysis. This technique can be explained in two ways.

(i) In narrow sense it is concerned with computing the break-even point.

(ii) In broad sense this technique is used to determine the possible profit/loss at any given level of production or sales.



Angle of Incidence

This angle is formed by the intersection of sales line and total cost line at the break-even point. This angle shows the rate at which profit is earned once the break-even point is reached. The wider the angle the greater is the rate of earning profits. A large angle of incidence with a high margin of safety indicates extremely favourable position

Margin of Safety

This is the difference between the expected level of sales and break even sales (no profit, no loss). The larger is the margin of safety higher is the profit and vice versa.

Variations of Basic Marginal Cost Equation and other formulae

i. Sales – Variable cost = Fixed cost + Profit / Loss
By multiplying and dividing L.H.S. by S
ii. $\dfrac{S\,(S - V)}{S} = F + P$
iii. S x P/V Ratio = F + P or Contribution (P / V Ratio = $\dfrac{S - V}{S}$ X 100)
iv. BES x P/V Ratio = F (∵ at BEP Profit is zero)
v. $\text{BES} = \dfrac{\text{Fixed cost}}{\text{P/V Ratio}}$
vi. $\text{P/V Ratio} = \dfrac{\text{Fixed cost}}{\text{BES}}$
vii S × P/V Ratio = Contribution (Refer to iii)

viii. $\text{P/V Ratio} = \dfrac{\text{Contribution}}{\text{Sale}} \times 100$

ix. (BES + MS) × P/V Ratio = Contribution (Total sales = BES + MS)

x. (BES × P/V Ratio) + (MS × P/V Ratio) = F + P

By deducting (BES × P/V Ratio) from L.H.S. and F from R.H.S. in (x) above, we get:

xi. M.S. × P/V Ratio = P

xii. $\text{P/V Ratio} = \dfrac{\text{Change in profit}}{\text{Change in sales}} \times 100$

xiii. $\text{P/V Ratio} = \dfrac{\text{Change in contribution}}{\text{Change in sales}} \times 100$

xiv. $\text{Profitability} = \dfrac{\text{Contribution}}{\text{Key factor}}$

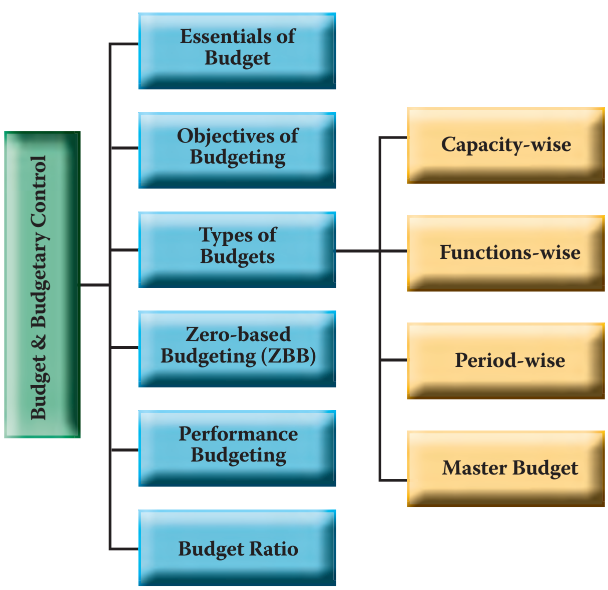
xv. Margin of Safety = Total Sales – BES or $\dfrac{\text{Profit}}{\text{P/V Ratio}}$

xvi. BES = Total Sales – MS

xvii. $\text{Margin of Safety Ratio} = \dfrac{\text{Total sales} - \text{BES}}{\text{Total Sales}}$

Budget & Budgetary Control

Chapter Overview



Definition and Terminology

Let us first define various important terminologies used in budget and budgetary control.

Budget	Budgeting	Budgetary control
Quantitative expression of a plan for a defined period of time	Coordinating the combined intelligence of an entire organisation into a plan of action based on past performance	The establishment of budgets relating to the responsibilities of executives of a policy and the continuous comparison of the actual with the budgeted results, either to secure by individual action the objective of the policy or to provide a basis for its revision

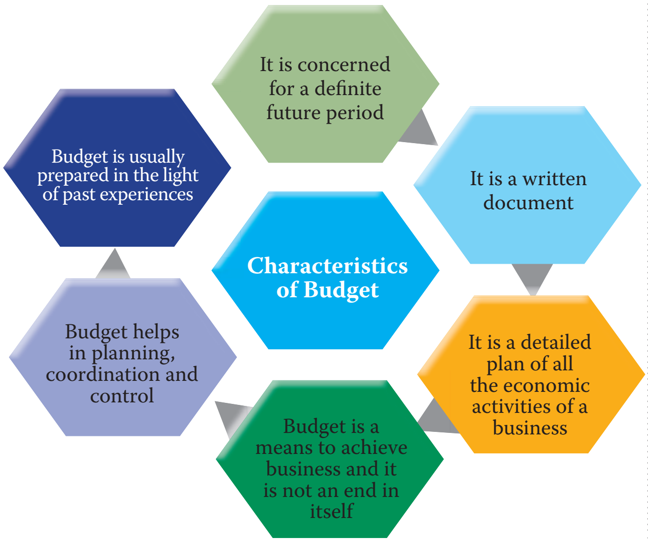
Essentials of Budget

Essential elements of budget are illustrated below:

Essential elements of a budget					
Organisational structure must be clearly defined	Setting of clear objectives and reasonable targets	Budgets are prepared for the future periods based on expected course of actions	Budgets are updated for the events that were not kept into the mind while establishing budgets	Budgets should be quantifiable and master budget should be broken down into various functional budgets. Budgets should be monitored periodically	Budgetary performance needs to be linked effectively to the reward system

Characteristics of Budget

Main characteristics of budget are as below:

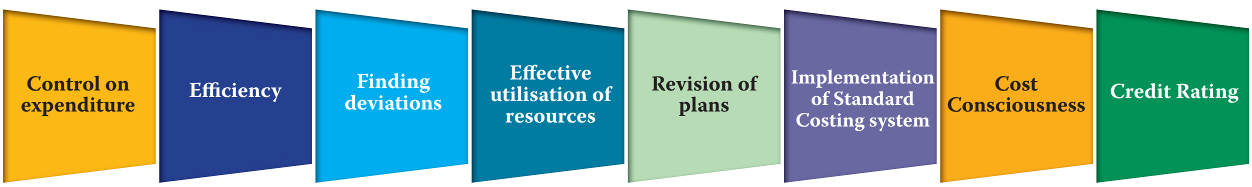


Objectives of Budgeting

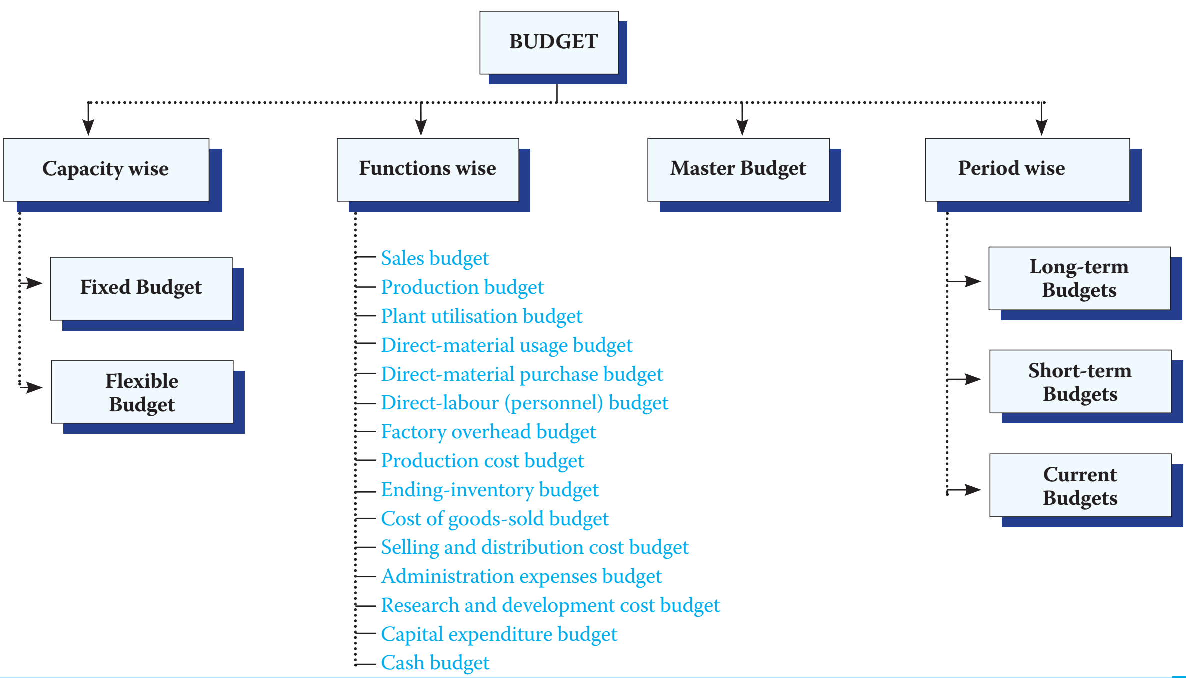
The objective of budgeting begins with planning and ends with controlling. Once the planning is done, they can be used for directing and controlling operations so that the stated targets in planning are achieved.

Advantages of Budgetary Control System

There are many advantages of budgetary control system, and some of the them are illustrated below:



Classification of Budget



Definition of different types of Budget

Functional Budgets	Budgets which relate to the individual functions in an organisation are known as Functional Budgets. For example, purchase budget; sales budget; production budget; plant-utilisation budget and cash budget.
Master Budget	It is a consolidated summary of the various functional budgets. It serves as the basis upon which budgeted P & L A/c and forecasted Balance Sheet are built up.
Long-term Budgets	The budgets which are prepared for periods longer than a year are called long-term budgets. Such budgets are helpful in business forecasting and forward planning. Capital expenditure budget and Research and Development budget are examples of long-term budgets.
Short-term Budgets	Budgets which are prepared for periods less than a year are known as short-term budgets. Cash budget is an example of short-term budget. Such types of budgets are prepared in cases where a specific action has to be immediately taken to bring any variation under control, as in cash budgets.
Basic Budgets	A budget which remains unaltered over a long period of time is called basic budget.
Current Budgets	A budget which is established for use over a short period of time and is related to the current conditions is called current budget.
Fixed Budget	According to CIMA official terminology, "a fixed budget, is a budget designed to remain unchanged irrespective of the level of activity actually attained".
Flexible Budget	According to CIMA official terminology, "a flexible budget is defined as a budget which, by recognizing the difference between fixed, semi-variable and variable costs is designed to change in relation to the level of activity attained."

Differences between Fixed Budget and Flexible Budget

Sl. no.	Fixed Budget	Flexible Budget
1.	It does not change with actual volume of activity achieved. Thus it is known as rigid or inflexible budget	It can be re-casted on the basis of activity level to be achieved. Thus it is not rigid.
2.	It operates on one level of activity and under one set of conditions. It assumes that there will be no change in the prevailing conditions, which is unrealistic.	It consists of various budgets for different levels of activity.
3.	Here as all costs like - fixed, variable and semi-variable are related to only one level of activity, so variance analysis does not give useful information.	Here, analysis of variance provides useful information as each cost is analysed according to its behaviour.
4.	If the budgeted and actual activity levels differ significantly, then the aspects like cost ascertainment and price fixation do not give a correct picture.	Flexible budgeting at different levels of activity facilitates the ascertainment of cost, fixation of selling price and tendering of quotations.
5.	Comparison of actual performance with budgeted targets will be meaningless specially when there is a difference between the two activity levels.	It provides a meaningful basis of comparison of the actual performance with the budgeted targets.

Zero- Based Budgeting (ZBB)

It is defined as 'a method of budgeting which requires each cost element to be specifically justified, although the activities to which the budget relates are being undertaken for the first time, without approval, the budget allowance is zero'.

Stages in Zero-based budgeting

Identification and description of Decision packages

↓

Evaluation of Decision packages

↓

Ranking (Prioritisation) of the Decision packages

↓

Allocation of resources

Performance Budgeting

A performance budget is one which presents the purposes and objectives for which funds are required, the costs of the programmes proposed for achieving those objectives, and quantitative data measuring the accomplishments and work performed under each programme.

Steps in Performance Budgeting

Establishing a meaningful functional programme and activity classification of government operations

→

Bring the system of accounting and financial management in accord with this classification

→

Evolving suitable norms, yardsticks, work units of performance and units costs, wherever possible under each programme and activity for their reporting and evaluation

Budget Ratio

Budget ratios provide information about the performance level, i.e., the extent of deviation of actual performance from the budgeted performance and whether the actual performance is favourable or unfavourable.

The following ratios are usually used by the management to measure development from budget

Efficiency Ratio

This ratio may be defined as standard hours equivalent of work produced expressed as a percentage of the actual hours spent in producing the work.

Standard Capacity Employed Ratio

This ratio indicates the extent to which facilities were actually utilized during the budget period.

Level of Activity Ratio

This may be defined as the number of standard hours equivalent to work produced expressed as a percentage of the budget of standard hours.

Capacity Usage Ratio

This is the relationship between the budgeted number of working hours and the maximum possible number of working hours in a budget period.

Calendar Ratio

This ratio may be defined as the relationship between the number of working days in a period and the number of working days as in the relative budget period.

Budget Ratios:

(i) **Efficiency Ratio** = $\dfrac{\text{Standard Hours}}{\text{Actual Hours}} \times 100$

(ii) **Activity Ratio** = $\dfrac{\text{Standard Hours}}{\text{Budgeted Hours}} \times 100$

(iii) **Calendar Ratio** = $\dfrac{\text{Available working days}}{\text{Budgeted working days}} \times 100$

(iv) **Standard Capacity Usage Ratio** = $\dfrac{\text{Budgeted Hours}}{\text{Max. possible hours in the budgeted period}} \times 100$

(v) **Actual Capacity Usage Ratio** = $\dfrac{\text{Actual Hours worked}}{\text{Max. possible working hours in a period}} \times 100$

(vi) **Actual Usage of Budgeted Capacity Ratio** = $\dfrac{\text{Actual working Hours}}{\text{Budgeted Hours}} \times 100$

CA INTERMEDIATE – PAPER 4A – INCOME TAX LAW

The provisions of Income-tax law, as amended by the Finance Act, 2022 to the extent included in the syllabus of Intermediate (New) Paper 4A: Income-tax Law, are relevant for May, 2023 and November, 2023 examinations. This Capsule on Income-tax law attempts to give an overview of the step by step procedure for computation of total income and tax payable by an individual for A.Y.2023-24, being the relevant assessment year for May, 2023 and November, 2023 examinations. For detailed study, students are advised to read the May, 2022 edition of the Study Material of Paper 4A: Income-tax Law webhosted at https://www.icai.org/post.html?post_id=18481 along with the Statutory Update webhosted at https://resource.cdn.icai.org/72468bos58397.pdf.

COMPUTATION OF TOTAL INCOME AND TAX PAYABLE BY AN INDIVIDUAL – STEP BY STEP PROCEDURE

Income-tax is levied on an assessee's total income. Such total income has to be computed as per the provisions contained in the Income-tax Act, 1961. Steps 1 to 8 given hereunder have to be followed for computing the total income of an individual assessee as per the regular provisions of the Income-tax Act, 1961. Thereafter, Steps 9 to 15 have to be followed for computing the tax payable.

Step 1 – Determination of residential status

The residential status of an individual has to be determined to ascertain which income is to be included in his total income (TI).

In case of an individual, the duration for which he is present in India in the relevant previous year or relevant previous year and the earlier previous years, as the case may be, determine his residential status. Based on the days spent by him in India, he may be resident or a non-resident.

- **Resident**
  - Resident and ordinarily resident
  - Resident but not ordinarily resident
- **Non-resident**

Note *– An Indian citizen who is a deemed resident in India would be a resident but not ordinarily resident in India.*

[Refer Fig 1]

Step 2 – Classification of income under five heads

An individual may earn income from different sources. Under the Income-tax Act, 1961, for computation of TI, all income of an individual tax payer can be classified into **five different heads of income.**

- Salaries
- Income from house property
- Profits and gains of business or profession
- Capital gains
- Income from other sources

Step 3 – Computation of income under each head

- Income under each head (–) exemptions (–) deductions allowable under that head

[For detail computation of income under each head, refer Module 2 of the Study Material]

Step 4 – Clubbing of income of spouse, minor child etc.

In case of individuals, income-tax is levied on a slab system on the total income. The tax system is progressive i.e., as the income increases, the applicable rate of tax increases. Some taxpayers in the higher income bracket have a tendency to divert some portion of their income to their spouse, minor child etc. to minimize their tax burden.

In order to prevent such tax avoidance, clubbing provisions have been incorporated in the Act, under which income arising to certain persons (like spouse, minor child etc.) have to be included in the income of the person who has diverted his income for the purpose of computing tax liability **[Refer Table 2]**.

Step 5 – Set-off of current year losses and brought forward losses

An assessee may have different sources of income under the same head of income. He may have profit from one source and loss from the other. Similarly, an assessee can have loss under one head of income and profits under another heads of income. There are provisions in the Act for allowing inter-head adjustment in certain cases. The losses is allowed to be set off in the following series -

- Inter-source set-off of losses
- Inter-head set-off of losses
- Set-off of brought forward losses
- Set-off of unabsorbed depreciation

Thereafter, unabsorbed losses and unabsorbed depreciation would be carried forward.

[Refer Fig 3]

Step 6 – Computation of gross total income

Gross Total Income = Add income computed under each head → Apply clubbing provisions → Apply the provisions for set-off and carry forward of losses

Step 7 – Deductions from gross total income

There are deductions under Chapter VI-A allowable from Gross Total Income. These deductions are of following types –

- Deductions in respect of certain payments
- Deductions in respect of certain incomes
- Deductions in respect of other incomes
- Other deductions

[Refer Table 4]

Step 8 – Computation of total income

- Total Income = Gross total income (–) Deductions under Chapter VI-A
- Total Income should be rounded off to the nearest multiple of ₹ 10

Step 9 – Application of rates of tax on total income in case of an individual

Total income (in ₹)	Rate of Tax
Upto ₹ 2,50,000 (in case of an individual below 60 years) Upto ₹ 3,00,000 (in case of an individual who is 60 years or more but less than 80 years and resident in India) Upto ₹ 5,00,000 (in case of an individual who is 80 years or more and resident in India)	Nil
₹ 2,50,001/ ₹ 3,00,001, as the case may be, to ₹ 5,00,000	5%
₹ 5,00,001 to ₹ 10,00,000	20%
Above ₹ 10,00,000	30%

Step 10 – Surcharge and Rebate

Surcharge

S. No.	Particulars	Rate of surcharge on income-tax
(i)	Where the TI (including dividend income and capital gains chargeable to tax u/s 111A, 112 and 112A) > ₹ 50 lakhs but ≤ ₹ 1 crore	10%
(ii)	Where TI (including dividend income and capital gains chargeable to tax u/s 111A, 112 and 112A) > ₹ 1 crore but ≤ ₹ 2 crore	15%
(iii)	Where TI (excluding dividend income and capital gains chargeable to tax u/s 111A, 112 and 112A) > ₹ 2 crore but ≤ ₹ 5 crore	25%
	The rate of surcharge on the income-tax payable on the portion of dividend income and capital gains chargeable to tax u/s 111A, 112 and 112A	Not exceeding 15%
(iv)	Where TI (excluding dividend income and capital gains chargeable to tax u/s 111A, 112 and 112A) > ₹ 5 crore	37%
	Rate of surcharge on the income-tax payable on the portion of dividend income and capital gains chargeable to tax u/s 111A, 112 and 112A	Not exceeding 15%
(v)	Where TI (including dividend income and capital gains chargeable to tax u/s 111A, 112 and 112A) > ₹ 2 crore in cases not covered under (iii) and (iv) above	15%

Rebate under section 87A: Rebate u/s 87A allowable to resident individuals having total income of up to ₹ 5 lakh.

Rebate would be equal to the amount of ₹ 12,500 or income-tax on total income, whichever is less.

However, rebate u/s 87A is not available in respect of tax payable @10% on long-term capital gains taxable u/s 112A.

Step 11 – Health and Education cess on Income-tax

Health and Education cess	4% of income-tax and surcharge, if applicable

Total Tax Liability	=	Tax on total income at applicable rates	(+) (-)	Surcharge, at applicable rates, if total income > ₹ 50 lakhs, or Rebate u/s 87A, if total income ≤ ₹ 5 lakh	(+)	HEC@4%

Step 12 – Examine the applicability of Alternate Minimum Tax (AMT)

- If an individual is claiming dedn u/s 10AA or u/s 35AD or section 80JJAA, 80QQB & 80RRB and his adjusted TI > ₹ 20 lakhs, AMT provisions will apply.
- Compute AMT [18.5% of adjusted TI plus surcharge, if applicable plus HEC @4%].
- If AMT > tax computed as per regular provisions, adjusted TI would be deemed to be TI.
- Tax is leviable @18.5% of adjusted total income plus surcharge, if applicable plus HEC @4%.
- Tax credit can be c/f for maximum 15 A.Ys. = AMT *less* Tax computed as per regular provisions.
- Individuals exercising option u/s 115BAC are not liable to AMT u/s 115JC.

Step 13 – Examine whether or not to exercise the option under section 115BAC for availing concessional tax slab rates

As per section 115BAC, **individuals have an option to pay tax** in respect of their TI (other than income chargeable to tax at special rates under Chapter XII) **at following concessional rates,** if they **do not avail certain exemptions/ dedns** like LTC, std deduction under the head "Salaries", int. on housing loan on self-occupied property, dedns under Chapter VI-A (other than 80CCD(2) or section 80JJAA), set-off of b/f loss or depr., if they relate to any of the above dedns, set-off of loss from house property against income under any other head, etc. –

	Total Income	Tax rate
(i)	Upto ₹ 2,50,000	Nil
(ii)	From ₹ 2,50,001 to ₹ 5,00,000	5%
(iii)	From ₹ 5,00,001 to ₹ 7,50,000	10%
(iv)	From ₹ 7,50,001 to ₹ 10,00,000	15%
(v)	From ₹ 10,00,001 to ₹ 12,50,000	20%
(vi)	From ₹ 12,50,001 to ₹ 15,00,000	25%
(vii)	Above ₹ 15,00,000	30%

Surcharge would be attracted **at the same rates** and above the same thresholds of TI as applicapbe under the regular provisions of the Income-tax Act, 1961. Further, **HEC @4%** would be attracted on income-tax so calculated *plus* surcharge, if applicable.

Examine the tax liability computed under the regular provisions of the Act (**including** provisions relating to **AMT, if applicable**) with the **tax liability computed u/s 115BAC.** Thereafter, **if tax liability is lower** as per the provisions **u/s 115BAC**, then **opt to pay tax** as per section **115BAC**.

Note - *If an individual having income from business or profession exercises option to pay tax u/s 115BAC in a P.Y., then, the said provisions would apply for all subsequent PYs.*

An individual not having income from business or profession can exercise the option to pay tax u/s 115BAC for each P.Y. He may exercise the option in a particular P.Y., but may not do so in another P.Y., depending on whether or not exercising the option is beneficial to him in the respective P.Y.

Step 14 – Credit for advance tax, TDS and TCS

Tax payable/ Tax refundable = Total tax liability (-) TDS (-) TCS (-) Advance tax paid

[Refer Table 5 for advance tax]

Step 15 – Tax payable/ Tax refundable

- Tax payable/ Tax refundable should be rounded off to the nearest multiple of ₹ 10.
- The assessee has to pay the amt of tax payable (called self-

assessment tax) at the time of filing of return of income.

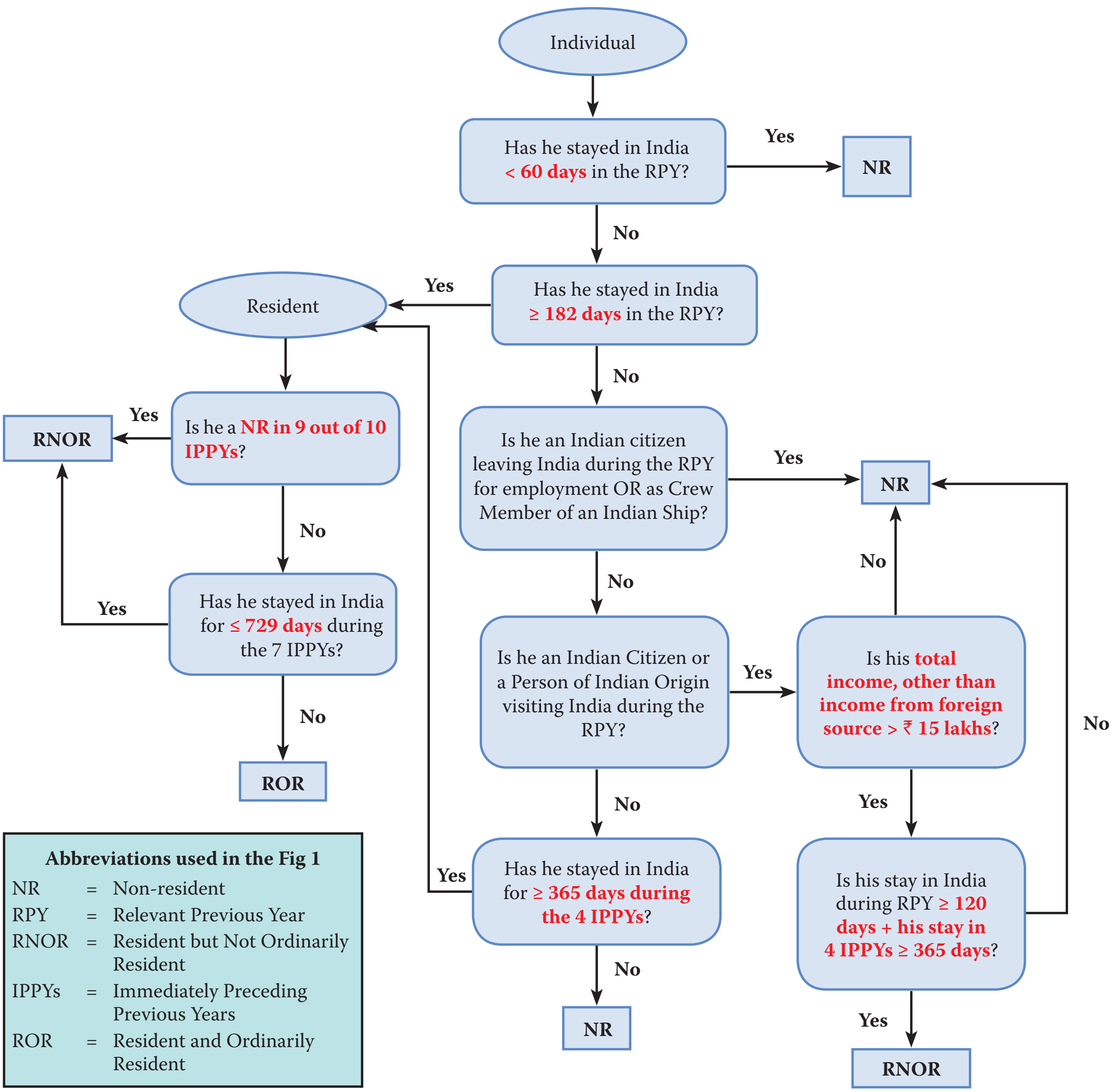
- If any refund is due, assessee will get the same after filing the return of income.

Step 16 - Return of Income

The Income-tax Act, 1961 contains provisions for filing of return of income. Return of income is the format in which the assessee furnishes information as to his total income and tax payable. The Act has prescribed due dates for filing return of income in case of different assessees. An individual is required to file a return of income in the prescribed form (ITR 1/2/3/4, as the case may be as applicable to him) if his total income exceeds the basic exemption limit or he fulfills certain other conditions.

Fig 1

Determination of Residential Status of an Individual



Abbreviations used in the Fig 1

NR	=	Non-resident
RPY	=	Relevant Previous Year
RNOR	=	Resident but Not Ordinarily Resident
IPPYs	=	Immediately Preceding Previous Years
ROR	=	Resident and Ordinarily Resident

Deemed resident [Section 6(1A)] - An individual, being an Indian citizen, having TI (other than the income from foreign sources) > ₹ 15 lakhs during the RPY would be deemed to be resident in India in that PY, if he is not liable to pay tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature. A deemed resident u/s 6(1A) would always be a RNOR.

***Note** – If an individual is a resident in India in the PY as per section 6(1), then, the provision of deemed resident u/s 6(1A) would not apply to him.*

Table 2

Income of Other Persons Included in Assessee's Total Income

Section	Income to be clubbed	Contents
60	Income transferred w/o transfer of asset	When a person transfers the income accruing to an asset w/o transfer of the asset itself, such income is to be included in the TI of the transferor, whether the transfer is revocable or irrevocable.
61	Income arising from revocable transfer of assets	Such income is to be included in the hands of the transferor. A transfer is deemed to be revocable if it – (i) contains any provision for re-transfer of the whole or any part of the income or assets to the transferor; or (ii) gives right to re-assume power over the whole or any part of the income or the asset.
64(1)(ii)	Income arising to spouse by way of remuneration from a concern in which the individual has substantial interest	Such income arising to spouse is to be included in the TI of the individual. However, if remuneration received is attributable to the application of technical or professional knowledge and experience of spouse, then, such income is not to be clubbed.
64(1)(iv)	Income arising to spouse from assets transferred w/o adequate consideration	Income arising from an asset (other than house property) transferred otherwise than for adequate consideration or not in connection with an agreement to live apart, from one spouse to another shall be included in the TI of the transferor. However, this provision will not apply in the case of transfer of house property, since the transferor-spouse would be the deemed owner as per section 27.
64(1)(vi)	Income arising to son's wife from an asset transferred w/o adequate consideration	Income arising from an asset transferred otherwise than for adequate consideration, by an individual to his or her son's wife shall be included in the TI of the transferor.
64(1(vii)/ 64(1(viii)	Income arising from transfer of assets for the benefit of spouse or son's wife	All income arising to any person or AoPs from assets transferred w/o adequate consideration is includible in the income of the transferor, to the extent such income is used by the transferee for the immediate or deferred benefit of the transferor's spouse or son's wife.
64(1A)	Income of **minor child**	All income arising or accruing to a minor child (including a minor married daughter) shall be included in the TI of his or her parent. The income of the minor child shall be included with the income of that parent, whose TI, before including minor's income, is higher. Where the marriage of the parents does not subsist, the income of the minor will be includible in the income of that parent who maintains the minor child in the relevant previous year. The parent, in whose TI, the income of the minor child or children are included, shall be entitled to exemption of such income subject to a maximum of ₹ 1,500 per child u/s 10(32). The following income of a minor child shall, however, not be clubbed in the hands of his or her parent - (a) Income from manual work done by him or activity involving application of minor's skill, talent or specialized knowledge and experience; and (b) Income of a minor child suffering from any disability specified in section 80U. In case the asset transferred to a minor child (not being a minor married daughter) w/o consideration or for inadequate consideration is house property, then, by virtue of section 27(i), the transferor-parent will be the deemed owner of the house property. Consequently, clubbing provisions u/s 64(1A) would not be attracted in respect of such income, due to which the benefit of exemption u/s 10(32) cannot be availed against such income. However, if the house property is transferred by a parent to his or her minor married daughter w/o consideration or for inadequate consideration, then, section 27(i) is not attracted. In such a case, the income from house property will be included u/s 64(1A) in the hands of that parent, whose total income before including minor child's income is higher; and benefit of exemption u/s 10(32) can be availed by that parent in respect of the income so included.
64(2)	Conversion of self-acquired property into the property of a HUF	Where an individual, who is a member of the HUF, converts his individual property into property of the HUF of which he is a member, directly or indirectly, to the family otherwise than for adequate consideration, the income from such property shall continue to be included in the total income of the individual. Where the converted property has been partitioned, either by way of total or partial partition, the income derived from such converted property as is received by the spouse on partition shall also be included in the total income of the individual who effected the conversion of such property.

***Note:** 'Income' includes 'loss.' Therefore, clubbing provisions would be attracted in all the above cases, even if there is a loss and not income.*

Fig 3

Set-Off and Carry Forward & Set-Off of Losses

Inter-source set-off of losses is allowed under the same head of income [Section 70]

Exceptions

- Loss from speculative business – Only against profits from any other speculative business
- Long term capital loss – Only against LTCG
- Loss from specified business u/s 35AD – Only against profits from any other specified business
- Loss from the activity of owning and maintaining race horses - Only against income from the activity of owning and maintaining race horses

Inter-head adjustment is allowed [Section 71]

Exceptions

- Loss under the head "Profits and gains of business or profession" cannot be set off against income under the head "Salaries"
- Speculation loss, loss from specified business u/s 35AD and loss from the activity of owning and maintaining race horses cannot be set-off against income under any other head
- Loss under the head "Capital gains" cannot be set-off against income under any other head.
- Loss from house property can be set off against income under any other head only to the extent of ₹ 2 lakhs

Carry forward and Set-off of brought forward losses

- Unabsorbed loss from house property can be carried forward for maximum 8 AYs for set-off against income from house property **[Section 71B]**
- Unabsorbed business loss can be carried forward for maximum 8 AYs for set-off against profits and gains from business or profession **[Section 72]**
- Unabsorbed loss from speculation business can be carried forward for maximum 4 AYs for set-off against income from speculation business **[Section 73]**
- Unabsorbed loss from specified business u/s 35AD can be carried forward for indefinite period for set-off against profit from any specified business **[Section 73A]**
- Unabsorbed long-term capital loss can be carried forward for maximum 8 AYs for set-off against long-term capital gains **[Section 74]**
- Unabsorbed short-term capital loss can be carried forward for maximum 8 AYs for set-off against capital gains **[Section 74]**
- Unabsorbed loss from the activity of owning and maintaining race horses can be carried forward for maximum 4AYs for set-off against income from the activity of owning and maintaining race horses **[Section 74A]**
- Unabsorbed depreciation can be carried forward for indefinite period for set-off against income under any head other than Salaries **[Section 32(2)]**

Order of set-off of losses by an Individual	
1.	Current year depreciation and current year capital expenditure on scientific research to the extent allowed.
2.	Brought forward loss from business/profession [Section 72(1)]
3.	Unabsorbed depreciation [Section 32(2)]
4.	Unabsorbed capital expenditure on scientific research [Section 35(4)].

Note - As per section 80, filing of loss return u/s 139(3) within the due date specified u/s 139(1) is mandatory for carry forward of the above losses except loss from house property and unabsorbed depreciation.

Table 4

Deductions from Gross Total Income – Chapter VI-A

<table>
<tr><th colspan="4">Deductions in respect of certain payments</th></tr>
<tr><th>Section</th><th>Eligible Assessee</th><th>Eligible Payments</th><th>Permissible Deduction</th></tr>
<tr><td>80C</td><td>Individual or HUF</td><td>Contribution to PPF, Payment of LIC premium, etc.
Sums paid or deposited in the previous year by way of
- Life insurance premium
- Contribution to PPF/ SPF/ RPF and approved superannuation fund
- Repayment of housing loan taken from Govt., bank, LIC, specified employer etc.
- Tuition fees to any Indian university, college, school for full-time education of any two children
- Term deposit for a fixed period of not less than 5 years with schedule bank
- Subscription to notified bonds of NABARD
- Five year post office time deposit
- Senior Citizen's Savings Scheme Account etc.
- Contribution by Central Govt. employee to additional account (Tier II A/c) of NPS referred to u/s 80CCD</td><td>Sum paid or deposited, subject to a maximum of ₹ 1,50,000</td></tr>
<tr><td>80CCC</td><td>Individual</td><td>Contribution to certain pension funds
Any amount paid or deposited to keep in force a contract for any annuity plan of LIC of India or any other insurer for receiving pension from the fund.</td><td>Amount paid or deposited, subject to a maximum of ₹ 1,50,000</td></tr>
<tr><td>80CCD</td><td>Individual employed by the Central Government or any other employer; Any other individual assessee</td><td>Contribution to Pension Scheme of Central Government
An individual employed by the Central Government on or after 1.1.2004 or any other employer or any other assessee, being an individual, who has paid or deposited any amount in his account under a notified pension scheme [to his individual pension account (Tier I A/c) under National Pension Scheme & Atal Pension Yojana]</td><td>Employee's Contribution/ Individual' Contribution
In case of a salaried individual, deduction of own contribution under section 80CCD(1) is restricted to 10% of his salary.
In any other case, deduction under section 80CCD(1) is restricted to 20% of gross total income.
Further, additional deduction of upto ₹ 50,000 is available under section 80CCD(1B).
Employer's Contribution
The entire employer's contribution would be included in the salary of the employee. The deduction of employer's contribution under section 80CCD(2) would be restricted to 14% of salary, where the employer is the Central Government or State Government and 10%, in case of any other employer.</td></tr>
<tr><td colspan="4">Note – As per section 80CCE, maximum permissible deduction u/s 80C, 80CCC & 80CCD(1) is ₹ 1,50,000. However, the limit ₹ 1.50 lakh u/s 80CCE does not apply to deduction u/s 80CCD(2) and 80CCD(1B).</td></tr>
<tr><td>80D</td><td>Individual and HUF</td><td>Medical Insurance Premium
(1) Any premium paid, otherwise than by way of cash, to keep in force an insurance on the health of –
<table><tr><td>in case of an individual</td><td>self, spouse and dependent children</td></tr><tr><td>in case of HUF</td><td>family member</td></tr></table>(2) In case of an individual, contribution, otherwise than by way of cash, to CGHS or any other scheme as notified by Central Government.</td><td>Maximum ₹ 25,000 (₹ 50,000, in case the individual or his or her spouse is a senior citizen)</td></tr>
</table>

<table>
<tr><th colspan="4">Deductions in respect of certain payments</th></tr>
<tr><th>Section</th><th>Eligible Assessee</th><th>Eligible Payments</th><th>Permissible Deduction</th></tr>
<tr><td></td><td></td><td>(3) Any premium paid, otherwise than by way of cash, to keep in force an insurance on the health of parents, whether or not dependent on the individual.

Notes:
(i) Any amount paid, otherwise than by way of cash, on account of medical expenditure incurred on the health of the assessee or his family member or his parent, who is a senior citizen and no amount has been paid to effect or to keep in force an insurance on the health of such person.

(ii) Payment, including cash payment, for preventive health check up of himself, spouse, dependent children and parents.</td><td>Maximum ₹ 25,000 (₹ 50,000, in case either or both of the parents are senior citizen(s))

Amount paid subject to a cap of ₹ 50,000 (in case one parent is a senior citizen, in respect of whom insurance premium is paid, and the other is a senior citizen on whom medical expenditure is incurred, the total deduction cannot exceed ₹ 50,000)

Amount paid subject to a cap of ₹ 5,000, in aggregate (subject to the overall individual limits of ₹ 25,000/ ₹ 50,000, as the case may be)</td></tr>
<tr><td>80DD</td><td>Resident Individual or HUF</td><td>Maintenance including medical treatment of a dependant disabled
Any amount incurred for the medical treatment (including nursing), training and rehabilitation of a dependent disabled
and / or
Any amount paid or deposited under the scheme framed in this behalf by the LIC or any other insurer or Administrator or Specified Company and approved by Board.
Meaning of Dependant
<table>
<tr><th>(1)
In case of</th><th>(2)
Dependant</th></tr>
<tr><td>An individual</td><td>Spouse, children, parents, brothers, sisters</td></tr>
<tr><td>A HUF</td><td>Any member</td></tr>
</table>
Persons mentioned in column (2) should be wholly or mainly dependant on the person mentioned in corresponding column (1) for support and maintenance. Such persons should not have claimed deduction u/s 80U in computing TI of that year.</td><td>Flat deduction of ₹ 75,000.
In case of severe disability (i.e. person with 80% or more disability) the flat deduction shall be ₹ 1,25,000.</td></tr>
<tr><td>80DDB</td><td>Resident Individual or HUF</td><td>Deduction for medical treatment of specified diseases or ailments
Amount paid for specified diseases or ailment
<table>
<tr><th>Assessee</th><th>Amount spent</th></tr>
<tr><td>An individual</td><td>For himself or his dependant being spouse, children, parents, brothers or sisters wholly or mainly dependant on the individual for support and maintenance</td></tr>
<tr><td>A HUF</td><td>For any member</td></tr>
</table></td><td>Actual sum paid or ₹ 40,000 (₹ 1,00,000, if the payment is for medical treatment of a senior citizen), whichever is less,

minus

the amount received from the insurance company or reimbursed by the employer.</td></tr>
<tr><td>80E</td><td>Individual</td><td>Interest on loan taken for higher education
Interest on loan taken from any financial institution or approved charitable institution.
Such loan is taken for pursuing his higher education or higher education of his or her relative i.e., spouse or children of the individual or the student for whom the individual is the legal guardian.</td><td>The deduction is available for interest payment in the initial A.Y (year of commencement of interest payment) and seven A.Y. immediately succeeding the initial A.Y.
(or)
until the interest is paid in full by the assessee, whichever is earlier.</td></tr>
</table>

<table>
<tr><th colspan="4">Deductions in respect of certain payments</th></tr>
<tr><th>Section</th><th>Eligible Assessee</th><th>Eligible Payments</th><th>Permissible Deduction</th></tr>
<tr><td>80EE</td><td>Individual</td><td>Deduction for interest on loan borrowed from any financial institution [bank/ housing finance company (HFC)] for acquisition of residential house property</td><td>Deduction of upto ₹ 50,000 would be allowed in respect of interest on loan taken from a financial institution (FI).
Conditions:
(1) Loan should be sanctioned during P.Y.2016-17
(2) Loan sanctioned ≤ ₹ 35 lakhs
(3) Value of house ≤ ₹ 50 lakhs
(4) The assessee should not own any residential house on the date of sanction of loan.</td></tr>
<tr><td>80EEA</td><td>Individual</td><td>Deduction in respect of interest payable on loan taken from a FI (bank or HFC) for acquisition of residential house property
(In case the property is self-occupied, the dedn would be over and above the dedn of ₹ 2 lakhs u/s 24)</td><td>Deduction of upto ₹ 1,50,000 would be allowed in respect of interest payable on loan taken from a FI for acquisition of house property.
Conditions:
(1) Loan should be sanctioned by a FI during the period between 1^{st} April 2019 to 31^{st} March 2022.
(2) Stamp Duty Value of house ≤ ₹ 45 lakhs
(3) The individual should not own any residential house on the date of sanction of loan.
(4) The individual should not be eligible to claim deduction u/s 80EE.</td></tr>
<tr><td>80EEB</td><td>Individual</td><td>Deduction in respect of interest payable on loan taken from a FI (bank or certain NBFCs) for purchase of electric vehicle</td><td>Deduction of upto ₹ 1,50,000 would be allowed in respect of interest payable on loan taken for purchase of electric vehicle.
Loan should be sanctioned by a FI during the period from 1.4.2019 to 31.3.2023</td></tr>
<tr><td>80G</td><td>All assessees</td><td colspan="2">Donations to certain funds, charitable institutions etc.
There are four categories of deductions –
<table>
<tr><th colspan="2">Category</th><th>Donee</th></tr>
<tr><td>(I)</td><td>100% deduction of amount donated, without any qualifying limit</td><td>Prime Minister’s National Relief Fund, National Children’s Fund, Swachh Bharat Kosh, National Defence Fund, PM CARES Fund etc.</td></tr>
<tr><td>(II)</td><td>50% deduction of amount donated, without any qualifying limit</td><td>Prime Minister’s Drought Relief Fund, Jawaharlal Nehru Memorial Fund, Indira Gandhi Memorial Trust, Rajiv Gandhi Foundation.</td></tr>
<tr><td>(III)</td><td>100% deduction of amount donated, subject to qualifying limit</td><td>Government or local authority, institution for promotion of family planning etc.</td></tr>
<tr><td>(IV)</td><td>50% deduction of amount donated, subject to qualifying limit.</td><td>Government or any local authority to be used for charitable purpose, other than promotion of family planning, notified temple, church, gurudwara, mosque etc.</td></tr>
</table>
</td></tr>
</table>

Deductions in respect of certain payments			
Section	**Eligible Assessee**	**Eligible Payments**	**Permissible Deduction**
		Calculation of Qualifying limit for Category III & IV donations: **Step 1:** Compute adjusted total income, i.e., the gross total income as reduced by the following: 1. Deductions under Chapter VI-A, except u/s 80G 2. Short term capital gains taxable u/s 111A 3. Long term capital gains taxable u/s 112 & 112A **Step 2:** Calculate 10% of adjusted total income. **Step 3:** Calculate the actual donation, which is subject to qualifying limit **Step 4:** Lower of Step 2 or Step 3 is the maximum permissible deduction. **Step 5:** The said deduction is adjusted first against donations qualifying for 100% deduction (i.e., Category III donations). Thereafter, 50% of balance qualifies for deduction u/s 80G. ***Note*** *- **No deduction** shall be allowed for donation **in excess of ₹ 2,000, if paid in cash.***	
80GG	Individual not in receipt of house rent allowance	**Rent paid for residential accommodation**	Least of the following is allowable as deduction: (1) 25% of total income; (2) Rent paid – 10% of total income (3) ₹ 5,000 p.m. No deduction if any residential accommodation is owned by the assessee/ his spouse/ minor child/ HUF at the place where he ordinarily resides or performs the duties of his office or employment or carries on his business or profession.
80GGC	Any person, other than local authority and an artificial juridical person funded by the Government.	**Contributions to political parties** Amount contributed to a registered political party or an electoral trust.	Actual contribution (otherwise than by way of cash)
Deductions in respect of Certain Incomes			
As per section 80AC, furnishing return of income on or before due date is mandatory for claiming deduction in respect of certain incomes.			
Section	**Eligible Assessee**	**Condition for Deduction /Eligible Income**	**Permissible Deduction**
80JJAA	An assessee to whom section 44AB applies, whose gross total income includes profits and gains derived from business	**Deduction in respect of employment of new employees**	30% of additional employee cost incurred in the previous year. Deduction is allowable for 3 assessment years including assessment year relevant to the previous year in which such employment is provided. *For conditions to be satisfied, read Chapter 7 of the Study Material.*
80QQB	Resident individual, being an author	**Royalty income, etc., of authors of certain books other than text books** Consideration for assignment or grant of any of his interests in the copyright of any book, being a work of literary, artistic or scientific nature or royalty or copyright fee received as lumpsum or otherwise.	Income derived in the exercise of profession or ₹ 3,00,000, whichever is less. In respect of royalty or copyright fee received otherwise than by way of lumpsum, income to be restricted to 15% of value of books sold during the relevant previous year.
80RRB	Resident individual, being a patentee	**Royalty on patents** Any income by way of royalty on patents registered on or after 1.4.2003	Whole of such income or ₹ 3,00,000, whichever is less.
Deductions in respect of Other Income			
Section	**Eligible Assessee**	**Eligible Income**	**Permissible Deduction**
80TTA	Individual or a HUF, other than a resident senior citizen	**Interest on deposits in savings account** Interest on deposits in a savings account with a bank, a co-operative society or a post office (not being time deposits, which are repayable on expiry of fixed periods)	Actual interest subject to a maximum of ₹ 10,000.

Deductions in respect of certain payments			
Section	**Eligible Assessee**	**Eligible Payments**	**Permissible Deduction**
80TTB	Resident senior citizen (i.e. an individual of the age of 60 years or more at any time during the previous year)	**Interest on deposits** Interest on deposits (both fixed deposits and saving accounts) with banking company, co-operative society engaged in the business of banking or a post office.	Actual interest or ₹ 50,000, whichever is less.
Other Deductions			
Section	**Eligible Assessee**	**Condition for Deduction**	**Permissible Deduction**
80U	Resident Individual	Deduction in case of a person with disability Any person, who is certified by the medical authority to be a person with disability.	Flat deduction of ₹ 75,000, in case of a person with disability. Flat deduction of ₹ 1,25,000, in case of a person with severe disability (80% or more disability).

Table 5

Advance Payment of Tax

Liability for payment of advance tax [Sections 207 & 208]

- Tax shall be payable in advance during any F.Y. in respect of the TI of an individual which would be chargeable to tax for the A.Y. immediately following that F.Y.
- Advance tax is payable during a F.Y. in every case where the amt of such tax payable by the assessee during the year is ₹ 10,000 or more.
- However, an individual resident in India of the age of 60 years or more at any time during the P.Y., who does not have any income chargeable under PGBP, is not liable to pay advance tax.

Instalments of advance tax and due dates [Section 211]

Advance tax payment schedule for corporates and non-corporates (other than an assessee computing profits on presumptive basis u/s 44AD or section 44ADA) – Four instalments

Due date of instalment	Amt payable
On or before 15th June	Not less than **15%** of advance tax liability
On or before 15th September	Not less than **45%** of advance tax liability (-) amt paid in earlier instalment
On or before 15th December	Not less than **75%** of advance tax liability (-) amt paid in earlier instalment or instalments
On or before 15th March	The whole amt of advance tax liability (-) amt paid in earlier instalment or instalments

Advance tax payment by assessees computing profits on presumptive basis u/s 44AD(1) or 44ADA(1)

An eligible assessee, opting for computation of profits or gains of business or profession on presumptive basis in respect of eligible business referred to in section 44AD(1) or in respect of eligible profession referred to in section 44ADA(1), shall be required to pay advance tax of the whole amt **on or before 15th March of the F.Y.**
However, any amt paid by way of advance tax **on or before 31st March** shall also be treated as advance tax paid during the F.Y. ending on that day.

Interest for defaults in payment of advance tax [Section 234B]

(1)	Interest u/s 234B is attracted for **non-payment of advance tax or payment of advance tax of an amt less than 90% of assessed tax.**
(2)	The interest liability would be **1% per month or part of the month from 1st April following the F.Y. upto the date of determination of TI u/s 143(1)**.
(3)	Such interest is calculated on the amt of **difference between the assessed tax and the advance tax paid.**
(4)	**"Assessed tax"** means the **tax on TI determined u/s 143(1) *less* TDS & TCS, any relief of tax allowed u/s 89, any tax credit** allowed to be set off in accordance with **the provisions of section 115JD.**
(5)	**Where self-assessment tax is paid** by the assessee u/s 140A or otherwise, **interest shall be calculated upto the date of payt of such tax** and reduced by the interest, if any, paid u/s 140A towards the interest chargeable under this section.

Interest for deferment of advance tax [Section 234C]

(a)	**Manner of computation of interest u/s 234C for deferment of advance tax by assessee, being an individual:** In case an assessee, other than an assessee who declares profits and gains in accordance with the provisions of section 44AD(1) or section 44ADA(1), **who is liable to pay advance tax u/s 208 has failed to pay such tax** or the **advance tax** paid by such assessee on its current income on or before the dates specified in column (1) below **is less than the specified percentage** [given in column (2) below] of tax due on returned income, **then simple interest@1% per month** for the period specified in column (4) on the amt of shortfall, as per column (3) **is leviable u/s 234C.**

Specified date	Specified %	Shortfall in advance tax	Period
(1)	(2)	(3)	(4)
15^{th} June	**15%**	15% of tax due on returned income (-) advance tax paid up to 15^{th} June	**3 months**
15^{th} September	**45%**	45% of tax due on returned income (-) advance tax paid up to 15^{th} September	**3 months**
15^{th} December	**75%**	75% of tax due on returned income (-) advance tax paid up to 15^{th} December	**3 months**
15^{th} March	**100%**	100% of tax due on returned income (-) advance tax paid up to 15^{th} March	**1 month**

Note *– However, **if the advance tax paid by the assessee on the current income, on or before 15th June or 15th September, is not less than 12% or 36%** of the tax due on the returned income, respectively, then, **the assessee shall not be liable to pay any interest** on the amt of the shortfall on those dates.*

Tax due on returned income *= Tax chargeable on TI declared in the return of income (-) TDS (-) TCS (-) any relief of tax allowed u/s 89 (-) any tax credit allowed to be set off in accordance with section 115JD.*

(b) **Computation of interest u/s 234C in case of an individual who declares profits and gains in accordance with the provisions of section 44AD(1) or 44ADA(1):**

In case an assessee, who declares profits and gains in accordance with the provisions of **section 44AD(1) or 44ADA(1)**, who is **liable to pay advance tax u/s 208** has –

- **failed to pay such tax** or
- the advance tax paid by the individual on his current income **on or before 15th March** is less than the tax due on the returned income, then, the assessee shall be liable to pay **simple interest at the rate of 1%** on the amt of the shortfall from the tax due on the returned income.

(c) **Non-applicability of interest u/s 234C in certain cases:**

Interest u/s 234C shall **not** be leviable in respect of any shortfall in payt of tax due on returned income, where **such shortfall** is on account **of under-estimate or failure to estimate –**

(i) the amt of **capital gains;**

(ii) income of nature referred to in section 2(24)(ix) i.e., **winnings from lotteries, crossword puzzles etc.;**

(iii) **income under the head "PGBP" in cases where the income accrues or arises under the said head for the first time.**

(iv) the amount of **dividend income other than deemed dividend referred u/s 2(22)(e).**

However, the assessee should have **paid the whole of the amt of tax payable** in respect of such income referred to in (i), (ii) (iii) and (iv), as the case may be, had such income been a part of the TI, **as part of the remaining instalments of advance tax which are due or where no such instalments are due, by 31st March of the F.Y.**

INCOME TAX LAW: A CAPSULE FOR QUICK RECAP

This Capsule on Income-tax law attempts to give an overview of the provisions relating to tax deduction at source, advance tax and tax collection at source, as amended by the Finance Act, 2022, to the extent included in the syllabus of Intermediate Paper 4A: Income-tax Law and relevant for May 2023 examination. These provisions are contained in Chapter 9 of Module 3 of the May 2022 edition of the Study Material of Intermediate Paper 4A Income-tax Law.

CHAPTER 9: ADVANCE TAX, TDS AND INTRODUCTION TO TCS

I. TAX DEDUCTION AT SOURCE						
Section	**Nature of payment**	**Threshold Limit for deduction of tax at source**	**Payer**	**Payee**	**Rate of TDS**	**Time of deduction**
192	Salary	Basic exemption limit (₹2,50,000 / ₹3,00,000, as the case may be). This is taken care of in computation of the average rate of income-tax.	Any person responsible for paying any income chargeable under the head "Salaries"	Individual (Employee)	**Average rate of income-tax** computed on the basis of the **rates in force** **(or)** **the rates specified in section 115BAC**, if intimated by the employee	At the time of payment (payt)[1]
192A	Premature withdrawal from EPF	Payt or aggregate payt ≥ **₹50,000**	Trustees of the EPF Scheme or any authorised person under the Scheme	Individual (Employee)	**10%** [**In case of failure to furnish PAN, TDS@ Maximum Marginal Rate**]	At the time of payt
193	Interest on securities	**> ₹10,000 in a F.Y.,** in case of interest on 8% Savings (Taxable) Bonds, 2003/ 7.75% Savings (Taxable) Bonds, 2018. **> ₹5,000 in a F.Y.,** in case of interest on debentures issued by a Co. in which the public are substantially interested, paid or credited to a resident individual or HUF by an A/c payee cheque. **> No threshold specified in any other case.**	Any person responsible for paying any income by way of interest on securities	Any resident	**10%**	At the time of credit of such income to the a/c of the payee or at the time of payt, whichever is earlier.
194	Dividend (including dividend on preference shares)	**> ₹5,000 in a F.Y.,** in case of dividend paid or credited to an individual shareholder by any mode other than cash **> No threshold in other cases**	The Principal Officer of a domestic company	Resident shareholder	**10%**	Before making any payt by any mode in respect of any dividend or before making any distribution or payt of dividend.
194A	Interest other than interest on securities	**> ₹40,000 in a F.Y.,** in case of interest credited or paid by – (i) a banking company; (ii) a co-operative society engaged in banking business; and (iii) a post office on any deposit under a notified scheme. In all the above cases, **if payee is a resident senior citizen,** tax deduction limit is **> ₹50,000.** **> ₹5,000 in a F.Y.,** in other cases.	Any person **(other than an individual or HUF whose total sales, gross receipts or turnover ≤ ₹1 crore in case of business or ₹50 lakhs in case of profession during the immediately preceding F.Y.)** responsible for paying interest other than interest on securities.	Any Resident	**10%**	At the time of credit of such income to the a/c of the payee or at the time of payt, whichever is earlier.
194B	Winnings from any lottery, crossword puzzle or card game or other game of any sort	**> ₹10,000**	The person responsible for paying income by way of such winnings	Any Person	**30%**	At the time of payt

[1]Except in case of TDS on perquisite of ESOP provided by eligible start-up

Section	Nature of payment	Threshold Limit for deduction of tax at source	Payer	Payee	Rate of TDS	Time of deduction
194BB	Winnings from horse race	> ₹10,000	Book Maker or a person holding licence for horse racing or for arranging for wagering or betting in any race course.	Any Person	30%	At the time of payt
194C	Payts to Contractors	Single sum credited or paid > ₹30,000 (or) The aggregate of sums credited or paid to a contractor during the F.Y. > ₹1,00,000 Individual/HUF need not deduct tax where sum is credited or paid exclusively for personal purposes	Central/State Govt., Local authority, Central/State/ Provincial Corpn., company, firm, trust, registered society, co-operative society, university estd under Central/ State/ Provincial Act, declared university under the UGC Act, Govt. of Foreign State or a foreign enterprise, Individual/ HUF whose total sales, gross receipts or turnover > ₹1 crore in case of business or ₹50 lakhs in case of profession during the immediately preceding F.Y.	Any Resident contractor for carrying out any work (including supply of labour)	1% of sum paid or credited, if the payee is an Individual or HUF 2% of sum paid or credited, if the payee is any other person.	At the time of credit of such sum to the a/c of the contractor or at the time of payt, whichever is earlier.
194D	Insurance Commission	> ₹15,000 in a F.Y.	Any person responsible for paying any income by way of remuneration or reward for soliciting or procuring insurance business	Any Resident	5%	At the time of credit of such income to the a/c of the payee or at the time of payt, whichever is earlier.
194DA	Any sum under a Life Insurance Policy	≥ ₹1,00,000 (aggregate amt of payt to a payee in a F.Y.)	Any person responsible for paying any sum under a LIP, including the sum allocated by way of bonus	Any Resident	5% of the amt of income comprised	At the time of payt
194E	Payt to non-resident (NR) sportsmen or sports associations of income referred to in section 115BBA	-	Any person responsible for making the payt	NR sportsman (including an athelete) or entertainer who is not a citizen of India or NR sports association or institution	20.8% (including health and education cess@4%)	At the time of credit of such income to the a/c of the payee or at the time of payt, whichever is earlier.
194EE	Payt of deposit under NSS	≥ ₹2,500 in a F.Y.	Any person responsible for paying	Individual or HUF	10%	At the time of payt
194G	Commission on sale of lottery tickets	> ₹15,000 in a F.Y.	Any person responsible for paying any income by way of commission, remuneration or prize on lottery tickets	Any person stocking, distributing, purchasing or selling lottery tickets	5%	At the time of credit of such income to the a/c of the payee or at the time of payt, whichever is earlier.
194H	Commission or brokerage	> ₹15,000 in a F.Y.	Any person (other than an individual or HUF whose total sales, gross receipts or turnover ≤ ₹1 crore in case of business or ₹50 lakhs in case of profession during the immediately preceding F.Y.) responsible for paying commission or brokerage.	Any resident	5%	At the time of credit of such income to the a/c of the payee or at the time of payt, whichever is earlier.

Section	Nature of payment	Threshold Limit for deduction of tax at source	Payer	Payee	Rate of TDS	Time of deduction
194-I	Rent	> ₹2,40,000 in a F.Y.	Any person (other than an individual or HUF whose total sales, gross receipts or turnover ≤ ₹1 crore in case of business or ₹50 lakhs in case of profession during the immediately preceding F.Y.) responsible for paying rent.	Any resident	**For P & M or equipment** - 2% **For land or building, land appurtenant to a building, furniture or fittings** -10%	At the time of credit of such income to the a/c of the payee or at the time of payt, whichever is earlier.
194-IA	Payt on transfer of certain immovable property other than agricultural land	≥ ₹50 lakh (Consideration (considn) for transfer or stamp duty value)	Any person, being a transferee (other than a person referred to in section 194LA responsible for paying compensation for compulsory acquisition of immovable property other than rural agricultural land)	Resident transferor	1% of considn for transfer or stamp duty value, whichever is higher	At the time of credit of such sum to the a/c of the transferor or at the time of payt, whichever is earlier.
194-IB	Payt of rent by certain individuals or HUF	> ₹50,000 for a month or part of a month	Individual/ HUF (other than Individual/HUF whose total sales, gross receipts or turnover > ₹1 crore in case of business or ₹50 lakhs in case of profession during the immediately preceding F.Y.) responsible for paying rent.	Any Resident	5%	At the time of credit of rent, for the last month of the P.Y. or the last month of tenancy, if the property is vacated during the year, as the case may be, to the a/c of the payee or at the time of payt, whichever is earlier
194-IC	Payt under specified agreement (agmt) referred to in section 45(5A)	No threshold specified.	Any person responsible for paying any sum by way of considn, not being considn in kind, under a registered agmt, wherein L or B or both are handed over by the owner for developmt of real estate project, for a considn, being a share in L or B or both in such project, with payt of part considn in cash.	Any Resident	10%	At the time of credit of such income to the a/c of the payee or at the time of payt, whichever is earlier.
194J	Fees for professional services or technical services(FPS/FTS)/ Royalty/ Non-compete fees/Director's remuneration	> ₹30,000 in a F.Y., for each category of income. **(However, this limit does not apply in case of payt made to director of a company).**	Any person, other than an individual or HUF; However, in case of FPS or FTS paid or credited, an individual/HUF, whose total sales, gross receipts or turnover > ₹1 crore in case of business or ₹50 lakhs in case of profession during the immediately preceding F.Y., is liable to deduct tax u/s 194J, except where FPS is credited or paid exclusively for his personal purposes.	Any Resident	2% - Payee engaged only in the business of operation of call centre. 2% - In case of FTS or royalty, where such royalty is in the nature of consideration for sale, distribution or exhibition of cinematographic films 10% - Other payts	At the time of credit of such sum to the a/c of the payee or at the time of payt, whichever is earlier.

Section	Nature of payment	Threshold Limit for deduction of tax at source	Payer	Payee	Rate of TDS	Time of deduction
194K	Income on units other than in the nature of capital gains	> ₹5,000 in a F.Y.	Any person responsible for paying any income in respect of units of a mutual fund/ Administrator of the specified undertaking/ specified company	Any resident	10%	At the time of credit of such sum to the a/c of the payee or at the time of payt, whichever is earlier.
194LA	Compensation on acquisition of certain immovable property other than agricultural land	> ₹2,50,000 in a F.Y.	Any person responsible for paying any sum in the nature of compensation or enhanced compensation on compulsory acquisition of immovable property	Any Resident	10%	At the time of payt
194M	-Payts to Contractors -Commission or brokerage - Fees for professional services	> ₹50,00,000 in a F.Y.	Individual or HUF other than those who are required to deduct tax at source u/s 194C or 194H or 194J	Any Resident	5%	At the time of credit of such sum to the a/c of the payee or at the time of payt, whichever is earlier.
194N	Cash withdrawals	> ₹1 crore	- a banking company or any bank or banking institution - a co-operative society engaged in carrying on the business of banking or - a post office who is responsible for paying any sum, being the amt or the aggregate of amts, as the case may be, in cash exceeding ₹1 crore during the P.Y., to any person from one or more accounts maintained by the recipient	Any person	@2% of such sum In case the recipient has not filed ROI for all the 3 immediately preceding P.Y.s, for which time limit u/s 139(1) has expired, such sum shall be the amt or agg. of amts, in cash > ₹20 lakh during the P.Y. TDS - @2% of the sum, where cash withdrawal > ₹20 lakhs but ≤ ₹1 crore - @5% of sum, where cash withdrawal > ₹1 crore	At the time of payt of such sum
194O	Sale considn or considn for services facilitated through digital electronic facility platform	> ₹5 lakhs, being gross amt of sales or service or both in a financial year to an e-commerce participant, being individual or HUF and such e-commerce participant has furnished PAN or Aadhar number to the e-commerce operator > No threshold in other cases	E-commerce operator, who facilitates sale of goods or provision of services of an e-commerce participant through digital or electronic facility or platform	E-commerce participant	1% of gross amt of sale or service or both [In case of failure to furnish PAN, Maximum TDS@5%]	At the time of credit of amt. of sale or services or both to the a/c of an e-commerce participant or at the time of payt, whichever is earlier.
194P	Pension (along with interest on bank account)	Basic exemption limit (₹3,00,000/ ₹5,00,000, as the case be) [i.e., total income after giving effect to the dedn allowable under Chapter VI-A > the basic exemption limit. Further, in case the individual is entitled to rebate u/s 87A from tax payable then the same should be given effect to]	Notified specified bank	Specified senior citizen i.e., An individual, being a resident in India, who - is of the age of 75 years or more at any time during the P.Y.; - is having pension income and no other income except interest income received or receivable from any a/c maintained by such individual in the same specified bank in which he is receiving the pension income; and - has furnished a declaration to the specified bank.	Rates in force	

Section	Nature of payment	Threshold Limit for deduction of tax at source	Payer	Payee	Rate of TDS	Time of deduction
194Q	Purchase of goods	> ₹50 lakhs in a P.Y.	Buyer, who is responsible for paying any sum for purchase of goods. Buyer means a person whose total sales, gross receipts or turnover from business > ₹10 crores during the F.Y. immediately preceding the F.Y. in which the purchase of goods is carried out.	Any resident	0.1% of sum > ₹50 lakhs	At the time of credit of such sum to the a/c of the seller or at the time of payt, whichever is earlier.
194R	Any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession	Value or aggregate of value of benefit or perquisite > ₹20,000 in a F.Y.	Any person (other than an individual or HUF whose total sales, gross receipts or turnover ≤ ₹1 crore in case of business or ₹50 lakhs in case of profession during the immediately preceding F.Y.) responsible for providing to a resident, any benefit or perquisite. In case of a company, "person responsible for paying" means company itself including the Principal Officer thereof.	Any resident	10% of value or aggregate of value of benefit or perquisite	Before providing such benefit or perquisite
206AA	Section 206AA requires furnishing of PAN by the deductee to the deductor, failing which the deductor has to deduct tax at the **higher of the following rates, namely, -** **(i) at the rate specified in the relevant provision of the Income-tax Act, 1961; or** **(ii) at the rate or rates in force; or** **(iii) at the rate of 20% and in case of section 194-O and 194Q, 5%.**					
206AB	Section 206AB requires tax to be deducted at source on any sum or income or amt paid or payable or credited, by a person to a specified person, **at higher of the following rates –** **(i) at twice the rate specified in the relevant provision of the Act;** **(ii) at twice the rate or rates in force i.e., the rate mentioned in the Finance Act; or** **(iii) at 5%.** However, section 206AB is **not** applicable in case of tax deductible at source u/s 192, 192A, 194B, 194BB, 194-IA, 194-IB, 194M or 194N. **Meaning of "specified person"** – A person who has **not** furnished the ROI for the A.Y. relevant to the P.Y. immediately preceding the F.Y. in which tax is required to be deducted, for which the time limit for furnishing the return of income u/s 139(1) has expired, and the agg. of tax deducted at source and tax collected at source in his case is ₹50,000 or more in the said P.Y. However, the specified person does not include a non-resident who does not have a PE in India. In case the provisions of section 206AA are also applicable to the specified person, in addition to the provisions of this section, then, tax is required to be deducted at higher of the two rates provided in section 206AA and section 206AB.					

II. ADVANCE PAYMENT OF TAX

Liability for payment of advance tax [Sections 207 & 208]

- Tax shall be payable in advance during any F.Y. in respect of the total income (TI) of the assessee which would be chargeable to tax for the A.Y. immediately following that F.Y.
- **Advance tax is payable** during a F.Y. in every case where the amt of such **tax payable** by the assessee during the year **is ₹10,000 or more.**
- However, **an individual resident in India of the age of 60 years or more** at any time during the P.Y., who **does not have any income chargeable under PGBP, is not liable to pay advance tax.**

Instalments of advance tax and due dates [Section 211]

Advance tax payment schedule for corporates and non-corporates (other than an assessee computing profits on presumptive basis u/s 44AD or section 44ADA) – Four instalments

Due date of instalment	Amt payable
On or before **15th June**	Not less than **15%** of advance tax liability.
On or before **15th September**	Not less than **45%** of advance tax liability (-) amt paid in earlier instalment.
On or before **15th December**	Not less than **75%** of advance tax liability (-) amt paid in earlier instalment or instalments.
On or before **15th March**	The whole amt of advance tax liability (-) amt paid in earlier instalment or instalments.

Advance tax payment by assessees computing profits on presumptive basis u/s 44AD(1) or section 44ADA(1)

An eligible assessee, opting for computation of profits or gains of business or profession on presumptive basis in respect of eligible business referred to in section 44AD(1) or in respect of eligible profession referred to in section 44ADA(1), shall be required to pay advance tax of the whole amt **on or before 15th March of the F.Y.** However, any amt paid by way of advance tax **on or before 31st March** shall also be treated as advance tax paid during the F.Y. ending on that day.

Interest for defaults in payment of advance tax [Section 234B]	
(1)	Interest u/s 234B is attracted for **non-payment of advance tax or payt of advance tax of an amt less than 90% of assessed tax.**
(2)	The interest liability would be **1% per month or part of the month from 1st April following the F.Y. upto the date of determination of TI u/s 143(1)** and where regular assessment is made, upto the date of such regular assessment.
(3)	Such interest is calculated on the amt of **difference between the assessed tax and the advance tax paid.**
(4)	**"Assessed tax"** means the **tax on TI determined u/s 143(1) or under regular assessment** *less* **TDS & TCS, any relief of tax allowed u/s 89, any tax credit** allowed to be set off in accordance with **the provisions of section 115JD.** Tax on the TI determined u/s 143(1) shall not include the additional income-tax, if any, payable u/s 140B.
(5)	Where self-assessment tax is paid by the assessee u/s 140A or otherwise, interest shall be calculated upto the date of payt of such tax and reduced by the interest, if any, paid u/s 140A towards the interest chargeable under this section. Thereafter, interest shall be calculated @1% on the amt by which the tax so paid together with the advance tax paid falls short of the assessed tax.

Interest for deferment of advance tax [Section 234C]

(a) **Manner of computation of interest u/s 234C for deferment of advance tax by corporate and non-corporate assessees:**
In case an assessee, other than an assessee who declares profits and gains in accordance with the provisions of section 44AD(1) or section 44ADA(1), who is liable to pay advance tax u/s 208 has failed to pay such tax or the advance tax paid by such assessee on its current income on or before the dates specified in column (1) below is less than the specified percentage [given in column (2) below] of tax due on returned income, then simple interest@1% per month for the period specified in column (4) on the amt of shortfall, as per column (3) is leviable u/s 234C.

Specified date	Specified %	Shortfall in advance tax	Period
(1)	(2)	(3)	(4)
15th June	**15%**	15% of tax due on returned income (-) advance tax paid up to 15th June	**3 months**
15th September	**45%**	45% of tax due on returned income (-) advance tax paid up to 15th September	**3 months**
15th December	**75%**	75% of tax due on returned income (-) advance tax paid up to 15th December	**3 months**
15th March	**100%**	100% of tax due on returned income (-) advance tax paid up to 15th March	**1 month**

Note *– However,* ***if the advance tax paid by the assessee on the current income, on or before 15th June or 15th September, is not less than 12% or 36%*** *of the tax due on the returned income, respectively, then,* ***the assessee shall not be liable to pay any interest*** *on the amt of the shortfall on those dates.*
Tax due on returned income *= Tax chargeable on TI declared in the return of income – TDS – TCS - any relief of tax allowed u/s 89 - any tax credit allowed to be set off in accordance with section 115JD.*

(b) **Computation of interest u/s 234C in case of an assessee who declares profits and gains in accordance with the provisions of section 44AD(1) or 44ADA(1):**
In case an assessee who declares profits and gains in accordance with the provisions of section 44AD(1) or 44ADA(1), who is liable to pay advance tax u/s 208 has –
- failed to pay such tax or
- the advance tax paid by the assessee on its current income **on or before 15th March** is less than the tax due on the returned income, then, the assessee shall be liable to pay **simple interest at the rate of 1%** on the amt of the shortfall from the tax due on the returned income.

(c) **Non-applicability of interest u/s 234C in certain cases:**
Interest u/s 234C shall **not** be leviable in respect of any shortfall in payt of tax due on returned income, where **such shortfall** is on a/c of **under-estimate or failure to estimate –**
(i) the amt of **capital gains;**
(ii) income of nature referred to in section 2(24)(ix) i.e., **winnings from lotteries, crossword puzzles etc.;**
(iii) **income under the head "PGBP" in cases where the income accrues or arises under the said head for the first time;**
(iv) the amt of **dividend income u/s 2(22)(a)/(b)/(c)/(d).**
However, the assessee should have **paid the whole of the amt of tax payable** in respect of such income referred to in (i), (ii), (iii) and (iv), as the case may be, had such income been a part of the TI, **as part of the remaining instalments of advance tax which are due or where no such instalments are due, by 31st March of the F.Y.**

III. TAX COLLECTION AT SOURCE [SECTION 206C]

(a) **Sale of certain goods [Section 206C(1)]** - Sellers of certain goods are required to collect tax from the buyers at the specified rates. The specified percentage for collection of tax at source is as follows:

	Nature of Goods	Percentage
(i)	Alcoholic liquor for human consumption	1%
(ii)	Tendu leaves	5%
(iii)	Timber obtained under a forest lease	2.5%
(iv)	Timber obtained by any mode other than (iii)	2.5%
(v)	Any other forest produce not being timber or tendu leaves	2.5%
(vi)	Scrap	1%
(vii)	Minerals, being coal or lignite or iron ore	1%

However, no collection of tax shall be made in the case of a resident buyer, if such buyer furnishes a declaration in writing in duplicate to the effect that goods are to be utilised for the purpose of manufacturing, processing or producing articles or things or for the purposes of generation of power and not for trading purposes [**Section 206C(1A)**]

(b) **Lease or a licence of parking lot, toll plaza or mine or a quarry** [Section 206C(1C)] - Every person who grants a lease or a licence or enters into a contract or otherwise transfers any right or interest in any
- parking lot or
- toll plaza or
- a mine or a quarry

to another person (other than a public sector company) for the use of such parking lot or toll plaza or mine or quarry for the purposes of business. The tax shall be collected as provided, from the licensee or lessee of any such licence, contract or lease of the specified nature, at the rate of 2%, at the time of debiting of the amt payable by the licensee or lessee to his account or at the time of receipt of such amt from the licensee or lessee in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier.

(c) **Sale of motor vehicle of value exceeding ₹10 lakhs [Section 206C(1F)]** - Every person, being a seller, who receives any amt as considn **for sale of a motor vehicle of the value exceeding ₹10 lakhs,** shall, at the time of receipt of such amt, collect tax from the buyer@1% of the sale considn.

(d) **Overseas remittance or an overseas tour package** [Section 206C(1G)] - Every person,
- **being an authorized dealer, who receives amt under the Liberalised Remittance Scheme of the RBI for overseas remittance from a buyer,** being a person remitting such amt out of India,
- **being seller of an overseas tour programme package who receives any amt from the buyer who purchases the package**

has to collect tax at the rate of 5% of such amt at the time of debiting of the amt payable by the buyer or at the time of receipt of such amt from the said buyer by any mode, whichever is earlier.

Rate of TCS in case of collection by an authorized dealer

S. No.	Amt and purpose of remittance	Rate of TCS
(i)	(a) Where the amt **is remitted for a purpose other than purchase of overseas tour program package; and** (b) the amt or aggregate of the amts being remitted by a buyer **is less than ₹7 lakhs in a F.Y.**	Nil (No tax to be collected at source)
(ii)	(a) Where the amt is remitted for a purpose **other than purchase of overseas tour program package; and** (b) the amt or aggregate of the **amts in excess of ₹7 lakhs is remitted by the buyer in a F.Y.**	**5% of the amt or agg. of amts > ₹7 lakh**
(iii)	(a) Where the amt being remitted out is **a loan obtained from any financial institution as defined in section 80E, for the purpose of pursuing any education; and** (b) the amt or aggregate of the **amts in excess of ₹7 lakhs is remitted by the buyer in a F.Y.**	**0.5% of the amt or agg. of amts > ₹7 lakh**

Cases where no tax is to be collected

(i)	No TCS by the authorized dealer on an amt in respect of which the sum has been collected by the seller
(ii)	No TCS, if the buyer is liable to deduct tax at source under any other provision of the Act and has deducted such tax
(iii)	No TCS, if the buyer is the Central Govt, a State Govt, an embassy, a High Commission, a legation, a commission, a consulate, the trade representation of a foreign State, a local authority or any other person notified by the Central Govt, subject to fulfillment of conditions stipulated thereunder. Accordingly, the CBDT has notified that the provisions of section 206C(1G) would not apply to a person (being a buyer) who is a non-resident in terms of section 6 and does not have a PE in India.

(e) **Sale of goods of value exceeding ₹50 lakhs [Section 206C(1H)]** - Every person, being **a seller, who receives any amt as consideration for sale of goods of the value exceeding ₹50 lakhs in a P.Y.,** other than exported goods or goods covered in (a)/(c)/(d)], is required to collect tax at source, at the time of receipt of such amt, @0.1% of the sale consideration **exceeding ₹50 lakhs.**
However, tax is not required to be collected if the buyer is liable to deduct tax at source under any other provision of the Act on the goods purchased by him from the seller and has deducted such tax.

(f) In case of **non-furnishing of PAN [PAN or Aadhar number in case of section 206C(1H)]** by the collectee to the collector, tax is required to be collected at the higher of –
(i) twice the rate specified in the relevant provisions of the Act; or
(ii) 5% [1%, in case tax is required to be collected at source u/s 206C(1H)]. [Section 206CC]
The provisions of section 206CC does **not** apply to a non-resident who does not have a permanent establishment in India.

(g) Section 206CCA requires tax to be collected at source on any sum or amt received by a person from a specified person, **at higher of the following rates –**
(i) at twice the rate prescribed in the relevant provision of the Act; or
(ii) at 5%
Meaning of "specified person" – A person who has **not** furnished the ROI for the A.Y. relevant to the P.Y. immediately preceding the F.Y. in which tax is required to be collected, for which the time limit for furnishing the return of income u/s 139(1) has expired, and the agg. of tax deducted at source and tax collected at source in his case is ₹50,000 or more in the said P.Y.
However, the specified person does not include a non-resident who does not have a PE in India.
In case the provisions of section 206CC are also applicable to the specified person, in addition to the provisions of this section, then, tax is required to be collected at higher of the two rates provided in section 206CC and section 206CCA.

CA INTERMEDIATE - PAPER 4B - INDIRECT TAXES

Goods and Services Tax: A Capsule for Quick Recap

It has always been the endeavour of Board of Studies to provide quality academic inputs to the students of Chartered Accountancy Course. Keeping with this objective, BoS has come up with a crisp and concise capsule on Section B - Indirect Taxes of Paper 4: Taxation of Intermediate Course, to facilitate students in quick revision before examination. The Capsule makes use of diagrams, tables, flow charts etc. to facilitate recap of select topics of Goods and Services Tax law namely, significant aspects of Time of Supply, Value of Supply and Input Tax Credit. The capsule is based on the GST laws as amended by the Finance Act, 2021, including significant notifications and circulars issued, up to 30th April, 2022 and is thus, very useful for quick recap on day before the examination for the students appearing in November 2022 examination. Students may note that this capsule is a tool for quick revision and thus, should not be taken as a substitute for the detailed study of the subject. Students are advised to refer to the August 2021 Edition of Intermediate Course Study Material along with Statutory Update for November 2022 examination which has been hosted on the ICAI website, for comprehensive study and revision. Students appearing for May 2023 examination may also refer this capsule alongwith the Statutory Update for May 2023 examination which will be hosted on the BoS Knowledge Portal.

CHAPTER 5 - TIME AND VALUE OF SUPPLY

TIME OF SUPPLY OF GOODS UNDER FORWARD CHARGE AS PER SECTION 12

- Date of issue of invoice / Last date of issue of invoice under section 31
- Date on which the payment is recorded in the books of account of the supplier – *presently irrelevant for the purpose of payment of tax*
- Date on which the payment is credited to the supplier's bank account – *presently irrelevant for the purpose of payment of tax*

Whichever is earlier

If it is not possible to determine the time of supply through above parameters, THEN

TIME OF SUPPLY WILL BE

Date on which goods are recorded in the books of account of the recipient of supply

SPECIAL PROCEDURE UNDER SECTION 148 FOR PAYMENT OF TAX IN CASE OF GOODS

GST to be paid at the time of supply → As specified in section 12(2)(a) → Date of issue of invoice / Last date of issue of invoice under section 31

Effectively, in case of goods, no GST is payable at the time of receipt of advance for supply of goods.

TIME OF SUPPLY OF VOUCHERS EXCHANGEABLE FOR GOODS

- **Supply is not identifiable at the time of issue of the voucher** → DATE OF REDEMPTION OF VOUCHER
- **Supply is identifiable at the time of issue of the voucher** → DATE OF ISSUE OF VOUCHER

TIME OF SUPPLY OF GOODS UNDER REVERSE CHARGE

- **Date on which goods are received**
- **Date on which the payment is recorded in the books of account of the recipient of goods**
- **Date on which the payment is debited from the bank account of the recipient of goods**
- **31st day from the issue of invoice by the supplier**

Whichever is earlier

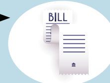
TIME OF SUPPLY OF GOODS IN RESIDUAL CASES

- **Where a periodical return is to be filed** → DATE ON WHICH RETURN IS REQUIRED TO BE FILED
- **Other Cases** → DATE ON WHICH GST IS PAID

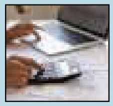
TIME OF SUPPLY OF SERVICES UNDER FORWARD CHARGE

Is invoice issued within the time specified u/s 31?

YES → Time of Supply



→ Date of issue of invoice



→ Date on which the payment is recorded in the books of account of the supplier

→ Date on which the payment is credited to the supplier's bank account

Whichever is earlier

NO → Time of Supply

Provision of Service → Date of provision of service

→ Date on which the payment is recorded in the books of account of the supplier

→ Date on which the payment is credited to the supplier's bank account

Whichever is earlier

If time of supply cannot be determined by both the above methods, then →

→ Date of receipt of services in the books of account of the recipient

TIME OF SUPPLY OF SERVICES UNDER REVERSE CHARGE

- Date on which the payment is recorded in the books of account of the recipient of services
- Date on which the payment is debited from the bank account of the recipient of services
- 61st day from issue of invoice by the supplier

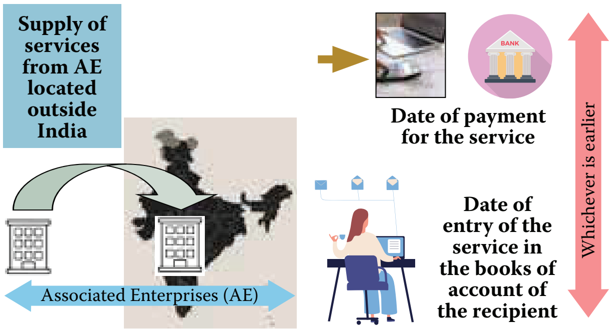
Whichever is earlier

If it is not possible to determine the time of supply under reverse charge through above parameters, THEN → TIME OF SUPPLY WILL BE

→ Date of entry of service in the books of account of the recipient of supply

TIME OF SUPPLY IN CASE OF IMPORT OF SERVICES FROM ASSOCIATED ENTERPRISES

Supply of services from AE located outside India



- Date of payment for the service
- Date of entry of the service in the books of account of the recipient

Whichever is earlier

TIME OF SUPPLY OF SERVICES IN RESIDUAL CASES

If all the above do not work for a situation

- Where a periodical return is to be filed → Due date of such return
- In any other case → Date on which tax is paid

TIME OF SUPPLY FOR ADDITION IN VALUE BY WAY OF INTEREST/ LATE FEE/PENALTY FOR DELAYED PAYMENT OF CONSIDERATION FOR GOODS AND SERVICES

Addition in value by way of interest, late fee/penalty for delayed payment of consideration for goods and services → • Date on which the supplier receives such addition in value

VALUE OF SUPPLY

VALUE OF SUPPLY

- Supply made to unrelated person where price is the sole consideration → Value of supply = Transaction value under section 15(1)
- Supply made to related person
- Supply where price is not the sole consideration
- Supply is a notified supply under section 15(5) of CGST Act, 2017

→ Value to be determined under Chapter IV: Determination of Value of Supply of CGST Rules, 2017

Inclusions in value under section 15(2) of CGST Act, 2017

- ⇒ Taxes other than GST
- ⇒ Third party payments made by recipient in relation to supply, which supplier was liable to pay and were not included in the price
- ⇒ Incidental expenses including anything done by the supplier in respect of the supply till delivery of goods/ supply of services, if charged to recipient
- ⇒ Subsidies directly linked to price of supply other than the ones given by Central/State Governments
- ⇒ Interest/late fee/penalty for delay in payment of consideration

Exclusions from value under section 15(2) of CGST Act, 2017

- Discounts given before or at the time of supply and recorded in the invoice
- Post supply discount/ incentive, if known in advance & linked with invoices & proportionate input tax credit reversed by the recipient

ALLOWABILITY OF DISCOUNT AS A DEDUCTION FROM THE VALUE

Discounts given →

- At the time of supply + Before the supply + → Shown in the invoice → Yes → Discounts deducted from the value of supply; No → Discounts not deducted from the value of supply
- After the supply + In terms of an agreement that existed at the time of supply + Can be linked to invoices + Proportionate ITC reversed by recipient → Yes → Discounts deducted from the value of supply; No → Discounts not deducted from the value of supply

CHAPTER 6 – INPUT TAX CREDIT

ELIGIBILITY AND CONDITIONS FOR TAKING ITC

INPUT TAX

Means
- Tax payable under forward charge in respect of supplies made to recipient

Includes
- Tax payable under reverse charge
- IGST leviable on import of goods

Excludes
- Composition tax

CGST | SGST | UTGST | IGST

Registered person to take credit of tax paid on inward supplies of goods and/or services

used/ intended to be used in the course or furtherance of business

if the following four conditions are fulfilled

CONDITIONS

- He has furnished return u/s 39
- Tax on such supply has been paid either in/by **cash** or **utilisation of ITC**
- He has received goods and/or services
- He has valid tax invoice/debit note/ prescribed tax paying document
- Invoices details have been furnished by the supplier in GSTR-1 and such details have been communicated to the recipient

Bill to Ship to Model

Goods delivered / services provided to third person on the direction of the registered person deemed to be received by the registered person

ITC available to registered person

Goods received in lots
- ITC allowed upon receipt of last lot

If depreciation claimed on tax component
- ITC not allowed

Time limit for availing ITC
- ITC pertaining to a particular FY can be availed by 20th October of next FY or filing of annual return, whichever is earlier.

Exception
Re-availment of ITC reversed earlier.

Payment for the invoice to be made within 180 days

- ITC to be added to the output tax liability with interest @ 18% if value + tax of goods and /or services is not paid within 180 days of the issuance of invoice.
- On payment, the ITC could be re-availed without any time limit

Exceptions

- Reverse charge supplies
- Deemed supplies without consideration
- Additions made to value of supplies on account of supplier's liability being incurred by the recipient of the supply

APPORTIONMENT OF CREDIT

Goods and/or services

- Used partly for business and partly for non-business purposes
- Used partly for making taxable (including zero rated supplies) supplies & partly for exempt supplies

ITC available only as

- Attributable to business purposes
- Attributable to taxable supplies including zero rated supplies

BLOCKED CREDIT

(i) Motor vehicles and other conveyances and related services (insurance, servicing and repair and maintenance)

S. No.	Goods and/ or services on which credit is blocked	Exceptions to goods and/ or services mentioned in column (2) on which credit is allowed	Remarks
(1)	(2)	(3)	(4)
(i)	Motor vehicles for transportation of persons with seating capacity ≤ 13 persons (including the driver) – Referred to as ineligible motor vehicle in this table	Ineligible motor vehicles when used for any of the following eligible purposes - ➢ making further taxable supply of such motor vehicles; ➢ making taxable supply of transportation of passengers; ➢ making taxable supply of imparting training on driving such motor vehicles.	❑ ITC on ineligible motor vehicles used for any purpose other than the eligible purposes is not allowed. ❑ ITC on motor vehicles for transportation of persons with seating capacity > 13 persons (including the driver) used for any purpose is allowed. ❑ ITC on motor vehicles other than ineligible motor vehicles (e.g. motor vehicle used for transportation of goods, dumpers, tippers, etc.) used for any purpose is allowed.
(ii)	Vessels and aircrafts	Vessels and aircraft when used for any of the following eligible purposes- ➢ making further taxable supply of such vessels or aircraft; ➢ making taxable supply of transportation of passengers; ➢ making taxable supply of imparting training on navigating such vessels; ➢ making taxable supply of imparting training on flying such aircrafts; ➢ transportation of goods.	ITC on vessels and aircrafts used for any purpose other than the eligible purposes
(iii)	General insurance, servicing, repair and maintenance relating to: ➢ Ineligible motor vehicles ➢ Vessels ➢ Aircraft	❑ Such services relating to ineligible motor vehicles, vessels or aircraft when used for eligible purposes ❑ Such services when received by- ● Manufacturer of ineligible motor vehicles, vessels or aircraft; or ● Supplier of general insurance services in respect of ineligible motor vehicles, vessels or aircraft insured by him	❑ ITC is not allowed on services of general insurance, servicing, repair and maintenance relating to motor vehicles, vessels or aircraft, ITC on which is not allowed. ❑ ITC is allowed on services of general insurance, servicing, repair and maintenance relating to motor vehicles, vessels or aircraft, ITC on which is allowed.
(iv)	Leasing, renting or hiring of motor vehicles, vessels or aircraft on which ITC is not allowed	❑ Such services when used for making an outward taxable supply of the same category of services or as an element of a taxable composite or mixed supply ❑ Such services when provided by an employer to its employees under a statutory obligation	❑ ITC on leasing, renting or hiring of motor vehicles, vessels or aircraft on which ITC is allowed, is also allowed. ❑ ITC on such services is allowed in the case of sub-contracting, i.e. when such services are used by the taxpayer who is in the same line of business.

(ii) Food & beverages, outdoor catering, health services and other services

S. No.	Goods and/ or services on which credit is blocked	Exceptions to goods and/or services mentioned in column (2) on which credit is allowed	Remarks
(1)	(2)	(3)	(4)
(i)	◆ Food and beverages ◆ Outdoor catering ◆ Beauty treatment ◆ Health services ◆ Cosmetic and plastic surgery ◆ Life insurance and health insurance	◆ Such goods and/or services when used by a registered person for making an outward taxable supply of the same category of goods and/ or services or as an element of a taxable composite or mixed supply ◆ Such goods and/ or services when provided by an employer to its employees under a statutory obligation	◆ ITC on such goods and/ or services is allowed in the case of sub-contracting, i.e. when such goods and/ or services are used by the taxpayer who is in the same line of business, e.g., outdoor catering service availed by another outdoor caterer.

S. No.	Goods and/ or services on which credit is blocked	Exceptions to goods and/or services mentioned in column (2) on which credit is allowed	Remarks
(i)			◆ When such goods and/ or services are provided by the employer to its employees without any statutory obligation, ITC thereon is blocked.
(ii)	Membership of a club, health and fitness centre	Such services when provided by an employer to its employees under a statutory obligation	When such goods and/or services are provided by the employer to its employees without any statutory obligation, ITC thereon is blocked.
(iii)	Travel benefits extended to employees on vacation such as leave or home travel concession	Such services when provided by an employer to its employees under a statutory obligation	When such goods and/ or services are provided by the employer to its employees without any statutory obligation, ITC thereon is blocked.

(iii) Works contract services for construction of immovable property and self-construction of immovable property

Credit is blocked on
- **Works Contract Service for construction of immovable property**
- **Inward supplies received by taxable person for construction of immovable property on his own account including when such supplies are used in the course or furtherance of business**

Works Contract Service (WCS) for construction of immovable property → **Exceptions (i.e., credit is availbale on)**
- **WCS for Plant & Machinery (P & M)**
- **WCS availed by a works contractor for further supply of WCS [Sub-contracting]**
- **Where value of WCS is not capitalized**

Works contract services for self-construction of immovable property → **Exceptions (i.e., credit is availbale on)**
- **Construction of P & M**
- **Construction of immovable property for others**
- **Value of construction is not capitalised**

(iv) Other blocked credits
- Inward supplies charged to composition levy
- Inward supplies used for personal consumption

Credit is blocked on
- Goods that are disposed of by way of gift
- Goods that are disposed of by way of free samples
- Lost goods
- Stolen goods
- Destroyed goods
- Goods that are written off

SPECIAL PROVISIONS FOR BANKING COMPANIES AND NBFCS

Option 1 → •Avail proportionate ITC

Option 2 → •Avail 50% of eligible ITC
- Remaining 50% ITC will lapse.
- Restriction of 50% shall not apply to the tax paid on supplies received from another registration within the same entity.
- Option once exercised cannot be withdrawn during remaining part of the year.

SPECIAL CIRCUMSTANCES ENABLING AVAILING OF CREDIT

S. No.	Persons eligible to take credit	Goods entitled to ITC: Inputs held in stock/capital goods	Goods entitled to ITC: As on	Restriction/ conditions
(1)	(2)	(3)	(4)	(5)
1	Person who has applied for **registration within 30 days from the date on which he becomes liable to registration** and has been granted such registration	**Inputs** held in stock and inputs contained in semi-finished or finished goods held in stock	The day immediately preceding the date from which he becomes liable to pay tax	➢ ITC to be availed within 1 year from the date of the issue of the tax invoice by the supplier.
2	Person who is not required to register, but obtains **voluntary registration**	**Inputs** held in stock and inputs contained in semi-finished or finished goods held in stock	The day immediately preceding the date of registration	
3	Registered person **who ceases to pay composition tax and switches to regular scheme**	**Inputs** held in stock and inputs contained in semi-finished or finished goods held in stock **and capital goods**	The day immediately preceding the date from which he becomes liable to pay tax under regular scheme	➢ ITC on capital goods will be reduced by 5% per quarter of a year or part of the year from the date of invoice. ➢ ITC claimed shall be verified with the corresponding details furnished by the corresponding supplier. ➢ ITC to be availed within 1 year from the date of the tax issue of the tax invoice by the supplier.
4	Registered person whose exempt supplies become taxable supplies	**Inputs** held in stock and inputs contained in semi-finished or finished goods held in stock relatable to such exempt supply **and capital goods exclusively used for such exempt supply**	The day immediately preceding the date from which such supply becomes taxable	

Conditions for availing above credit

(i) Filing of electronic declaration giving details of inputs held in stock/contained in semi-finished goods and finished goods held in stock and capital goods on the days immediately preceding the day on which credit becomes eligible.

(ii) Declaration has to be filed within 30 days from becoming eligible to avail credit.

(iii) Details in (i) to be certified by a CA/ Cost Accountant if aggregate claim of CGST, SGST/ IGST credit is more than ₹2,00,000.

SPECIAL CIRCUMSTANCES LEADING TO REVERSAL OF CREDIT/PAYMENT OF AMOUNT

Special circumstances leading to reversal of credit /payment of amount

- Registered person (who has availed ITC) switching from regular scheme of payment of tax to composition levy
- Supplies of registered person getting wholly exempted from tax
- Cancellation of registration
- Supply of capital goods (CG)/ plant and machinery (P&M) on which ITC has been taken

Amount to be reversed is equivalent to ITC on:

- Inputs held in stock/ inputs contained in semi-finished or finished goods held in stock
- Capital goods

on the day immediately preceding the date of switch over/ date of exemption/date of cancellation of registration

Manner of reversal of credit on inputs and capital goods & other conditions

(i) Inputs ⇛ Proportionate reversal based on corresponding invoices. If such invoices not available, prevailing market price on the effective date of switch over/ exemption/ cancellation of registration should be used with due certification by a practicing CA/ Cost Accountant

(ii) Capital goods ⇛ Reversal on *pro rata* basis pertaining to remaining useful life (in months), taking useful life as 5 years.

(iii) ITC to be reversed will be calculated separately for ITC of CGST, SGST/UTGST and IGST.

(iv) Reversal amount will be added to output tax liability of the registered person.

(v) Electronic credit/cash ledger will be debited with such amount. Balance ITC, if any, will lapse.

Amount to be paid is equivalent to higher of the following:

(i) ITC on CG or P&M less 5% per quarter or part thereof from the date of invoice

(ii) Tax on transaction value of such CG or P & M

- If amount at (i) exceeds (ii), then reversal amount will be added to output tax liability.
- Separate ITC reversal is to be done for CGST, SGST/UTGST and IGST
- Tax to be paid on transaction value when refractory bricks, moulds, dies, jigs & fixtures are supplied as scrap.

Transfer of unutilised ITC on account of change in constitution of registered person

In case of sale, merger, amalgamation, lease or transfer of business, unutilised ITC can be transferred to the new entity if there is a specific provision for transfer of liabilities to the new entity. The inputs and capital goods so transferred should be duly accounted for by the transferee in his books of accounts.	In case of demerger, ITC is apportioned in the ratio of value of entire assets (including assets on which ITC has not been taken) of the new units as per the demerger scheme.	Details of change in constitution are to be furnished on common portal along with request to transfer unutilised ITC. CA/Cost Accountant certificate is to be submitted certifying that change in constitution has been done with specific provision for transfer of liabilities.	Upon acceptance of such details by the transferee on the common portal, the unutilized ITC is credited to his Electronic Credit Ledger.

Transfer of unutilised ITC on obtaining separate registrations for multiple places of business within a State/UT

Registered person having separate registrations for multiple places of business can transfer the unutilised ITC to any or all of the newly registered place(s) of business in the ratio of the value of assets held by them at the time of registration.

Value of assets means the value of the entire assets of the business irrespective of whether ITC has been availed thereon or not.

The resgistered person should furnish the prescribed details on the common portal within a period of 30 days from obtaining such separate registrations.

Upon acceptance of such details by the newly registered person (transferee) on the common portal, the unutilised ITC is credited to his electronic credit ledger.

PROVISIONS RELATING TO UTILIZATION OF ITC

A supplier making intra-State, inter-State and imported purchases (of goods) is eligible for ITC as under:

Intra-State purchases	Inter-State purchases	Import of goods
CGST SGST	IGST	BCD IGST
CGST SGST	IGST	IGST

ORDER OF UTILIZATION OF ITC

ITC of	Output IGST liability	Output CGST liability	Output SGST/ UTGST liability
IGST	(I)	(II) – In any order and in any proportion	
(III) ITC of IGST to be completely exhausted mandatorily			
CGST	(V)	(IV)	Not permitted
SGST/ UTGST	(VII) Only after ITC of CGST has been utilized fully	Not permitted	(VI)
The numerals given above can be further explained in the following manner:			

(I)	IGST credit should first be utilized towards payment of IGST.
(II)	Remaining IGST credit, if any, can be utilized towards payment of CGST and SGST/UTGST in any order and in any proportion, i.e., remaining ITC of IGST can be utilized – • first towards payment of CGST and then towards payment of SGST; or • first towards payment of SGST and then towards payment of CGST; or • towards payment of CGST and SGST simultaneously in any proportion, e.g., 50: 50, 30: 70, 40: 60 and so on.
(III)	Entire ITC of IGST should be fully utilized before utilizing the ITC of CGST or SGST/UTGST.
(IV) & (V)	ITC of CGST should be utilized for payment of CGST and IGST in that order. ITC of CGST cannot be utilized for payment of SGST/UTGST
(VI) & (VII)	ITC of SGST /UTGST should be utilized for payment of SGST/UTGST and IGST in that order. However, ITC of SGST/UTGST should be utilized for payment of IGST, only after ITC of CGST has been utilized fully. ITC of SGST/UTGST cannot be utilized for payment of CGST.

- **Cross-utilization of credit is available only between CGST - IGST and SGST/UTGST - IGST.**
- **CGST credit cannot be utilized for payment of SGST/UTGST and SGST/UTGST credit cannot be utilized for payment of CGST.**
- **ITC of IGST need to be exhausted fully before proceeding to utilize the ITC of CGST and SGST in that order.**

Order of utilization of ITC has been can alternatively be represented as follows: