1 Theoretical Framework

Unit -1 Meaning and Scope of Accounting

Meaning Of Accounting

1. "Accounting is the art of recording, classifying, and summarising in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the result thereof.
2. "The process of identifying, measuring and communicating economic information to permit informed judgments and decisions by the users of accounts."
3. "The function of accounting is to provide quantitative information, primarily of financial nature, about economic entities, that is needed to be useful in making economic decisions."

Accounting covers the following activities:

- Identifying the Transactions and Events
- Measuring the Identified Transactions
- Recording
- Classifying
- Summarizing
- Analyzing
- Interpreting
- Communicating

Identifying the Transactions and Events: Transaction, Event, Entity

Identifying the Transactions and Events	Transaction	Exchange in which each participant receives or sacrifices value (e.g., purchase of raw material).
	Event	Happening of consequence to an entity (e.g., use of raw material for production).
	Entity	An economic unit that performs economic activities (e.g., TATA Steels, Birla Industries Ltd., Reliance Industries Ltd., Infosys, Bharti Airtel).

Measuring the Identified Transactions	Accounting measures the transactions in terms of a **common measurement unit**, (that is the ruling currency of a country.)	
Recording	It is concerned with the recording of **identified and measured financial transactions** in an orderly manner, soon after their occurrence in the proper books of account.	
Classifying	It is concerned with the classification of the recorded transactions so as to group the transactions of similar type at one place.	
	For example, all purchases of goods made for cash or on credit on different dates are brought to purchases account.	
Summarising	It is concerned with the summarization of the classified transactions in a manner useful to the users.	
	This function involves the preparation of Financial Statements such as Income Statement, Balance Sheet, Cash Flow Statement.	
Analysing	It is concerned with the establishment of relationship between the various items or group of items taken from Income Statement or Balance Sheet or both.	
	Its purpose is to identify the financial strengths and weaknesses of the enterprise. It provides the basis for interpretation.	
Interpreting	It is concerned with explaining the meaning and significance of the relationship so established by the analysis.	
Communicating	It is concerned with the transmission of **summarised, analysed** and **interpreted** information to the users to enable them to make reasoned decisions.	

Objectives Of Accounting

The objectives of accounting can be given as follows:

- Objectives of Accounting
  - Systematic Recording of Transactions
    - Book-keeping: Journal, Ledger and Trial Balance
  - Ascertainment of Results
    - Manufacturing, Trading, Profit and Loss Account
  - Ascertainment of Financial Position
    - Balance Sheet
  - Communicatinig Information to various Users
    - Financial Reports

Functions Of Accounting

(a) Measurement:	Accounting measures past performance of the business entity and depicts its current financial position.
(b) Forecasting:	Accounting helps in forecasting future performance and financial position of the enterprise using past data and analysing trends.
(c) Decision-making	Accounting provides relevant information to the users of accounts to aid rational decision-making.
(d) Comparison & Evaluation:	Accounting assesses performance achieved in relation to targets and discloses information regarding accounting policies and contingent liabilities which play an important role in predicting, comparing and evaluating the financial results.
(e) Control:	Accounting also identifies weaknesses of the operational system and provides feedbacks regarding effectiveness of measures adopted to check such weaknesses.
(f) Government Regulation and Taxation:	Accounting provides necessary information to the government to exercise control on the entity as well as in collection of tax revenues.

Book-Keeping

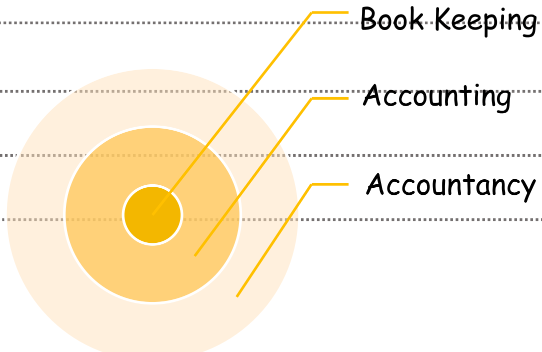
Meaning	Is a part of accounting and is concerned with record, keeping or maintenance of books of accounting which is often routine and clerical in nature.
Activities	It only covers the following four activities: 1.Identifying the transactions and events. 2.Measuring the identified transactions and events in a common measuring unit. 3.Recording the identified and measured transactions and events in Proper Books of Accounts. 4.Classifying the recorded transactions and events in the ledger.
Objectives	1. **Complete Recording of Transactions** – It is concerned with complete and permanent record of all transactions in a systematic and logical manner to show its financial effect on the business. 2. **Ascertainment of financial Effect on the Business** – It is concerned with the combined effect of all the transactions made during the accounting period upon the financial position of the business as a whole.

Distinction Between Book-Keeping & Accounting

Basis	Book-keeping	Accounting
1. Scope	Book-keeping involves — • **Identifying** the transactions, • **measuring** the identified transactions, • **recording** the measured transactions and • **classifying** the recorded transactions.	Accounting in addition to Book-keeping involves — • **summarizing** the classified transactions, • **analysing** the summarized results, • **interpreting** the analysed results and • **communicating** the interpreted information to the interested

		parties.
2. Stage	Book-keeping is **primary** stage.	Accounting is the **secondary** stage. It starts where book-keeping ends.
3. Basic Objective	The basic objective of book-keeping is **to maintain systematic records** of financial transactions.	The basic objective of accounting is **to ascertain Financial Performance and Financial Position and to communicate** information to the interested parties.
4. Who Performs	Book-keeping work is performed by **junior staff**.	Accounting work is performed by **senior staff**.
5. Knowledge Level	The book-keeper is not required to have **higher** level of **knowledge** than that of an accountant.	The accountant is **required** to have **higher** level of **knowledge** than that of book-keeper.
6. Analytical Skill	The book-keeper may or **may not possess** analytical skill.	An accountant is **required** to **possess** analytical skill.
7. Nature of Job	The job of a book-keeper is often **routine** and clerical in nature.	The job of an accountant is **analytical** in nature.
8. Designing Of Accounting System	It does **not cover** designing of accounts system.	It **covers** designing of accounting system.
9. Supervision & Checking	The book-keeper **does not** supervise and check the work of an accountant.	An accountant **supervises and checks** the work of a book-keeper.

Relationship of Accounting and Book-keeping can be depicted as:



Sub-fields of Accounting:

1. Financial Accounting	Preparation of Balance-sheet and Profit and Loss account, determination of net result and for the period and financial position as on given date.
2. Managerial Accounting	The different ways of grouping information and preparing reports for Planning, control and decision making.
3. Cost Accounting	The process of accounting for cost which begins with the recording of income and expenditure or the bases on which they are calculated and ends with the preparation of periodical statements and reports for ascertaining and controlling costs.
4. Social Responsibility Accounting	Concerned with accounting for social cost incurred by the enterprise and social benefits created.
5. Human Resource Accounting	An attempt to identify, quantify and report investment made in human resources of an organization.

Users Of Accounting Information And Their Needs

Users	Need for information
1. Present investors [Shareholders]	Present investors need information to judge prospects for their investment and to determine whether they should buy, hold or sell the shares.
2. Potential Investors [those who want to invest]	Potential investors need information to judge prospects of an enterprise and to determine whether they should buy the shares.
3. Tax Authorities	Tax authorities need information to assess the tax liabilities of an enterprise.

4. Customers	Customers have an interest in information about the continuation of an enterprise, especially when they have established a long-term involvement with, or are dependent on, the enterprise.

Branches Of Accounting:

Financial Accounting	Process of identifying, measuring and communicating accounting information to permit informed judgements and decisions by the users of accounting
Cost Accounting	Process of accounting and controlling the cost of a product, operation or function.
Management Accounting	It is the application of accounting techniques for providing information for the purpose of planning, controlling and decision making.
Social Responsibility Accounting	Process of identifying, measuring and communicating the social effects of business decisions to permit informed judgements and decisions by the users of information.
Human Resource Accounting	Process of identifying, measuring and communicating the investments made in human resources of an enterprise to permit informed judgements and decisions by the users of accounting.

Primary Objectives Of Accounting

Systematic Accounting Records	Written records are always better than oral records.
	Nowadays, the volume of transactions is so large, a human memory cannot absorb each and every transaction.
	Accounting is done to keep a systematic record of

	(i) Financial Transactions, (ii) Assets and (iii) Liabilities.
Ascertain the Financial Performance	A systematic record of Incomes and Expenses facilitates the preparation of the Income Statement.
Ascertain the Financial Position	To evaluate the **financial strengths** and **weakness** of an enterprise and a businessman wants to know **what the business owes** to others and **what it owns**, and what happened to his capital whether the capital has increased, decreased or remained constant.
	A systematic record of various assets and liabilities facilitates the preparation of a Position Statement (also known as Balance Sheet) which answers all these questions.
Communicate the Information to the users	Accounting communicates information to internal users and external users.
	The internal users include all the organizational participants at all levels of management (i.e. top, middle and lower).
	Since the external users (e.g. Banks, Creditors) do not have direct access to all the records of an enterprise, they have to rely on financial statements as the source of information. External users are basically interested in the **solvency** and **profitability** of an enterprise.

Limitation Of Accounting:

Ignores the Qualitative Elements	Since the accounting is confined to the monetary matters only, the qualitative elements like quality of management, quality of labour force, public relations are ignored.
Not Free from Bias	The subjectivity is inherent in personal judgement; the

	financial statements are therefore not free from bias.
	As a result, the analysis of financial statements also cannot be said to be free from bias.
Ignores the Price Level Changes in case of Financial Statements Prepared on Historical Costs	In case of financial statements prepared on historical costs, the Fixed Assets are shown in the Balance Sheet at historical costs less depreciation and not at the replacement value which is often far higher than the value stated in the Balance Sheet.
Estimated Position and not Real Position	Since the financial statements are prepared on a going concern basis as against liquidation basis, they report only the estimated periodic results and not the true results since the true results can be ascertained only on the liquidation of an enterprise.
Danger of Window Dressing	When the management decides to enter wrong figures to artificially inflate or deflate the figure of Profits, Assets and Liabilities, the Income Statement fails to provide true and fair view of the Financial Performance and Balance Sheet fails to provide true and fair view of the Financial Position of the enterprise.

Unit -2 Accounting Concepts, Principles And Conventions

➤Accounting Principles:

Accounting principles are body of doctrines commonly associated with the theory and practices of accounting, based on real assumptions, simple, understandable and explanatory to users and followed consistently. They should be able to reflect future prediction and informational to users.

➤ Accounting Concepts:

The word Concepts means idea. Concepts are basic assumption and condition upon which accountancy has been laid. Unlike physical science accounting concepts are result of broad consensus. The accounting concepts lay the foundation for formulation of accounting principles.

Accounting Is Based On Various Accounting Concepts:

Entity concept	• Business enterprise is a separate identity apart from its owner. Accountants should treat business as distinct from its owner. Business transactions are recorded in the business books of accounts and owners transactions in his personal books of accounts.
Money Measurement concept	• This concept requires that those transactions alone that are capable of being measured in terms of money be only to be recorded in the books of accounts. Transactions, even if, they affect the results of the business materially, are not recorded if they are not convertible in monetary terms.
Periodicity concept	• According to this concept, accounts should be prepared after every period and not at the end of the life of entity. Usually this period is one calendar year from 1 April of a year to 31 March of the immediately following year.
Accrual concept	• The effects of transactions and other events are recognised on mercantile basis i.e., when they occur (and not as cash or a cash equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate.

Matching concept

- All expenses matched with the revenue of that period should be taken into consideration. In the financial statements of the organization if any revenue is recognized then expenses related to earn that revenue should also be recognized.

Cost concept

- The value of an asset is to be determined on the basis of historical cost, in other words, acquisition cost. Although there are various measurement bases, accountants traditionally prefer this concept in the interest of objectivity.

Realisation concept

- Any change in value of an asset is to be recorded only when the business realizes it. Accountants anticipate decrease in value they count it, but if there is increase in value, they ignore it until it is realized.

Dual aspect concept

- This concept is the core of double entry book-keeping. Every transaction or event has dual aspect.
- 1. It increases one Asset and decreases other Asset
- 2. It increases an Asset and simultaneously increases Liability
- 3. It decreases one Asset, increases other Asset
- 4. It decreases one Asset, decreases a Liability.

Materiality

- All the items having significant economic effect on the business of the enterprise should be disclosed in the financial statements and any insignificant item which will not be relevant to the users need should not be disclosed in the financial statement.

Fundamental Accounting Assumptions

Going concern

- The financial statements are normally prepared on the assumption that an enterprise is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the enterprise has neither the intention nor the necessity of liquidation or curtailing materially its scale of operations.

Consistency

- It is assumed that accounting policies are consistent from one period to another. Whatever accounting practices are selected for a given category of transactions, they should be followed on a horizontal basis from one accounting period to another to achieve compatibility.

Accrual

- The effect of transaction and other events are recognized on mercantile basis i.e. when they occur. Financial statements prepared on the accrual basis inform users not of past events involving the payments and receipts of cash but also of obligations to pay cash in the future and of resources that represent cash to be received in the future.

Qualitative Characteristics

Understandability	The financial statements should present information in a manner as to be readily understandable by the users with reasonable knowledge of business and economic activities.
	No relevant information can be however withheld on the grounds of complexity.
Relevance	The financial statements should contain relevant information only.
	Information, which is likely to influence the economic decisions of the users, is said to be relevant.
	The relevance of a piece of information should be judged by its materiality
Reliability	To be useful, the information must be reliable; that is to say, they must be free from material error and bias.
	➔ The information provided are not likely to be reliable **unless:** **(a)** Transactions and events reported are **faithfully represented.** **(b)** Transactions and events are reported in terms of their substance and economic reality not merely on the basis of their legal form. This principle is called the principle of **'substance over form'.** **(c)** The reporting of transactions and events are **neutral, i.e. free from bias.** **(d)** Prudence is exercised in **reporting uncertain outcome** of transactions or events.
Comparability	The financial statements should permit both inter-firm and intra-firm comparison.
	One essential requirement of comparability is disclosure of financial effect of change in accounting policies.
True and Fair View	Financial statements are required to show a true and fair view of the performance, financial position and cash flows of an enterprise.

Unit -3 Capital And Revenue Expenditures and Receipts

Capital Expenditure

1. Meaning	It is an expenditure which is incurred: a) To acquire or bring into existence an asset, or b) To acquire or bring into existence an advantage or benefit of an enduring nature, or c) To increase the productivity or earning capacity.
2. Benefits	It normally yields benefits beyond current accounting period.
3. Accounting Treatment	It is debited to the Respective Asset Account which appears on the Assets side of the Balance Sheet.
4. Examples	a) Cost of Land and Building b) Cost of Plant and Machinery c) Cost of Furniture and Fixtures
5. Disclosure in Financial Statements	Balance Sheet As At ....

Liabilities	₹	Assets	₹
		Capital Expenditure	………

Revenue Expenditure

1. Meaning	It is an expenditure which is incurred: a) To maintain the productivity or earning capacity of a business. b) To carry out operating activities in the normal course of business.
2. Benefits	It normally does not yield benefits beyond current accounting period.
3. Accounting Treatment	It is debited to Respective Expense Account which appears on the debit side of Trading A/c (If Direct Expense) or P&L A/c (If Indirect Expense).
4. Examples	a) Depreciation on Land & Building b) Rent of Machines c) Repairs of Building d) Insurance of Building

5. Disclosure in Financial Statements

Dr. Income Statement for The Period Ended On.... Cr

Particulars	₹	Particulars	₹
To Revenue Expenditure	………		……….

Distinction Between Capital Expenditure And Revenue Expenditure

Basis of Distinction	Capital Expenditure	Revenue Expenditure
1. Meaning	It is an expenditure which is incurred: a) To acquire or bring into existence an asset, or b) To acquire or bring into existence an advantage or benefit of an enduring nature, or c) To increase the productivity or earning capacity.	It is an expenditure which is incurred: a) To maintain the productivity or earning capacity of a business, or b) To carry out operating activities in the normal course of business.
2. Benefits	It normally yields benefits during current accounting period.	It normally does not yield benefits during current accounting period.
3. Accounting Treatment	It is debited to the Respective Asset Account.	It is debited to Respective Expense Account.
4. Examples	a) Cost of Land and Building b) Cost of Plant and Machinery c) Cost of Furniture & Fixtures	a) Depreciation on Land and Building b) Rent of Machines c) Repairs of Building d) Insurance of Building

Deferred Revenue Expenditure

1. Meaning	➔ It refers to that expenditure which is, for the time being, deferred from being charged to income i.e. expenditure which is carried forward on the presumption that it will be of benefit over a subsequent period or periods. ➔ Such deferment of charging off the expenses may be due to the nature of expenses and the benefit is expected over a number of years.
2. Examples	Heavy advertising to launch a new product is a deferred revenue expenditure since the benefit from it will be availed over the next 3 to 5 years.

3. Accounting Treatment	Normally such expenditure should be written off over a period of 3 to 5 years. The written off portion is debited to P&L Account and unwritten off portion is shown on the Assets Side of Balance Sheet.

4. Disclosure in Financial Statements

Dr. Income Statement For The Period Ended On.... Cr

Particulars	₹	Particulars	₹
To Deferred Revenue Expenditure w/o			

Balance Sheet As At ....

Liabilities	₹	Assets	₹
		Deferred Revenue Expenditure (Unwritten off portion i.e. carried forward portion)	

Classification Of Receipts

The Receipts May Be Classified as Follows:

Capital Receipts

1. Meaning	Capital receipts refer to those receipts which are not revenue in nature.
2. Accounting Treatment	These are credited to the respective account of capital nature.
3. Examples	**a)** Sale of Land and Building by a person other than a dealer in real estate. **b)** Raising of Loan by a person other than one engaged in the business of finance/banking. **c)** Raising of Capital.

Revenue Receipts

1. Meaning	Revenue receipts refer to those receipts which arise in the normal course of business.
2. Accounting Treatment	These are credited to Respective Revenue Account which appears in the Income Statement.
3. Examples	**a)** Sale of Land and Building by a dealer in real estate. (Sale of goods)

	b) Sale of Securities by a dealer in securities. (Sale of goods)

Distinction Between Capital Receipts And Revenue Receipts

Basis of Distinction	Capital Receipts	Revenue Receipts
1. Meaning	Capital receipts refer to those receipts which are not revenue in nature.	Revenue receipts refer to those receipts which arise in the normal course of business.
2. Accounting Treatment	These are credited to the respective account of capital nature.	These are credited to Respective Revenue Account which appears in the Income Statement.
3. Examples	**a)** Sale of Land and Building by a person other than a dealer in real estate. **b)** Raising of Loan by a person other than one engaged in the business of finance/banking. **c)** Raising of Capital.	**a)** Sale of Land and Building by a dealer in real estate. **b)** Sale of Securities by a dealer in securities

Unit - 4 Contingent Assets and Contingent Liabilities

Contingent Asset

Meaning	As per Accounting Standard 29, "A contingent asset is a 1. Possible asset 2. That arises from past events 3. The existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.
	It usually arises from unplanned or unexpected events that give rise to the possibility of an inflow of economic benefits to the enterprise.
Example	A claim that an enterprise is pursuing through legal process, where the outcome is uncertain, is a contingent asset.

Terms	Explanation
No Recognition In Financial Statements	As per the concept of prudence as well as the present accounting standards, an enterprise should not recognize a contingent asset.
	This is because, it is possible that recognition of contingent assets may result in recognition of income that may never be realized.
	However, when the realization of income is virtually certain, then the related asset no longer remains as contingent asset and can be realized in the financial statements.
No Disclosure Of Contingent Asset	A contingent asset need not be disclosed in the financial statements.
	A contingent asset is usually disclosed in the report of the approving authority (i.e., Board of Directors in the case of a company, and the corresponding approving authority in the case of any other enterprise), if an inflow of economic benefits is probable.
When recognised	Contingent assets are assessed continually and if it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognized in the financial statements of the period in which the change occurs.

Contingent Liabilities

Meaning	**As per AS 29,** 1. A possible obligation 2. That arises from past events 3. The existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; **or**

	1. A present obligation that arises from past events but is not recognised because: 2. It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or 3. A reliable estimate of the amount of the obligation cannot be made.
	Possible Obligation - An obligation is a possible obligation if, based on the evidence available, its existence at the balance sheet date is considered not probable. (Chances of happening are <50%) **Present Obligation** - An obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not. (Chances of happening are >50%)

Terms	Explanation
No Recognition Of Contingent Liability	An enterprise should not recognise a contingent liability.
Disclosure Of Contingent Liability By way Of Note To The Balance Sheet	A Contingent liability is required to be disclosed by way of Note to the Balance Sheet unless possibility of outflow of a resource embodying economic benefits is remote.
When Recognised	Contingent liabilities are assessed continually to determine whether an outflow of resources embodying economic benefits has become probable.
	If it becomes **probable** that an outflow or future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised in financial statements of the period in which the change in probability occurs except in the extremely rare circumstances where no reliable estimate can be made.

<u>Distinction Between Contingent Liability And Other Liabilities</u>

Basis of Distinction	Contingent Liability	Other Liabilities
1. Meaning	It is an obligation which may or may not arise depending on the happening or non-happening of an uncertain future event.	These are financial obligations of an enterprise other than owners' equity.
2. Disclosure	It is disclosed by way of foot note to the Balance Sheet.	These are disclosed on the liabilities side of the Balance Sheet.

3. Example	1. Bills discounted but not yet matured 2. Arrears of dividend on Cum-Pref- Shares	1. Creditors for Goods 2. Outstanding Expenses

Provision

Meaning	In relation to **Assets**: Any amount written off to P&L by way of providing for diminution in the value of assets. Eg: Provision for Depreciation, Provision for Doubtful Debts. In relation to **Liability**: Any amount written off to P&L by way of providing for any known liability of which the amount cannot be determined with substantial accuracy. Eg: Provision for Warranties.
	As per AS 29, A provision is a liability which can be measured only by using a substantial degree of estimation. AS-29 doesn't cover provision in relation to Assets. It only covers provision in relation to liability.
Conditions	1. An enterprise has a present obligation as a result of a past event.
	2.It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and
	3.A reliable estimate can be made of the amount of the obligation. All the above 3 conditions should be satisfied in order to recognize a provision.

Distinction Between Provision And Contingent Liability

Basis of Distinction	Provision	Contingent Liability
1. Meaning	Provision is a present liability of uncertain amount, which can be measured reliably by using a substantial degree of estimation.	It is an obligation which may or may not arise depending on the happening or non-happening of an uncertain future event.
2. Recognition criteria	A provision meets the recognition criteria.	A contingent liability fails to meet the same.

3. Conditions for Recognition	Provision is recognised when (a) an enterprise has a present obligation arising from past events; an outflow of resources emobodying economic benefits is probable, and (b) a reliable estimate can be made of the amount of the obligation.	Contingent liability includes present obligations that do not meet the recognition criteria because either it is not probable that settlement of those obligations will require outflow of economic benefits, or the amount cannot be reliably estimated.

Unit - 5 Accounting Policies

Accounting Policies

Meaning	Refer to;
	1. **Specific accounting principles and**
	2. **Methods** of applying those principles
	in the **preparation and presentation** of financial statements.

Major Considerations In The Selection Of Accounting Policies

Prudence

Anticipated **losses and expenses**: to be recognized immediately.

Anticipated **profits and incomes** : to be deferred.

Substance over form

Transactions and other events should be accounted for and presented **in accordance** with their **substance** and **financial reality** and **not** merely with **their legal form.**

Materiality

Financial Statements should disclose all material items, that is, items, the knowledge of which might **influence the decision of the users** of the financial statements.

Disclosure Of Accounting Policies

According to AS-1: Disclosure of Accounting Policies	All significant accounting policies adopted in the preparation and presentations of financial statements should be:
	disclosed at one place in the financial statements under the heading significant accounting policies.

Change In Accounting Policy

When The Change In Accounting Policy Is Recommended

The change in Accounting Policy is recommended only when	It is **required by statute(law)** for compliance with an accounting standard.
	It is **required by an Accounting Standard.**
	If it is considered that the change would **result in a more appropriate presentation of the financial statements** of an enterprise.

Disclosure Requirements In Case Of Change In Accounting Policy

The disclosure requirements are as follows:

Case	Disclosure Requirements
1. If change has a material effect in current period and the effect of change is **ascertainable.**	The **amount of change** should be disclosed.
2. If change has a material effect in current period and the effect of change is **not ascertainable, wholly or in part.**	The **fact** should be disclosed.
3. If change has **no material effect** in **current period** but which is reasonably expected to have a **material effect** in **later periods**	The **fact that such change will have a material impact in the later accounting periods** should be appropriately disclosed.

Distinction Between Fundamental Accounting Assumptions And Accounting Policies

The Fundamental accounting assumptions differ from accounting policies in the following respects:

Basis of Distinction	Fundamental Accounting Assumptions	Accounting Policies
1. Number	There are only **three** fundamental accounting assumptions viz. **Going Concern, Consistency and Accrual.** **Memory technique:** ***CAG= Comptroller and Auditor General*** ***CAG= Consistency, Accrual, Going Concern***	There is no single list of accounting policies which are applied in all circumstances. As a result, there may be **different accounting policies adopted by different enterprises.**
2. Disclosure if followed	**No disclosure** is required if all the fundamental assumptions have been **followed.**	**Disclosure** is required if a particular accounting policy has been **followed.**

3. Disclosure if not followed	In case the fundamental assumptions are **not followed**; the fact has to be **disclosed** in the financial statements together with the reasons.	In case, the policy is **changed** in subsequent year, the reasons for such change and the resulting financial consequences have to be **disclosed.**
4. Choice	There is **no choice.**	The firm has **a choice** to select a particular policy

Unit - 6 Accounting as a Measurement Discipline - Valuation Principles, Accounting Estimates

Meaning of Measurement: Prof. R.J.Chamber defined measurement as "Assignment of number to object and events according to rules specifying the property to be measured, the scale to be used and the dimension of the unit"

Elements of Measurement
- Identification of Objects and Events
- Selection of Standards or Scale
- Evaluation of Dimension of Measurement Standards or Scale

Objects or Events to be measured

Past and present objects or events can be measured with some degree of accuracy

Future objects or events are only predicted but not measured

Although decision makers need past, present and future information but generally the past information is communicated to the external users.

Standard or Scale of Measurement:

Money is the scale of measurement.

Money as a measurement scale has no universal application because it takes the shape of currency ruling in a country which differs from one reporting country to another reporting country.

Accounting as a measurement discipline

1. Accounting is not exact measurement discipline because accounting measures information mostly in money terms which is

a. Not a stable scale

b. Not having universal applicability

c. Not stable in dimension or comparison over the time

2. Though measurement is an important part of accounting discipline but a set of theorems which govern the measurement system such as Going Concern, Consistency and Accrual should be carefully understood to know how the cogs of accounting wheel work

3. Although quantitative information is also required in many cases but such information is only supplementary to monetary.

Valuation Principles

There are four generally accepted measurement bases or valuation principles. These are:

Historical Cost → **Current Cost** → **Realisable Value** → **Present Value**

Historical Cost	It means acquisition price. 1. Assets are recorded at an amount of cash or cash equivalent paid at the time of acquisition. 2. Liabilities are recorded at the amount of proceeds received in exchange for the obligation.
Current Cost	The assets are recorded 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 recorded at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.
Realizable Value	Assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the assets in an orderly disposal. Haphazard disposal may yield something less. Liabilities are carried at their settlement values; i.e., the undiscounted amount of cash or cash equivalents expressed to be paid to satisfy the liabilities in the normal course of business.
Present Value	An asset is recorded at the present discounted value of the future net

	cash inflows that item is expected to generate in the normal course of business. Liabilities are recorded at the present discounted value of future net cash outflow s that are expected to be required to settle the liabilities in the normal course of business.

Accounting Estimates

Meaning	The measurement of certain assets and liabilities is based on estimates of uncertain future events. As a result of the uncertainties inherent in business activities, many financial statement items cannot be measured with precision but can only be estimated.
Change in estimates	Differences arising between certain parameters estimated earlier and re-estimated during the current period or difference between earlier estimates and actual result during the current period.
Revision in estimates	If changes occur regarding circumstances on which the estimate was based or as a result of new information, more experience or subsequent developments. For examples: a. Change in the amount of doubtful debts b. Change in useful life of depreciable asset c. Change in estimated residual value of the depreciable asset.

Unit - 7 Accounting Standards

Meaning of Accounting Standard

Accounting standard is a selected set of accounting policies or broad guidelines regarding the principles and methods to be chosen out of several alternatives. Standards conform to applicable laws, customs usage and business environment. So, there is no universally acceptable set of standards.

Objective of Accounting Standard

The main objective of accounting standard is to harmonize the diverse accounting policies and practices at present in use in India. Accounting standards standardize diverse accounting policies with a view to:

1. Eliminate the non-comparability of financial statements and thereby improving the reliability of financial statements

2. Provide a set of standard accounting policies, valuation norms and disclosure requirements

Accounting standards reduce the accounting alternatives in the preparation of financial statements of different enterprises.

Benefits of Accounting Standards

Standard reduces to a reasonable extent or eliminate altogether confusing variations in the accounting treatments used to prepare financial statements

There are certain areas where important information is not statutorily required to be disclosed. Standards may call for disclosure beyond that required by law.

The application of accounting standard would, to a limited extent, facilitate comparison of financial statements of companies situated in different parts of the world and also of different companies situated in the same country. However, it should be noted in this respect that differences in the institutions, traditions and legal systems from one country to another give rise to differences in accounting standards adopted in different countries.

Limitations of accounting standards

Difficulties in making choice between different treatments	Alternative solutions to certain accounting problems may each have arguments to recommend them.
Restricted scope	Accounting standards cannot override the statute. The standards are required to be framed within the ambit of prevailing statutes

2 Accounting Process

UNIT -1 BASIC ACCOUNTING PROCEDURES – JOURNAL ENTRIES

Debit And Credit

We know that by deducting the total of liabilities from the total of assets the amount of capital is ascertained, as is indicated by the accounting equation.

Assets = Liabilities + Capital

OR

Assets – Liabilities = Capital

To understand the equation better, let us expand it: -

Assets = Liabilities + Stockholders' Equity

Assets = Liabilities + (Contributed capital + beginning retained earnings + revenue – expenses – dividends)

Rules

- Increases in assets are debits; decreases are credits;
- Increases in liabilities are credits; decreases are debits;
- Increases in owner's capital are credits; decreases are debits;
- Increases in expenses are debits; decreases are credits; and
- Increases in revenue or incomes are credits; decreases are debits.

Whether an entry is to the debit or credit side of an asset depends on the type of account and the transactions

Debit	**Credit**
Increase in Purchases	Increase in Sales
Increase in Expenses	Increase in revenue and Incomes
Increase in Assets	Increase in Liabilities and Owners' Capital

In the same way, decrease in purchases, expenses and assets are credits and decrease in sales, income, liabilities and owners' capital are debit.

Classification Of Accounts: As Per Traditional Approach

Types of Accounts	Meaning	Examples
a) Personal Accounts	These accounts relate to natural persons, artificial persons and representative persons.	Natural-Ram's A/c Artificial-Ram & Co.'s etc Representative-Outstanding Salary A/c, Prepaid Insurance
b) Real Accounts	These accounts relate to the tangible or intangible real assets.	Tangible-Land A/c Intangible-Goodwill A/c
c) Nominal Accounts	These accounts relate to losses, profit & gains.	Expenses-Purchases A/c Loss-Loss by fire A/c Profits & Gains-Sales A/c, Discount Received A/c

As Per Accounting Equation Approach

Types of Accounts	Meaning	Examples
(a) Assets Accounts	These accounts relate to Tangible or Intangible real assets.	Land A/c, Building A/c, Cash A/c, Goodwill, Patents.
(b) Liabilities Accounts	These accounts relate to the financial obligations of an enterprise towards outsiders.	Trade Creditors, Bank overdraft, Short-term loans, Long-term loans.
(c) Capital Accounts	These accounts relate to owners of an enterprise.	Capita! A/c, Drawings A/c.

(d) Revenue Accounts	These accounts relate of the amount charged for goods sold or services rendered or permitting others to use enterprise's resources yielding Interest, Royalty or Dividend.	Sales A/c, Discount Received A/c, Dividend Received A/c, Royalty Received A/c, Interest Received A/c.
(e) Expenses Accounts	These accounts relate to the amount incurred or lost in the process of earning revenue.	Purchases A/c, Discount Allowed A/c, Salaries A/c, Interest Allowed A/c, Loss by Fire A/c.

Traditional Classification & Accounting Equation Based Classification Of Accounts

Traditional Classification of Accounts	Accounting Equation Based Classification of Accounts
1. Personal Accounts having debit balances (other than those relating to Owner)	Assets Accounts
2. Personal Accounts having credit balances (other than those relating to Owner)	Liabilities Accounts
3. Personal Account relating to Owner	Capital Account
4. Real Accounts	Assets Account
5. Nominal Accounts relating to Revenue	Revenue Account
6. Nominal Accounts relating to Expenses	Expenses Account

Rules For Debit And Credit

When The Accounts Are Classified As Personal, Real And Nominal

Types of Accounts	Rules for Debit	Rules for Credit
a) For Personal Accounts	Debit the Receiver	Credit the Giver
b) For Real Accounts	Debit What Comes in	Credit What Goes out
c) For Nominal Accounts	Debit All Expenses & Losses	Credit all Gains and Profits

When The Accounts Are Classified On Accounting Equation Basis

Types of Accounts	Rules for Debit	Rules for Credit
a) For Assets Accounts	Debit the Increase	Credit the Decrease
b) For Liabilities Accounts	Debit the Decrease	Credit the Increase
c) For Capital Accounts	Debit the Decrease	Credit the Increase

d) For Revenue Accounts e) For Expenses Accounts	Debit the Decrease Debit the Increase	Credit the Increase Credit the Decrease

Meaning And Format Of Journal

Journal	➢ a book in which transactions are recorded in the order in which they occur i.e., in chronological order. ➢ A Journal is called a book of prime entry (also called of original entry) because all business transactions are entered first in this book.
Journalising	The process of recording a transaction in a journal
Journal Entry	An entry made in the journal

Limitations Of Journal

1) Time and Cost Consuming	The system of recording all the transactions in a journal requires (i) the writing down of the name of the account involved as many times as the transactions occur; and (ii) an individual posting of each account debited and credited and hence involves the repetitive journalising and posting labour.
1) Delay	Such a system does not provide the information on prompt basis.
2) No Internal Check	Such a system does not facilitate the installation of an internal check system since the journal can be handled by only one person.
3) Bulky and Voluminous	The journal becomes bulky and voluminous.

Meaning

Trade Discount	It is a reduction granted by a supplier from the List Price of goods or services on business considerations (such as quantity bought, trade practices, etc.,) other than for prompt payment.
Cash Discount	A reduction granted by a supplier from the Invoice Price in consideration of immediate payment or payment within a stipulated period.

Trade Discount And Cash Discount

Basis of Distinction	Trade Discount	Cash Discount
1. Meaning	It is a reduction granted by a supplier from the List Price of goods or services on business considerations (such as quantity bought, trade practices, etc.,) other than for prompt payment.	A reduction granted by a supplier from the Invoice Price in consideration of immediate payment or payment within a credit period allowed.
2. Purpose	allowed to promote the sales or as a trade practices.	allowed to encourage the prompt payment.
3. Time when allowed	allowed on purchase of goods.	allowed on immediate payment or payment within a specified period.
4. Disclosure in the Invoice	shown by way of deduction in the invoice itself.	not shown in the invoice.
5. Ledger Account	Trade Discount Account is not opened in the ledger.	Cash Discount Account is opened in the ledger.
6. Variation	It may vary with the quantity purchased.	It may vary with the period within which the payment is made.

Books Of Original Entry/Journal And Ledger

Basis of Distinction	Books of Original Entry	Ledger
1. Nature of Book	There are books of original or prime entry.	This is a book of final or secondary entry.
2. Basis for Preparation	These books are prepared on the basis of source documents.	This book is prepared on the basis of books of original entry.
3. Stage of Recording	Recording of entries in these books is the first stage.	Recording of entries in the ledger is the second stage.
4. Net effect of various transactions	These books do not help to know the net effect of the various transactions affecting a particular account.	A ledger helps to know the net effect of the various transactions affecting a particular account.
5. Format	In the Journal, there is one column for particulars and two columns for amounts - one for debit and another for credit.	In the ledger, there are two divided sides having identical columns. The left side is known

	Special journals (except Cash Book) have only one column of amount.	as debit and the right side is known as credit.
6. Balancing	In the books of original entry (except Cash Book) balancing is not done.	In the ledger, all the accounts (except nominal accounts) are balanced.
7. Next stage of accounting process	From the books of original entry, entries are transferred to the ledger.	From the ledger, first the trial balance is drawn and then financial statements are prepared.
8. Name of the process of recording entries	The process of recording entries in these books	The process of recording entries in the ledger

Unit 2: Ledgers

1. **Ledger**: - It is a secondary/principal book.
2. **Posting:** It is a process of transferring transaction recorded in journal into ledger.
3. **Opening Entry**: - It is a journal entry by which various assets & liabilities, appearing in the B/s of previous year are brought forward in the books of current year. ie. (To b/f or By b/f)
4. **Balancing:** - Ascertainment of difference between total debit and total credit.
   - The balance of account is known by the side which is higher.
   - The balance of an account is recorded on the side which is shorter.
5. **Column of ledger:** There are „8" eight columns in ledger.

UNIT – 3 SUBSIDIARY BOOKS

Subsidiary books: - It is a book of original/prime entry (journal)

Types of subsidiary books

(i) Cash Book: - It records all cash/Bank receipts and payments.

(ii) Purchase Book: - It records all credit purchase of goods dealt in.

(iii) Purchase return book: It records the return of credit purchase of goods dealt in (Purchase return book is prepared on the basis of Debit Note.)

(iv) Sale book: It records the credit sale of goods dealt in:

(v) Sale-return book: It records the return of credit sale of goods dealt in. (This book is prepared on the basis of Credit Note.)

(vi) Bills receivable book: It records the details of bills receivable.

(vii) Bills payable: - It records the details of bills payable accepted.

(viii) Journal proper: - It records

- Opening entry
- Closing entry
- Transfer entry
- Adjustment entries
- Rectifying entries
- Dishonour entry etc.

Unit 4: Cash Book

Specific Transactions

Name of Special Journal	Specific transactions to be recorded
I. Cash Journals:	
a) Simple Cash Book	a) Cash Transactions
b) Cash Book with Discount Column	b) Cash and Discount transactions
c) Cash Book with Bank & Discount Column	c) Cash, Bank and Discount transactions
d) Petty Cash Book	d) Petty Cash transactions
II. Goods Journals:	
a) Purchases Book	a) Credit Purchases of Goods
b) Sales Book	b) Credit Sales of Goods
c) Sales Returns Book (or Returns Inward book)	c) Goods returned by those customers to whom goods were sold on credit
d) Purchase Returns Book (or Returns Outward Book)	d) Goods returned to those suppliers from whom goods were purchased on credit
III. Bills Journal:	
a) Bills Receivable Book	a) Bills Receivable drawn
b) Bills Payable Book	b) Bills Payable accepted
IV. Journal Proper	Transactions not covered elsewhere

Advantages Of Special Journals

Facilitates division of work	The accounting work can be divided among many persons.
Permits the installation of Internal Check System	With the use of internal check, the possibility of occurrence of error/fraud may be avoided.
Permits the use of specialized skill	With the use of a specialised skill, prompt, economical and more accurate supply of accounting information may be obtained.

Features Of Petty Cash Book

- ➔ The amount of cash received from the main cashier is recorded on the left hand side column.
- ➔ The payments of petty cash expenses are recorded on the right hand side in the respective columns.

→ can never show a credit balance because the cash payments can never exceed the cash receipts.
→ Its balance represents unspent petty cash in hand.
→ Recording is done on the basis of internal as well as external vouchers.
→ Petty Cash Book is both a book of original entry as well as a book of final entry.

Similarities Between Main Cash Book & Petty Cash Book

Both are books of original entry	both serve the purpose of journal Both are journal in the sense that the transactions are recorded in it for the first time from the source documents.
Both are books of final entry	both serve the purpose of ledger Both are ledger in the sense that main cash book serves the purpose of 'Main Cash A/c' & 'Bank Account' (only in case of three column cash book) and Petty Cash Book serves the purpose of 'Petty Cash A/c'.

Main Cash Book & Petty Cash Book

Main Cash Book	Petty Cash Book
all Cash Receipts are recorded	only Cash Receipts from Main Cashier are recorded.
all Cash Payments except payments of Petty Cash Expenses are recorded	only Payments of Petty Cash Expenses are recorded.

Imprest And Non-Imprest System Of Petty Cash Book

Imprest System	The Chief Cashier makes the reimbursement of the amount spent by the petty cashier and the Petty Cashier again has the same amount of petty cash at the end as in the beginning.
Non-Imprest System	The Chief Cashier may hand over the cash to the Petty Cashier equal to/more than/less than the amount spent by the petty cashier.

Features Of Imprest System

Estimation by Chief Cashier	estimates the total petty cash expenses for a particular fixed period.
Advances by Chief Cashier	advances the estimated amount to the petty cashier in the beginning of the period.
Submission of Petty Cash Book by Petty Cashier	submits the petty cash book along with supporting vouchers to the chief cashier at the end of the period.
Reimbursement of Amount Spent	Chief Cashier makes the reimbursement of the amount spent by the Petty Cashier.
Availability of Same Amount of Petty Cash	The Petty Cashier again has the same amount of petty cash in the beginning of new period.

Advantages Of Petty Cash Book

Saving of Chief Cashier's Time	saved when petty expenses are recorded in petty cash book.
Control over Mistakes	chances of mistakes are reduced since the chief cashier regularly examines the petty cash book.
Control over Petty Expenses	Petty cashier can never spend more than the available petty cash.
Control over Fraud	Misappropriation is always kept within the limits of imprest.
Benefits of Specialisation	available since recording of cash transactions is divided between main cash book and petty cash book.

Debit Note And Credit Note

Basis of Distinction	Debit Note	Credit Note
1. Who prepares?	Prepared by **Purchaser.**	Prepared by **Seller.**
2. Contents	a) Date of return b) Name of supplier to who returned c) Details of goods returned d) Reasons for returning goods	a) Date of return b) Name of Customer who returned c) Details of goods returned d) Reason for returning goods

3. Source Document	Used as source document for recording in **Purchase Return Book.**	Used as source document for recording in **Sales Return Book.**
4. Why Prepared?	prepared to debit supplier's account.	prepared to give credit to customer.

Unit 5: Rectification Of Errors

1. Types of errors
2. Stages of errors
3. Rectification of errors before preparation of trial balance
4. Rectification of errors after preparation of trial balance but before preparation of final accounts
5. Rectification of efforts after prerpration of final accounts

TOPIC 1: - TYPES OF ERRORS

ERRORS OF PRINCIPLE

When **wrong accounting principles** are applied for recording a journal entry it is called an error of principle.

Eg: Machine Purchased Dr. to Purchase Account

CLERICAL ERRORS

ERRORS OF OMISSION

When a transaction is completely or partially omitted from being recorded or posted.

Eg: Goods sold not recorded at all.

ERRORS OF COMMISION

When a transaction is posted to a wrong account or is posted to the wrong side of a particular account or a wrong balance is calculated of a particular account.

COMPENSATING ERRORS

If an effect of one error gets cancelled out or nullified by another error, such errors are called compensating errors.

TOPIC 2: - STAGES OF LOCATION OF ERRORS

BEFORE PREPARATION OF TRIAL BALANCE

Errors at such stage happen at four different stages

- JOURNAL
- LEDGER
- BALANCING
- TOTALING

AFTER PREPARATION OF TRIAL BALANCE

When errors are rectified after preparation of TB, the following changes will take place;

1. For rectification entries that had only 1 effect, the second effect will be given in suspense a/c
2. For rectification entries that had 2 effects, no change will take place.

IN THE NEXT FINANCIAL YEAR (AFTER PREPARATION OF FINAL ACCOUNTS)

When errors are rectified after preparation of final accounts, all effects of NOMINAL nature i.e. Incomes, Gains, Expenses, Losses will be debited to P&L adjustment a/c.

For rectification entries that have only 1 rectification effect, the 2nd effect will be given in suspense a/c

TOPIC 3: - RECTIFICATION OF ERRORS BEFORE PREPARATION OF TRIAL BALANCE

Errors Occurring While Recording in Journal or Subsidiary Books

Goods sold to Ram for cash for ₹ 500 debited to Ram

WRONG

Ram a/c Dr. 500
To Sales a/c 500

CORRECT

Cash a/c Dr. 500
To Sales a/c 500

Reverse

As it is

RECTIFICATION

Ram a/c Cr.
~~Sales a/c Dr.~~
Cash a/c Dr.
~~Sales a/c Cr.~~

Cash a/c Dr. 500
To Ram a/c 500

Bad debts of Mukesh written off as Suresh's a/c

WRONG

Bad debts a/c Dr. 500
To Suresh a/c 500

CORRECT

Bad debts a/c Dr. 500
To Mukesh a/c 500

Reverse

As it is

RECTIFICATION

~~Bad debts a/c Cr. 500~~
Suresh a/c Dr. 500
~~Bad debts a/c Dr. 500~~

Mukesh a/c Cr. 500

Suresh a/c Dr. 500
Mukesh a/c Cr. 500

POINT TO BE NOTED

Whenever we make a mistake/error while recording (i.e., Journal OR Subsidiary Books), then the rectification of such errors will have 2 EFFECTS

Errors occurring while posting in LEDGER

Goods sold for ₹5000 posted in cash a/c as ₹500

WRONG

Cash a/c Dr. 500

To Sales a/c 5000

CORRECT

Cash a/c Dr. 5000

To Sales a/c 5000

Reverse

As it is

RECTIFICATION

Cash a/c Cr. 500

~~Sales a/c Dr. 5000~~

Cash a/c Dr. 5000

~~Sales a/c Cr. 5000~~

Cash a/c Dr. 4500

Goods sold for ₹5000 posted to the credit of Purchases

WRONG

Cash Dr. 5000

To Purchase 5000

CORRECT

Cash a/c Dr. 5000

To Sales a/c 5000

Reverse　　　　　　　　　　　　As it is

RECTIFICATION

~~Cash a/c　Cr. 5000~~

Purchase a/c　Dr. 5000

~~Cash a/c　Dr. 5000~~

Sales a/c　Cr.　5000

Purchase a/c Dr.　5000

To Sales a/c　　　5000

POINT TO BE NOTED

When there is an error while posting in Ledger a/c, rectification of such errors can have.

ONE EFFECT　　　　　　　　　　TWO EFFECTS

ERRORS OCCURING WHILE BALANCING OF LEDGERS

Balance of Modi a/c ₹10000 Dr.　c/f as ₹10000 cr.

WRONG　　　　　　　　　　　　CORRECT

Modi a/c　Cr.　10000　　　　　　Modi a/c　Dr.　10000

Reverse　　　　　　　　　　　　As it is

RECTIFICATION

Modi a/c　Dr.　10000

Modi a/c　Dr.　10000

Modi a/c　Dr.　20000

Balance of Rahul a/c ₹50000 Cr.　c/f　as ₹5000 Dr.

WRONG

Rahul a/c Dr. 5000

Reverse

CORRECT

Rahul a/c Cr. 50000

As it is

RECTIFICATION

Rahul a/c Cr. 5000

Rahul a/c Cr. 50000

Rahul a/c Cr. 55000

POINT TO BE NOTED

While rectifying errors that occur during balancing of ledgers, the rectification effect has just ONE EFFECT

ERRORS OCCURING WHILE TOTALLING OF SUBSIDIARY BOOKS

WRONG

Purchase a/c Dr. 50000

Reverse

CORRECT

Purchase a/c Dr. 5000

As it is

RECTIFICATION

Purchase a/c Cr. 50000

Purchase a/c Dr. 5000

Purchase a/c Cr. 45000

Total of Sales Book ₹10000 cr. c/f to Sales a/c as 5000 Dr.

WRONG

Sales a/c Dr. 5000

Reverse

CORRECT

Sales a/c Cr. 10000

As it is

RECTIFICATION

Sales a/c Cr. 5000

Sales a/c Cr. 10000

Sales a/c Cr. 15000

POINT TO BE NOTED: -

Rectification of Errors occurred while totaling of subsidiary, will have only ONE EFFECT

3 Bank Reconciliation Statement

Chunnu 's books
Bank A/c

Big Bank Books
Chunnu 's A/c

Deposits	Withdrawal
	Cl. Bal. 100000

Deposits	Withdrawal
Cl. Bal. 100000	

Opposite but equal balance in books of Chunnu and Bank

If there is a difference in these two balances, then we need to prepare a Bank Reconciliation Statement.

Reconciliation is the process of ensuring that two sets of records (usually the balances of two accounts) are in agreement in accounting books.

Bank Reconciliation statement (BRS) is a statement which reconciles the bank balance as per Cash Book with the balance as per Bank Pass Book/Statement (ledger copy issued by bank to customers as recorded in their books) showing causes of all differences between two. Some entries may have been recorded in Cash Books but do not appear in Bank passbook/statement and vice versa. Hence, on a particular date balance as per Bank and Cash Book may not tally.

Who prepares BRS?

- **BRS is prepared by individual (Chunnu) and not by the bank.**
- **It is a prepared as a rough work and is not a part of final accounts of the individual.**

- **While reconciling, the individual needs to ensure that he matches all his transactions with the transactions of the bank. This means:**

- If the bank has passed the entry and the individual has not, then the individual will have to pass the entry. (TIMING DIFFERENCE)
- If the individual has passed the entry and bank has not, then the individual will have to reverse the entry in his books. (TIMING DIFFERENCE)
- If the bank has made a mistake in it books, then the individual will also record the same for the purpose of reconciliation. (DIFFERENCE DUE TO ERROR)
- If the individual has committed an error, then he will reverse it. (DIFFERENCE DUE TO ERROR)

Remember:
Individual will
match the Bank

Reasons for Differences

Timing Differences

Bank has Passed the entry & Individual has not → Record the Entry

Individual has Passed the entry & The bank has not. → Reverse the Entry

Differences arising due to errors

Bank has made an error & Individual has not → Repeat the Error

Individual has made an error & Bank has not → Reverse the Entry

Chunnu's Books

Cash book (Bank Column) OR Bank A/c

Dr. | **Cr.**

Balance as per Cash book (Fav.)	X				**Balance as per Cash book (Fav.)**	X			
Balance as per Pass book (U. Fav.)				X	**Balance as per Pass book (U. Fav.)**				X
2.Cheque issued but not presented	+	-	-	+	1.Cheque deposited but not cleared	-	+	+	-

3.Cheque directly deposited by a customer	+	-	-	+	5.Expenses directly paid by bank	-	+	+	-
4.Income directly received by bank	+	-	-	+	6.Bank charges levied by bank	-	+	+	-
9.Wrong credit in Cash book	+	-	-	+	7.Locker rent levied by bank	-	+	+	-
11.Wrong credit in Pass book	+	-	-	+	8.Wrong Debit in Cash book	-	+	+	-
12.Undercasting of Debit side of Cash book	+	-	-	+	10.Wrong Debit in Pass book	-	+	+	-
15.Overcasting of Credit side of Cash book	+	-	-	+	13.Overcasting of Debit side of Cash book	-	+	+	-
16.Bills receivable collected directly by bank	+	-	-	+	14.Undercasting of Credit side of Cash book	-	+	+	-
					17.Interest on Bank O/D charged	-	+	+	-

PREPRATION OF BANK RECONCILIATION STATEMENT AFTER PREPARING ADJUSTED CASH BOOK

-All the logics as studied earlier will apply in the same manner.

-However, the changes need to be considered: -

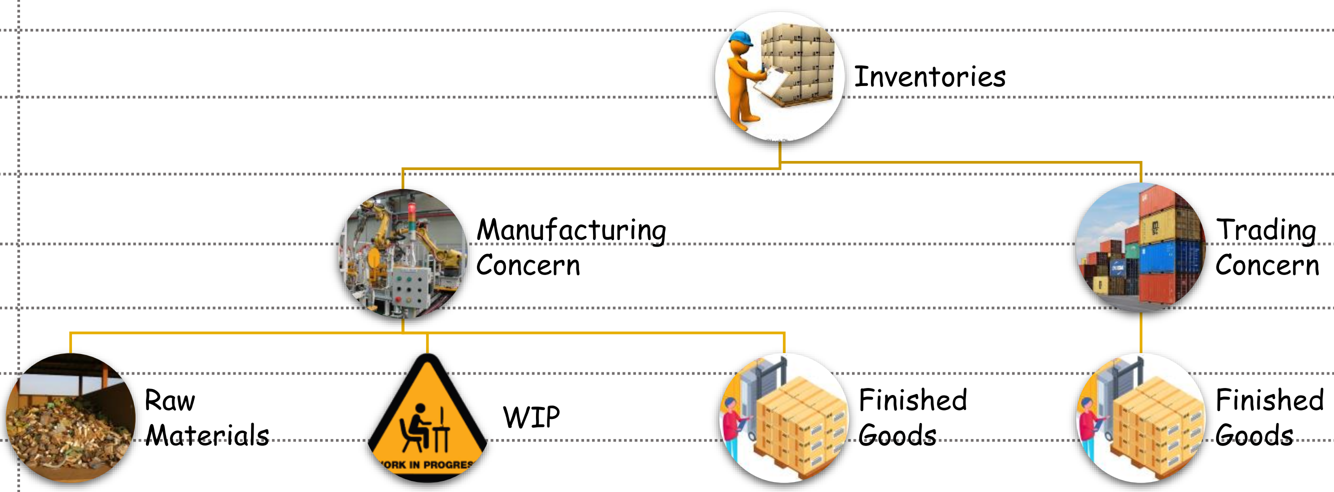
1. Effects of all errors made by the entity will be done in adjusted cash book.
2. After doing so, the effects of errors committed by the bank will be done in BRS.

4 Inventories

Meaning

Inventory can be defined as assets held

- for sale in the ordinary course of business, or
- in the process of production for such sale, or
- for consumption in the production of goods or services for sale, including maintenance supplies and consumables other than machinery spares, servicing equipment and standby equipment.



Inventory Valuation

A primary issue in accounting for inventories is the determination of the value at which inventories are carried in the financial statements until the related revenues are recognized. Main objective of arriving at value at which inventories are carried in financial statement until finally sold in market and revenues are recognized. The significance of inventory valuation arises due to various reasons as explained in the following points:

(i) Determination of Income:	The valuation of inventory is necessary for determining the true income earned by a business entity during a particular period. To determine gross profit, cost of goods sold is matched with revenue of the accounting periods. Cost of goods sold is calculated as follows: **Cost of goods sold = Opening inventory + Purchases + Direct Expenses – Closing inventory.** Hence, Value of Inventory has major impact on determination of Income 1. If Closing Inventory is overstated, income for the period will be overstated and due to this income for subsequent period will be understated as opening inventory is overstated. 2. if Closing Inventory is understated, Income for the period will be understated and income for subsequent period will be overstated as opening inventory is understated.
(ii) Ascertainment Financial Position	Inventories are classified as current assets. The inventory is not properly valued, the balance sheet will not disclose the truthful financial position of the business.
(iii) Liquidity Analysis	It is one of the components of net working capital which reveals the liquidity position of the business. Current ratio which studies the relationship between current assets and current liabilities is significantly affected by the value of inventory.
(iv)Statutory Compliance	Schedule III to the Companies Act, 2013 requires valuation of each class of goods i.e. raw material, work-in-progress and finished goods under broad head to be disclosed in the financial statements. As per the requirements of the Accounting Standards, the financial state- -ments should disclose: (a) the accounting policies adopted in measuring inventories, including

	the cost formula used, and (b) the total carrying amount of inventories and its classification appropriate to the enterprise. The common classification of inventories are raw materials; work-in-progress; finished goods; stores-in- trade (in respect of goods acqu--ired for trading) and spares and loose tools.

Basis of Inventory Valuation

Inventories should be generally valued at the *lower of cost or net realizable value*.

Under the principle of 'lower of cost or net realizable value' any loss due to decrease in sales price of the inventory below its cost is recognized immediately as it is anticipated that the enterprise will make losses whenever it will sell.

Cost: As per Accounting Standards, Cost of inventories should comprise

All cost of purchase → costs of conversion (primarily for finished goods and work - in progress) and → other costs incurred in bringing the inventories to their present location and condition.

1. **Cost of Purchase:** Purchase price +Taxes & Duties (not recoverable) +direct expenses related to acquisition of goods like freight, unloading charges etc.

2. **Cost of Conversion:** Direct labour+ Power & Fuel+ Direct expense incurred in relation to production of goods.

3. **Other Expenses:** incurred in bringing the inventories to their present condition includes designing for specific product etc.

4. **Exclusions from cost of inventories:** Following expenses are generally not included in the costs of inventories:

   (a) abnormal amounts of wasted materials, labour or other production overheads;

   (b) storage costs, unless those costs are necessary in the production process prior to further production stage;

(c) administrative overheads that do not contribute to bringing the inventories to their present location and condition; and

(d) selling and distribution costs.

5. Net Realisable Value: Estimated Selling price in ordinary course of business less cost of completion and sales related direct expenses.

Inventory Record Systems

There are *two principal systems* of determining the physical quantities and monetary value of inventories sold and in hand. One system is known as 'Periodic Inventory System' and the other as the 'Perpetual Inventory System'.

Periodic Inventory System

- A method of ascertaining inventory by taking an actual physical count (or measure or weight) of all the inventory items on hand at a particular date on which inventory is valued. It is because of actual physical count that the system is also called physical inventory system.
  - The cost of goods sold is determined as shown below:

    Opening inventory (known) + Purchases (known) – closing inventory (physically counted) = Cost of goods sold.
- This system is used by small enterprises where is easy to control physical inventory. This system is not considered suitable for medium or larger enterprises which generally use Perpetual Inventory system.

Perpetual Inventory System

- A system of recording inventory balances after each receipt and issue. In order to ensure accuracy of perpetual inventory records, physical inventory should be checked and compared with recorded balances.
- Under perpetual inventory system, closing inventory is determined as follows: **Opening inventory (known) + Purchases during the period (known) – Cost of Goods Sold (known) = Closing Inventory (balancing figure)**

Distinction Between Periodic Inventory System And Perpetual Inventory System

Periodic Inventory System	Perpetual Inventory System
1. This system is based on physical verification 2. This system provides information about inventory and cost of goods sold at a particular date. 3.This system determines inventory and takes cost of goods sold as residual figure. 4. Cost of goods sold includes loss of goods as goods not in inventory are assumed to be sold. 5.Under this method, inventory control is not possible. 6. This system is simple and less expensive. 7.Periodic system requires closure of business for counting of inventory.	1. It is based on book records. 2. It provides continuous information About inventory and cost of sales. 3. It directly determines cost of goods Sold and computes inventory as balancing figure. 4. Closing inventory includes loss of goods as all unsold goods are assumed to be in Inventory. 5. Inventory control can be exercised under this system. 6.It is costlier method. 7. Inventory can be determined without affecting the operations of the business.

Formulae/Methods to Determine Cost Of Inventory

Historical Cost Methods

Specific Identification Method → FIFO Method → LIFO Method → Simple Average Price Method → Weighted Average Price Method

Specific Identification Method	Pricing under this method is based on actual physical flow of goods. It attributes specific costs to identified goods and requires keeping different lots purchased separately to identify the lot out of which units in inventories are left. This method is generally used to ascertain the cost of inventories of items that are not ordinarily interchangeable and their value is high like expensive medical equipment.
FIFO Method	Goods which are received first are consumed first, inventory on hand therefore, consist of last lot received and valued based on price paid for last lot. When prices of good are continuously rising, higher income is

	reported as old cost which had lower rate is matched with revenue. When prices of goods are going down, lower income is reported as old cost which had higher rate is matched with revenue. Value of closing inventory tends to be nearer to current market price, more realistic.
LIFO Method	Goods which are received last are consumed first, inventory on hand therefore, consist of earlier lot received and valued based on price paid for earlier lot. When prices of good are continuously rising, lower income is reported as old cost which had higher rate is matched with revenue. When prices of goods are going down; higher income is reported as old cost which had lower rate is matched with revenue. Value of closing inventory tends to be different from current market price.
Simple Average Price Method	Simple Average price for computing value of inventory is a very simple approach. All the different prices are added together and then divided by the number of prices. The closing inventory is then valued according to the price ascertained.
Weighted Average Price Method	This technique of valuation is based on assumption that each issue of good consist of due proportion of earlier lot. Evert time new lot for material purchased, new weighted price is calculated. Weighted Average Price= $\frac{\textit{Total cost of material in stock}}{\textit{Total quantity of material in stock}}$ It averages out effect of price fluctuation, more suitable to continuous process industry. Weighted Average Price / unit= $\frac{\textit{Total cost of goods available for sale during the period}}{\textit{Total number of units available for sale during the period}}$ Closing inventory = No. of units in inventory Weighted average price/unit Cost of goods sold No. of units sold x Weighted average price/unit.

Non-Historical Cost Methods

Non-historical cost methods do not consider the historical cost incurred to acquire the goods.

Adjusted Selling Price method

Standard Cost method

Adjusted Selling Price method	This method is also called retail inventory method. It is used widely in retail business or in business where the inventory comp--rises of items, the individual costs of which are not readily asce--rtainable. The cost of the inventory is determined by reducing from the sales value of the inventory an appropriate percentage of gross margin. The percentage used takes into consideration inventory which has been marked below its original selling price. An average percentage for each retail department is often used.
Standard Cost method	Under this method, standard cost is set for all items of inventory and used as basis for pricing the material issue. While determining standard cost, factors like purchase of material, issue, storage, usage, level of consumption etc are considered and standard cost is reviewed and updated on regular intervals to give realistic picture.

5 Concept & Accounting of Depreciation

Concept of Depreciation

Property, plant and equipment are tangible items that:

are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

are expected to be used during more than a period of twelve months.

►The utility or value of an asset goes down over a period of time mainly due to wear & tear and many other reasons.

►*Depreciation is the permanent and continuous decrease in the book value of a depreciable fixed asset due to use, efflux ion of time, obsolescence, expiration of legal right or any other cause.*

►Depreciation is allocated so as to charge fair proportion of the depreciable amount in each accounting period during the expected useful life of an asset. It includes amortisation of asset whose useful life is predetermined.

As per *Schedule II under the Companies Act, 2013*, Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. The depreciable amount of an asset is the cost of an asset or other amount substituted for cost, less its residual value. The useful life of an asset is the period over which an asset is expected to be available for use by an entity, or the number of production or similar units expected to be obtained from the asset by the entity.

►Thus, there are 3 important factors for computing depreciation:

- Estimated useful life of the asset
- Cost of the asset
- Residual value of the asset at the end of the of its estimated useful life

Objectives for Providing Depreciation

Prime objectives for providing depreciation are:

Correct income measurement

- In case an enterprise does not account for depreciation on Property, Plant & Equipment, it will not be considering loss in value of property, plant & equipment due to their use in production or operations of the enterprise and will not result in true profit or loss for the period.

True position statement

- Should be adjusted for depreciation charged in order to depict the actual financial position.
- In case depreciation is not accounted for appropriately, the property, plant and equipment would be disclosed in financial statements at a value higher than their true value.

Funds for replacement

- A portion of profit is set aside in the form of depreciation and accumulate each year. This will provide definite amount at certain future date for replacement of specific assets.

Ascertainment of true cost of production

- For ascertaining the cost of the production, it is necessary to charge depreciation as an item of cost of production.

Factors in the Measurement of Depreciation

Estimation of exact amount of depreciation is not easy as it involves lot of estimation.

Historic cost of Assets

- Cost of depreciable asset represents the cost incurred in its acquisition, installation, commissioning and any other expenses for improvement thereof of capital nature.

Expected useful life

- Life of depreciable assets means the period over which a depreciable asset is expected to be used by firm or the number of production or similar units expected to be obtained from the asset by the firm

Estimates Scrap (Salvage) Value

- Scrap value means amount expected to be realized on sale of asset on completion of its useful life. If it is insignificant, it is normally regarded as Nil.

Methods For Providing Depreciation

- **Methods of Depreciation**
  - **Straight-line Method**
    - Results in a constant charge over the useful life if the residual value of the asset does not change
  - **Diminishing Balance Method**
    - Results in a deceasing charge over the useful life
  - **Units of Production Method**
    - Results in a charg based on the expected use or output

Straight-line Method	An equal amount is *written off every year* during the working life of an asset so as to reduce the cost of the asset to nil or its residual value at the end of its useful life. The advantage of this method is that it is simple to apply and gives accurate results especially in case of leases, and also, in case of plant and machinery. This method is also known as *Fixed Instalment Method*. Straight Line Depreciation = $\frac{Cost\ of\ Asset - Scrap\ Value}{Useful\ life}$ Straight Line Depreciation Rate = $\frac{Straight\ Line\ Depreciation}{Cost\ of\ Asset} \times 100$ **Example: Company A purchases a machine for ₹100,000 with an Estimated salvage value of ₹20,000 and a useful life of 5 years.** **Solution:** The straight-line depreciation for the machine would be calculated as: 1. Cost of the asset: ₹100,000

	2. Cost of the asset – Estimated salvage value: ₹100,000 – ₹20,000 = ₹80,000 total depreciable cost 3. Useful life of the asset: 5 years Divide step 2 by step 3: ₹80,000/5 years = ₹16,000 annual depreciation Amount. Therefore, Company A would depreciate the machine at the amount of ₹16,000 annually for 5 years. The depreciation rate can also be calculated if the annual depreciation amount is known. The depreciation rate is the annual depreciation amount /total depreciable cost. In this case, the machine has a straight -line depreciation rate of ₹16,000 / ₹80,000 = 20%.
Reducing or Diminishing Balance Method or Written Down Value (WDV) Method	A fixed percentage of the original cost on the written down value of an asset is charged every year so as to reduce the asset to its *break-up value at the end of its life*. Annual charge of depreciation reduces from year to year. Commonly used for plant, fixtures etc. where repairs are high in later years and depreciation would be lower. Rate of Depreciation= $1 - \sqrt[n]{\frac{Residual\ Value}{Cost\ of\ asset}}$ x 100 (n= useful life of asset) Ex: Purchase a Machine Rs.500000 and spent ₹35000 on registration, insurance etc.. Useful life 5 years, Residual value Rs.1,10,000 Cost of Asset =Rs.5,35,000(5,00,000+35,000) Rate of Depr.= $1 - \sqrt[5]{\frac{1,10,000}{5,35,000}}$ x 100 = $1 - \sqrt[5]{0.2056}$x 100 =72.87%

<u>**Accounting Entries under Straight Line and Reducing Balance Methods:**</u>

There are two alternative approaches for recording accounting entries for depreciation.

First Alternative	*Second Alternative*
A provision for depreciation or Accumulated Depreciation account is opened to accumulate	Amount of Depreciation is credited to the Asset Account every year and the Asset

the balance of depreciation and the assets are carried at historical cost. This method is pre--ferred by most of the organizations as it presents both the gross investment and the current value of the assets. ***Accounting entry*** 1. Depreciation Account Dr. To Provision for Depreciation Account or Accumulated Depreciation 2. Profit and Loss Account Dr. To Depreciation Account	Account is carried at historical cost less depreciation. ***Accounting entries:*** 1. Depreciation Account Dr. To Asset Account 2. Profit and Loss Account Dr. To Depreciation Account

Machine Hour method	This method considers actual machine hours running during the year out of total estimated life of working hour of machine. Amount of Depreciation $= \frac{Cost\ of\ Asset - Residual\ Value}{Expected\ total\ hours\ of\ life} \times Machine\ hour\ run\ during\ the\ year.$
Production Units Method	The asset is determined by comparing the annual production with the estimated total production. The amount of depreciation is computed by the use of following method: Depreciable Amount × $\frac{Production\ during\ the\ period}{Estimated\ total\ production}$ The method is applicable to machines producing product of uniform specifications.
Depletion Method	Depletion is the allocation of the cost of wasting natural resources such as oil, gas, timber, and minerals to the production process. This method is used in case of mines, quarries etc. containing only a certain quantity

	of product. The depreciation rate is calculated by dividing the cost of the asset by the estimated quantity of product likely to be available to be extraced. Annual depreciation will be the quantity extracted multip--lied by the rate per unit.

Profit Or Loss On The Sale/Disposal Of Property, Plant And Equipment

Whenever any depreciable asset is sold during the year, depreciation is charged on it for the period it has been used in the sale year. The written down value after charging such depreciation is used for calculating the profit or loss on the sale of that asset.

The resulting profit or loss on sale of the asset is ultimately transferred to profit and loss account.

A new account titled Asset disposal Account may also be opened in the ledger for the purpose of calculating profit or loss on sale of asset. In that case the book value of the asset will be transferred from the asset account to the asset disposal account and all entries related to sale like sale proceeds and calculation of profit or loss on sale will be posted in the Asset disposal account.

Change In Method Of Depreciation:

-->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.

-->Depreciation of method will be changed only if;

→If required by Law

→ To Comply with Accounting standards

→To have more appropriate presentation of Financial Statement of firm.

-->Depreciation should be re-calculated as per new method from date of asset put to use.

->Treatment of deficiency/Surplus: The deficiency in amount of depreciation after re-calculation should be charged to Profit and Loss account and similarly any surplus to be credit to profit and Loss account.

Revision Of The Estimated Useful Life Of An Asset

There should be periodic review of useful life of the depreciable assets. Whenever there is a revision in estimated life, the unamortized depreciable amount should be charged to asset over revised remaining estimated life of asset.

Revaluation Of Property, Plant And Equipment

- **Revaluation**
  - **Increase**
    - Credited directly to owners' interests under the heading of Revaluation suplus
    - Exceptions: When it is subsequent increase (Initially Decrease)
      - recognised in the Statement of Profit and loss to the fextent that it reverses a revaluation decrease of the same asset previously recognised in the Statement of profit and loss
  - **Decrease**
    - Charged to the Stetement of profit and loss
    - Exception: When it is subsequent Decrease (Initially Increase)
      - Decrease should be debited directly to owners' interests under the heading of Revaluation surplus to the extent of any credit balance existing in the Revaluation surplus in respect of that asset

6 Bills of Exchange and Promissory Notes

Trade Bills

Two types of Bills: -

Promissory Note: - Promise to pay.

Bills of Exchange: - Order to pay,

Bill of Exchange	Promissory Note
A bill contains an unconditional order to pay	A promissory note contains only a promise to pay certain sum of money
There are generally 3 parties (Drawer, Drawee and Payee) in bill of exchange	There are 2 parties (Maker and Payee) in promissory note
A bill is paid by Acceptor	A promissory note is paid by maker
A bill is drawn by creditor	A promissory note is made by debtor
The drawer and payee may be same person in case of bill of exchange	In promissory note maker and payee cannot be same person
In a bill of exchange, the liability of drawer is secondary and conditional	In a promissory note the liability of a maker is primary and absolute
A bill of exchange can be accepted conditionally	A promissory note cannot be made conditionally
In a bill of exchange, notice of dishonor must be given	Notice of dishonor is not required in case of promissory note
In case of dishonor, a bill of exchange must be noted and protested	Noting and protest is not required in case of dishonor of a promissory note.

Bill of Exchange
- Drawer (Seller)
- Drawee / Acceptor (Purchaser)
- Payee

Promissory Note
- Maker/ Promisor
- Payee

Drawer & Payee may / may not be the same person

Foreign Bills of Exchange

When a bill of exchange is drawn for a foreign trade, it is called as **foreign bill of exchange**.

Term of Bill
- Bill is drawn after Sight — Term of bill begins from the date of acceptance of the bill.
- Bill is drawn after Date — Term of bill begins from the date when it is drawn.

Expiry/ Due Date of Bill: -

Date on which term expires is called due date.

Days of Grace : - 3 grace days are added to all bills from the date of expiry

Exception to the above are followings
- Payable on demand
- Payable at Sight
- *Payable on presentation.*

Date of Maturity of Bill

The date which arrives after adding the 3 grace days to the due date is called **DATE OF MATURITY OF BILL**

Payment of Bill

→No time for payment is specified.

→When it is expressed to be paid on demand, at Sight, On presentation.

→No grace days added.

→Time for payment is mentioned. E.g. After a specified period

-- Specific Day.

-- After Sight.

-- Happening of a certain event

Calculation of Due date of Bill (Maturity Date)

While calculating the due date following points should be kept in mind: -

If due date is public holiday: - Preceding day is due date.

If due date is emergency holiday: - Succeeding day is due date.

Term Start + **Term of Bill** = **Due Date of Bill**

Term Start: After Sight / After date

Term of Bill: 3 months / 60

Due Date of Bill: (Expiry Date) + 3 Grace Days

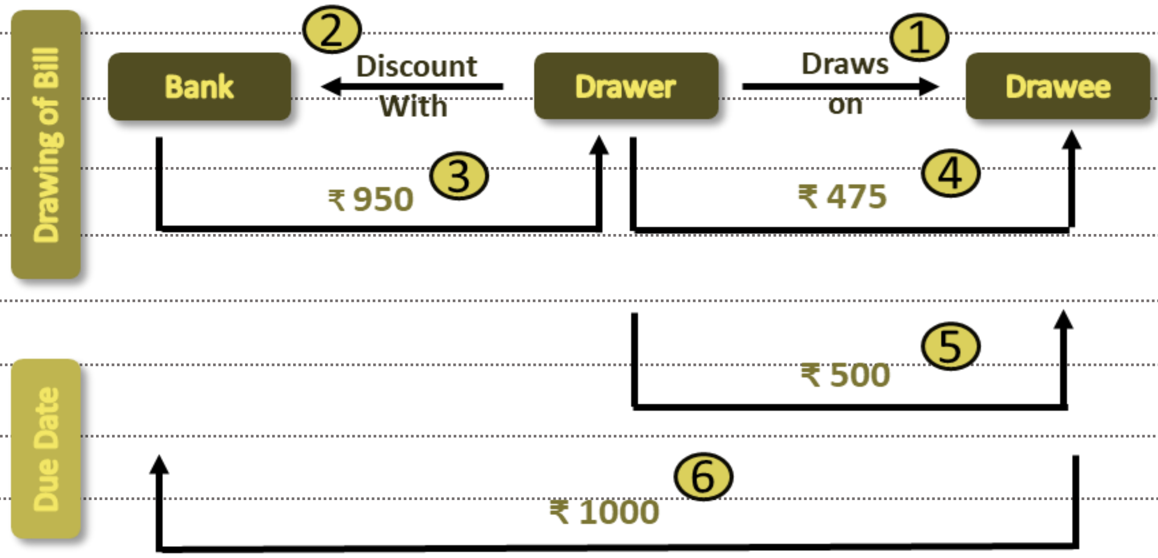
Maturity Date

Public Holiday: Maturity Date is Preceding Date

Emergency Holiday: Maturity Date is succeeding date.

Accommodation Bills

Accommodation bills are made to arrange funds for the parties without actually conducting a trade. One party draws bills on other and then discounts it with the banks to arrange funds which are then shared by the parties. On the due date the drawer sends his proportionate share to drawee, who then repays the funds to the bank.

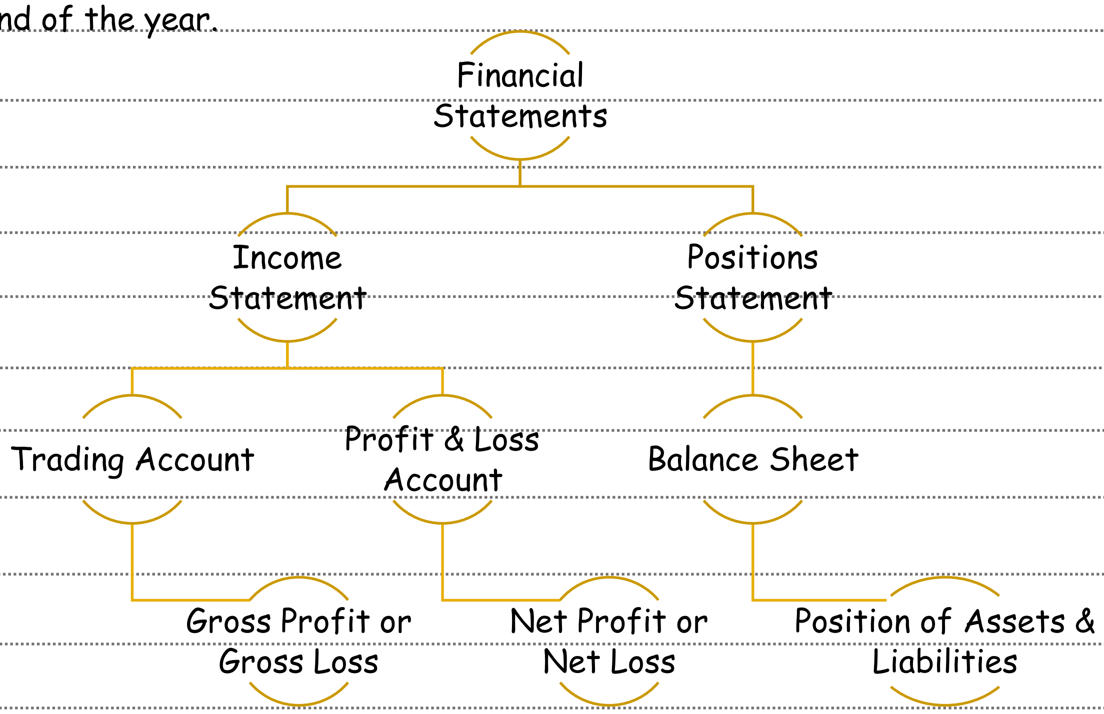


- If on due date, the drawer fails to make payment to drawee, the drawee will draw a bill on the drawer and the entire process of 6 points will be repeated, but this time the drawee is drawer.

7 Preparation of Final Accounts of Sole Proprietors

Unit -1 Final Accounts of Non-Manufacturing Entities

Non-manufacturing entities are the trading entities, which are engaged in the purchase and sale of goods at profit without changing the form of the goods. The final outcome of the business i.e., the income and financial position, they prepare financial statements at the end of the year.



The profit or loss of the enterprise is obtained through the preparation of **Income Statement i.e Trading and Profit & Loss A/c**.

The financial position of the business enterprise is judged by measuring the assets, liabilities and capital of the enterprise and the same is communicated to the users of financial statements. Financial position of the enterprise can be known through the preparation of the ***Position Statement i.e Balance Sheet***.

Comparison between Income Statement and Position Statement

Income Statement	Position statement
Profit or loss is disclosed in the Income	It exhibits assets and liabilities of the

Statement prepared at the close of the financial year	business as at the close of the financial year.
Income Statement is sub-divided into following two parts for a non-manufactur--ing concern: (i) Trading account; and (ii) Profit and Loss account	Apart from balance sheet, to judge financial position of the business, sometimes addi--tional statements are also prepared like cash flow statement, value added statement etc. which is not mandatory for non- corpor--ate entities. These additional statements are prepared for the better understanding of the financial position of the business.
Income Statement discloses net profit or net loss of the business after adjusting from the income earned during the year, all the expenditures of the business incurred in that year.	Position statement discloses the assets and liabilities position as on a particular date.

Trading Account

At the end of the year, as has been seen above, it is necessary to ascertain the net profit or the net loss. For this purpose, it is first necessary to know the gross profit or gross loss. Gross Profit is the difference between the selling price and the cost of the goods sold. For a trading firm, the cost of goods sold can be ascertained by adjusting the cost of goods still on hand at the end of the year against the purchases. It is done as follow:-

Opening Stock	***
Add: - Purchases (Net)	***
Add: - Direct Expenses	***
	***
Less: - Cost of Goods Sold	(**)

Closing Stock ***

The *format of Trading Account* can be shown as below: -

Trading Account of…..for the year ended…..

Particulars	₹	Particulars	₹
To Opening Stock	**	By Sales	**
To Purchases	**	Less: Returns Inwards	**
Less: Returns outwards	**	By Closing Stock	**
To Direct expenses:		By Gross Loss c/d	**
Freight & Carriage	**		
Customs & Insurance	**		
Wages	**		
Gas, Water & Fuel	**		
Factory Expenses	**		
Royalty on production	**		
To Gross Profit c/d	**		
	**		**

Point to Remember:-

- ✓ The opening inventory and purchases are written on the debt side.
- ✓ Sales and the closing inventory are entered on the credit side.
- ✓ If there are any direct expenses then they should also be written on the debit side of the Trading account.
- ✓ If the balances of credit side is more, the difference is written on the debit side as gross profit. This amount will also be carried forward to the Profit and Loss Account on the credit side.
- ✓ In case of gross loss, i.e., when the debit side of the Trading Account exceeds the credit side, the amount will be written on the credit side of the Trading Account and transferred to the debit side of the Profit and Loss Account.

Trading Account Items

Opening Inventory	–Closing inventory of the last year –In the first year of a business there will be no opening inventory. –Trading A/c Dr. To Opening Stock A/c
Purchases and Purchase Returns	–Purchases account will have debit balance; –Purchase returns account will have credit balance; –Purchases Return A/c Dr. To Purchases A/c (This Net Purchases is transferred to Trading account) –Trading a/c Dr. To Purchase a/c –It happens sometimes that goods are received but the relevant invoice is not received from the supplier. On the date of the closing of the account, an entry must be passed to debit the purchases account and credit the supplier with the cost of goods.
Carriage or Freight Inwards/Freight	–Debited to the Trading Account –If any freight or cartage is paid on any asset, like machinery, it should be added to the cost of the asset and not debited too the Trading Account. –Trading a/c Dr. To Carriage or Freight Inwards
Wages	–Debited to the Trading Account; –If wages are paid for installation of a fixed asset, it should be added to the cost of the asset. –Trading a/c Dr. To Wages

Sales and Sales Returns	–Sales account will have a credit balance; –Sales return account will have a debit balance; net of the two amounts is entered on the credit side of the Trading Account. –Sales A/c Dr. To Sales return To Trading A/c
Closing Inventory & its valuation	–No account to show the value of goods lying in the godown at the end of the year. –<u>The entry is</u> Closing Inventory Account Dr. To Trading Account –*Alternatively*, Closing Inventory can be adjusted with purchases: Closing Inventory Account Dr. To Purchases Account –The effect of this entry is to reduce the debit in the Purchases Account. The closing inventory is also shown in balance sheet on Assets side. –***<u>If Closing Stock appears in the Trial balance: -</u>*** ***The closing inventory is then not entered in the trading account, it is shown only in the balance sheet. This is because it has already been adjusted to arrive at Cost of Goods Sold.*** ***–The valuation principle is cost or net realisable value w.i.l.***

–The other entries are usually summarised as follows:

(1) Trading Account Dr.

To Opening Inventory Account

To Purchases Account

To Wages Account

To Freight on Purchases Account, etc.

(2) Sales Account Dr.

Closing Inventory Account Dr.

To Trading Account

–At this stage Trading Account will reveal the gross profit, if the credit side is more, or gross loss if the credit side is less. The gross profit will be transferred to the Profit and Loss Account by the entry:

Trading Account Dr.

To Profit and Loss Account

The entry for gross loss, if there be any is :

Profit and Loss Account Dr.

To Trading Account

Profit And Loss Account

The *format of Profit & Loss Account* can be shown as below: -

Dr. Profit and Loss Account for the year ended Cr.

Particulars	₹	Particulars	₹
To Gross Loss b/d	**	**By Gross Profit b/d**	**
Management expenses		**Other Income**	
To Salaries (administrative)	**	By Discount Received	**
To Office rent, rates and taxes	**	By Commission Received	**
To Printing and stationery	**	**Non-trading Income**	
To Telephone charges	**	By Bank Interest	**
To Postage and telegrams	**	By Rent of property let-out	**
To Insurance	**	By Dividend from shares	**
To Audit Fees	**		

Particulars	₹	Particulars	₹
To Legal Charges	**	**Abnormal Gains**	
To Electricity Charges	**	By Profit on sale of machinery	**
Maintenance expenses		By Profit on sale of investment	**
To Repairs & renewals	**	**By Net Loss (transferred to capital A/c)**	**
To Depreciation on:	**		
Office Equipment	**		
Office Furniture	**		
Office Buildings	**		
Selling and Distribution expenses			
To Salaries (selling staff)	**		
To Advertisement	**		
To Godown rent	**		
To Carriage Outward	**		
To Bad Debts	**		
To Provision for bad debts	**		
To Selling commission	**		
Financial expenses			
To Bank charges	**		
To Interest on loans	**		
To Discount on bills	**		
To discount allowed to customers	**		
Abnormal Losses			
To Loss on sale of machinery	**		
To Loss on sale of investment	**		

To loss by fire **To Net Profit (transferred to Capital A/c)**	** **		

Note: (i) Gross loss appears in the debit side of the Profit and Loss Account at the top; while Gross Profit on the credit side.

(ii) Net loss appears in the credit side of the Profit and Loss Account; while Net profit on debit side as balancing figures.

A few items individually:

Drawings	–Drawings are not expenses for the firm but reduction of capital and therefore, should not be debited to the Profit and Loss Account but to Capital account of the proprietor. Capital A/c Dr. To Drawings
Income Tax	–The income tax payable is treated like other expenses. But in the case of sole proprietorship, income tax is treated as a personal expense. It is debited to the Capital Account and not to the Profit and Loss Account. Capital A/c Dr. To Income Tax A/c
Discount received and allowed	–Discount is of two types. Trade discount and Cash discount. **Trade discount:** is deducted from the invoice; **Cash discount** is allowed to a customer if he makes the payment before a certain date. –Therefore, Trade discount is not debited to P/L a/c, but cash discount is. –Discount received is really in the nature of interest received and similarly, discount allowed really means interest paid. Discount received is a gain and is credited to the Profit and Loss Account while discount allowed is debited.

	Profit/Loss A/c Dr. To Discount Allowed A/c Discount Received A/c Dr. To Profit/Loss A/c
Rebate	Rebate Account is debited and is later written in the profit and Loss Account on the debit side. Various customers who have earned the rebate are credited. *Initially when Rebate is given:* Rebate A/c Dr. To Customer A/c *In the year end* Profit/Loss A/c Dr. To Rebate A/c
Bad Debts	The bad debts account is debited, which is later on written in the Profit and Loss Account on the debit side. Since it is no use showing the amount due still as an asset, the account of the customer concerned is closed by being credited. The entry Bad Debts Account Dr. To Debtor's/Customer (by name) Account Profit/Loss Account Dr. To Bad Debts A/c In case of Provision for Bad debts has already been prepared then bad debt be written off first from it. Entry for it will be: Provision for Bad Dents A/c Dr. To Bad Debts A/c If later on, the amount is recovered, it should be treated as a gain. It should not be credited to the party paying it. It should be credited to Bad

	Debts Recovered Account. It will be entered in the Profit and Loss Account on the credit side. Bad Debts Recovered Account Dr. To Profit/Loss Account

Closing Entries

The under mentioned three entries will be necessary.

(a) For items to be debited to the Profit and Loss Account this account will be debited and the various accounts concerned will be credited. For example,

Profit and Loss Account Dr.

To Salaries Account

To Rent Account

To Interest Account

To Other Expenses Account

(b) Items of income or gain such as interest received or miscellaneous income will be credited to Profit and Loss Account.

Discount Received Account Dr.

Bad debts Recovered Account Dr.

To Profit and Loss Account

(c) At this stage, the Profit and Loss Account will show net profit or net loss. Both have to be transferred to the Capital Account. In case of net profit, i.e., when the credit side is bigger than the debit side, the entry is:

Profit and Loss Account Dr.

To Capital Account

In the case of net loss, the entry will be

Capital Account Dr.

To Profit and Loss Account

Certain Adjustments And Their Treatments

Abnormal loss of Inventory by accident or fire	Abnormal Loss Account is to be debited and Purchase Account or Trading Account is to be credited. If amount of loss is recoverable from insurance company, then insurance company is to be debited instead of Profit & Loss A/c. Till the money is not received from the insurance company, Insurance Company's Account will be shown in the Assets side of the Balance Sheet. If any part of the loss is recoverable from the insurance company, then the portion not compensated by the insurance company should be debited to Profit & Loss A/c. Loss by Fire Account Dr. To Purchases/Trading Account Insurance Company's A/c (Insurance Claim) Dr. Profit & Loss A/c Dr. To Loss by Fire A/c
Goods sent on Approval basis	(i) Sales A/c Dr. To Trade receivables A/c (ii) Stock on approval A/c Dr. To Trading A/c These goods should now be included in the amount of Closing Stock at their cost price.
Goods used other than for sale	Goods are used for some other purposes, such as distributed as free samples, used in construction of any assets or used by proprietor for personal use. In such cases the amount used for other purposes are subtracted from Purchases A/c

	When goods are given away as donation Donation A/c Dr. To Purchases A/c When goods are used by the proprietor for his personal use Drawings A/c Dr. To Purchases A/c When goods are distributed as free samples :- Free Samples / Advertisement A/c Dr. To Purchases A/c When goods are used in business for construction of Building or the Machinery :- Building A/c / Plant & Machinery A/c Dr. To Purchases A/c When goods are used for maintenance of business premises/ Machinery: - Repair & Maintenance A/c Dr. To Purchases A/c
Commission based on profit	commission is payable to manager based on net profit (i) Commission on net profit before charging such commission = Profit before commission x $\frac{\text{Rate of commission}}{100}$ (ii) Commission on net profit after charging such commission = Profit before commission x $\frac{\text{Rate of commission}}{100+Rate\ of\ commission}$ Commission is recorded by following journal entry Commission A/c Dr. To Commission Payable A/c (Being commission payable to Mr.....@.....% on net profit after

	charging such commission, net profit before charging commission being ₹........) Commission will be debited in the Profit & Loss Account and Commission Payable Account will be shown in the Balance Sheet on liability side. Profit/Loss Account Dr. To Commission A/c

Balance Sheet

Arrangements Of Assets And Liabilities

(1) Assets: Assets may be grouped in one of the following two ways:

(i) Liquidity: Under this approach, the asset, which can be converted into cash first, is presented first. Those assets, which are most difficult in this respect, are presented at the bottom. As per Liquidity the balance sheet can be prepared as follow:-

Liabilities	₹	Assets	₹
Bills Payable	**	Cash in Hand	**
Trade Creditors	**	Cash at Bank	**
Loans	**	Government Securities	**
Outstanding Expenses	**	Other Investments	**
Reserves & Surplus	**	Bills Receivable	**
Capital	**	Sundry Debtors	**
		Stock	**
		Furniture & Fixtures	**
		Plant & Machinery	**
		Land and Building	**

(ii) Permanence: Assets, which are to be used, for long term firm in the business and are not meant to be sold are presented first. Assets, which are most liquid, such as cash in hand, are presented at the bottom.

Liabilities	**₹**	**Assets**	**₹**
Capital	**	Land and Building	**
Reserves & Surplus	**	Plant & Machinery	**
Outstanding Expenses	**	Furniture & Fixtures	**
Loans	**	Stock	**
Trade Creditors	**	Sundry Debtors	**
Bills Payable	**	Bills Receivable	**
		Other Investments	**
		Government Securities	**
		Cash at Bank	**
		Cash in Hand	**

Note:- Some of the assets may be capable of being sold easily like investment in government securities or shares of some companies. They should be treated as liquid or permanent according to the intention of the firm.

(2) Liabilities: Liabilities may also be shown according to the urgency with which payment has to be made. One way is to first show the capital, then long-term firm liabilities and last of all short-term firm liabilities like amounts due to suppliers of goods or bills payable. The other way is to start with short-term firm liabilities and then show long term firm liabilities and last of all capital.

9 Financial Statements of Not For-Profit Organizations

Non-profit making organisations such as public hospitals, public educational institutions, clubs, Temples, churches etc., conventionally prepare Receipts and Payments Account and Income and Expenditure Account to show periodic performance and Balance Sheet to show financial position at the end of the period.

Features:

It is the summary of the cash and bank transactions like cash book, all the receipts (capital or revenue) are debited, similarly, all the expenditures (capital or revenue) are credited.

↓

It starts with opening cash and bank balances and also ends with their closing balances.

↓

This account is usually not a part of the double entry system.

↓

It includes all cash and bank receipts and payments, whether they are related to current, past or future periods.

↓

Surplus or deficit for an accounting period cannot be ascertained from this account, since, it shows only the Cash/Bank position and excludes all non-cash items.

Limitations of Receipts and Payments Account

- The increase in the cash and bank balances at the end of the year, as compared to those in beginning, does not truly represent the surplus for the year since it does not take into account the cost of construction of the pavilion, which is in excess of the donation received, the outstanding subscription or those which were collected in advance, etc.

Ordinarily one must ascertain whether for a current year income is sufficient to meet the current expenses.

- The Receipts and Payments Account includes items relating to all periods or of all types, it does not serve the purpose mentioned above. Due to these drawbacks, the preparation of Receipts and Payments Account is not favoured except where the activities of the organization, the results of which are to be exhibited, are simple and modest, involve no carry over from one period to the next and it has no assets, apart from cash balance and no liabilities.

Income And Expenditure Account

Features:

- It is a revenue account prepared at the end of the accounting period for finding out the surplus or deficit of that period.
- It is prepared by matching expenses against the revenue of that period concerned.
- Both cash and non-cash items, such as depreciation, are taken into consideration.
- All capital expenditures and incomes are excluded.
- Only current years' income and expenses are considered.

Main Sources of Income

- ✓ These are subscriptions, ordinary donations, membership fees or entrances fees (if the amount is normal or provided according to by-laws of the society), recurring grants from local authorities and income from investments, etc. Any amount raised for a special activity, e.g., on sale of match tickets, is deducted from the expenditure of that activity and net amount is shown in the income and expenditure account.
- ✓ Any receipt of capital nature shall not be shown as income but will be credited to the Capital Fund or special purpose fund e.g. "Building Fund' or if the receipts is on account of sale of a fixed asset, it shall be credited to the asset account.

Examples:

Hospital - medicines and cost of tests and investigations.

Sports Club - sports materials, tournament expenses, etc.

Drama Club - expenses of staging plays, rent of the hall, payment to artists, etc.

Educational Societies - award of scholarships, organisation of seminars, etc.

Library Societies - newspapers and magazines.

Any expenditure for acquisition of a fixed asset will be capitalised, though the amount of annual depreciation shall be debited to revenue expenditure.

Distinction between Receipts and Payments Account and Income and Expenditure Account

- Not for profit organizations such as public hospitals, public educational institutions, clubs, Temples, churches etc., conventionally prepare Receipt and Payment Account and Income and Expenditure Account to show periodic performance for a particular accounting period. The distinguishing features of both the accounts can be summarized as:
- Receipt and Payment Account is an elementary form of account consisting of a classified summary of cash receipts and payments over a certain period together with cash balances at the beginning and close of the period.
- The receipts are entered on the left-hand side and payments on the right hand side i.e. same sides as those on which they appear in cash book.
- All the receipts and payments whether of revenue or capital nature are included in this account. The balance of the account at the end of a period represents the difference between the amount of cash received and paid up. It is always in debit since it is made up of cash in hand and at bank.
- Income and Expenditure Account resembles a Profit and Loss Account and serves the same function in respect of a non-profit making concern as the last-mentioned account does for a firm, carrying on business or trade.

❖ Income and Expenditure Account is drawn up in the same form as the Profit and Loss Account. Expenditure of revenue nature is shown on the debit side, income and gains of revenue nature are shown on the credit side.

❖ Income and Expenditure Account contains all the items of income and expenditure relevant to the period of account, whether received or paid out as well as that which have fallen due for recovery or payment. Capital Receipts, prepayments of income and capital expenditures, prepaid expenses are excluded. It does not start with any opening balance. The closing balance represents the amount by which the income exceeds the expenditure only or vice versa.

Accounting Treatment of Some Special Items

1. Donations:

- These may have been raised either for meeting some revenue or capital expenditure;
- those intended for the first mentioned purpose are credited directly to the Income and Expenditure Account.
- If the donors have declared their specific intention, are credited to special fund account and in the absence thereof, to the Capital Fund Account. If any investments are purchased out of a special fund or an asset is acquired therefrom, these are disclosed separately.
- Any income received from such investments or any donations collected for a special purpose are credited to an account indicating the purpose and correspondingly the expenditure incurred in carrying out the purpose of the fund is debited to this account.
- On no account any such expense is charged to the Income and Expenditure Account. The term "Fund" is strictly applicable to the amounts collected for a special purpose when these are invested, e.g. Scholarship Fund, Prize Fund etc. In other cases, when the amounts collected are not invested in securities or assets distinguishable from those belonging to the institution, the word "Account" is more appropriate e.g. Building Account, Tournament Account etc.

2. Entrance and Admission Fees:

- Such fees which are payable by a member on admission to club or society are normally considered capital receipts and credited to Capital Fund.
- This is because these do not give rise to any special obligation towards the member who is entitled to the same privileges as others who have paid only their annual subscription.
- Nevertheless, where the amount is small, meant to cover expenses concerning admission, or the rules of the society provided that such fees could be treated as income of the society, these amounts may be included in the Income and Expenditure Account. The treatment depends upon the requirement of question. If the question is silent then always take it to be capital receipt.

3. Subscription:

- Subscriptions being an income should be allocated over the period of their accrual.
- If some subscriptions have been received in advance, their amount is also indicated. In such cases, it is always desirable to set up a Subscription Account for determining the amount of subscription pertaining for the period for which accounts are being prepared.

4 Life Membership Fee: Fees received for life membership is a capital receipt as it is of non-recurring nature. It is directly added to capital fund or general fund.

For adjusting lump sum subscription collected from the life members, one of the following methods can be adopted:

(1) The entire amount may be carried forward in a special account until the member dies, when the same may be transferred to the credit of the Accumulated Fund.

(2) An amount equal to the normal annual subscription may be transferred every year to the Income and Expenditure Account and balance carried forward till it is exhausted. If, however, the life member dies before the whole of the amount paid by him has been transferred in this way, the balance should be transferred to the Accumulated Fund on the date of his death.

(3) An amount, calculated according to the age and average life of the member, may annually be transferred to the credit of Income and Expenditure Account.

Other concepts

Treatment of Important Items in Not For Profit Organization

1. **Donation:** it is gift in cash or kind from some person. It may be of two types:

(a) Specific Donation: It is received for certain specific purpose like Building Donation, Library Books donation etc. It should be capitalized and shown on the liabilities side of the balance sheet.

(b) General Donation: It is not received for any specific purpose and shown on the credit side of Income and Expenditure Account.

2. **Entrance Fees:** It may also be known as admission fees. Entrance Fees should be capitalized and added to the capital fund for all organization. If the question gives any specific treatment of Entrance fees, then it should be followed accordingly.

3. **Legacy:** It is an amount received by an organization as per the will of the person after the death of the person. It should be capitalized and shown on the liabilities side of the balance sheet by adding to the Capital Fund.

4. **Life Membership Fees:** It should be capitalized and shown on the liabilities side of the balance sheet. If the question gives any specific treatment of Life membership Fees, then it should be followed accordingly.

5. **Endowment Fund Donation**: It is a donation received and only income from that donation is to be used for certain specific purpose. In such cases income relating to special funds should be added to these funds on the liabilities side of the B/S. All the expenses should be deducted from that fund on the liabilities side of the Balance Sheet.

6. **Treatment of Sale of Old Newspaper and Periodicals**: The amount received on such sale is shown as Income on the credit side of income and expenditure account.

7. **Sale of old Fixed Assets**: The Sale proceeds of old Fixed Assets are treated as capital receipts. The profit or loss on sale of fixed asset is shown in the Income and Expenditure A/c

8. **Honorarium:** It is paid to someone for receiving any services from person who are not the employees of the Not-for-Profit Organisation.

Educational Institutions

Salient Features

The basic tenets pre-suppose, that part of the expenses of the educational institutions are met from the funds raised by the educational institutions themselves, either from donations, or from charities, collected from benevolent citizens in the country.

The State Governments through grant-in-aid-code have evolved different patterns of giving assistance to the educational institutions. There is, as such, no uniformity in the giving of assistance to the educational institutions in the form of grants.

All the educational institutions follow financial year as their accounting year.

1. **Sources of Finance for Running the Educational Institution**

There are three main sources through which amounts are collected by the educational institutions. These are:

(1) Donation from Public;

(2) Fees in the form of annual tuition fees, term fees, admission fees, laboratory fee etc., and

(3) Grants received from the Government.

The Government grants are of four kinds namely Maintenance Grant, Equipment grant, Building Grant and such other grants as may be sanctioned by the Government from time to time.

2. Specific items

(a) Donation from Public: These are received either for recurring or non-recurring purposes. Donations are received either in cash or in kind. The 'in kind' donations are in the form of land and building, shares and securities, utensils, furniture and fixtures and the like, generally with a desire to perpetuate the memory of a distinguished member of the family of the donor.

(b) Capitation fees or admission fees: Amounts are collected from parents/guardians of the students who seek admission in the educational institution. These are either in the form of capitation fees or admission fees and are generally collected by the Parent Body which runs the institution. In recent times, such collections have been a matter of severe attack and ban.

(c) Laboratory and Library deposit: These are generally collected by schools and colleges and they remain with the institution till the student finally leaves it. The School Code prescribes the rates of tuition and other fees, to be charged from the students.

(d) Use of Term Fees: A separate account of receipts and expenditures shall be maintained and surplus carried over to the next year. The following are main items on which term fee can be used:

(1) Medical Inspection.

(2) School Magazine-manuscript and/or printing.

(3) Examination expenses i.e., printing, of question papers and supply of answer books if there is sufficient balance.

(4) Contribution to athletic and cultural associations, connected with school activities.

(5) School functions and festivals.

(6) Inter-class and Inter-school tournaments.

(7) Sports and Games-major and minor.

(8) Newspapers and magazines.

(9) Extra-curricular excursion and visits.

(10) School competition such as elocution competition etc.

(11) Scouting and guiding.

(12) School Band.

(13) Social and Cultural activities and equipment required for the same.

(14) Vocational Guidance in general.

(15) Prizes for Co-curricular activities.

(16) Any other extra-curricular or co-curricular activities.

(17) Maintenance of playground.

(18) Purchase of books for Pupils Library.

(19) Drawing and Craft material.

(20) Audio-Visual Education.

(21) Curricular visits and excursions.

(22) Equipment for Physical education

(e) Recurring grants: Recurring grants in the form of Maintenance Grants are received in instalments spread out throughout the year.

(f) Use of grant-in-aid: The School Code provides a detailed list of items of expenditure which are admissible for grant-in-aid:

(1) Staff salaries and allowances

(2) Leave Allowance.

(3) Bad Climate Allowance.

(4) Water Allowance.

(5) Leave Salary.

(6) Expenditure on training of teachers.

(7) Pension and Gratuity as may be applicable.

(8) Expenditure on the appointment of Librarian.

(9) Rent, Taxes and Insurance.

(10) Other Contingencies: expenditure of printing and stationery, conveyance expenditure, expenditure on purchase of books and furniture equipment.

(11) Current repairs.

(12) Miscellaneous Expenses: e.g., School Garden, Physical Education.

(13) Prizes.

(14) Expenditure on co-operative stores.

(15) Registration fee paid to the Board for recognition.

(16) Maintenance of Tiffin Rooms.

(17) Bonus to Teachers.

(18) Electrical charges.

(19) Telephone Charges.

(20) Expenditure in connection with Conferences.

(21) Subscription to educational Association etc.

(22) Medical charges.

(23) Audit fees of the auditors in accordance with prescribed scale.

(24) Sales-tax and General tax on purchase of the school requirements.

(25) Payments for merit scholarships.

9 Partnership Accounts

Unit – 1 Introduction To Partnership Accounts

As per Section 4 of the Partnership Act, 1932:

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

Features of a partnership:

Existence of an agreement	• The relation of partnership arises from contract between parties and not from status as it happens in case of HUF (Hindu Undivided Family). A formal or written agreement is not necessary to create a partnership.
Business	• A partnership comes into existence only when partners begin to carry on business in accordance with their agreement. Section 2 (b)of Indian Partnership Act, 1932 only states that business includes every trade, occupation and profession.
Sharing of profit	• no person is a partner unless he or she has the right to share the profits of the business. Section 4 of Indian Partnership Act, 1932 does not insist upon sharing of losses. Thus, a provision for sharing of loss is not necessary.
Mutual agency	• the business is to be carried on by all or any of them acting for all. Thus, if the person carrying on the business acts not only for himself but for others also so that they stand in the positions of principals and agents, they are partners.

Number of Partners

- **Minimum Partners:** Two
- **Maximum Partners:** Section 464 of the Companies Act, 2013, no association or partnership consisting of more than 100 number of persons as may be prescribed shall be formed for the purpose of carrying on any business. Rule 10 of Companies (incorporation) Rules 2014 specifies the limit as 50. Thus, maximum number of members in a partnership firm are 50.

Distinction Between An Ordinary Partnership Firm And An LLPs

Key Elements	Partnerships	LLPs
1. Applicable Law	Indian Partnership Act 1932	The Limited Liability Partnerships Act, 2008
2. Registration	Optional	Compulsory with ROC
3. Creation	Created by an Agreement	Created by Law
4. Body Corporate	No	Yes
5. Separate Legal Entity	No	Yes
6. Perpetual Succession	Partnerships do not have perpetual	It has perpetual succession and succession individual partners may come and go
7. Number of Partners	Minimum 2 and Maximum 50	Minimum 2 but no maximum limit
8. Ownership of Assets	Firm cannot own any assets. The partners own the assets of the rm	The LLP as an independent entity can own assets
9. Liability of Partners / Member	Unlimited: Partners are Severally and jointly liable for other partners and the rm and their liability extends to personal assets	Limited to the extent of them contribution towards LLP except in case of intentional fraud or wrongful act of omission or commission by a partner.
10.Principal Agent Relationship	Partners are the agents of the firm and of each other	Partners are agents of the rm only and not of other partners

Rules in the absence of Partnership Deed

- No partner has the right to a salary,
- No interest is to be allowed on capital,
- No interest is to be charged on the drawings,
- Interest at the rate of 6%. p. a is to be allowed on a partner's loan to the firm, and
- Profits and losses are to be shared equally.

Note: In the absence of an agreement, the interest and salary payable to a partner will be paid only if there is profit.

Unit – 2: Treatment Of Goodwill In Partnership Accounts

Goodwill is the value of reputation of a firm in respect of profits expected in future over and above the normal rate of profits.

Goodwill is an ***intangible asset***; it cannot be seen; it cannot be felt; it cannot be transported physically. ***Even then it is very real***.

Methods For Goodwill Valuation

There are three methods for valuation of goodwill

1) Average profit basis,-Simple and Weighted
2) Super profit basis,-Number of Year Purchase, Annuity basis, and Capitalization of Super Profit
3) Capitalization basis- Average Profits.

Average Profit Basis: In this case the average profits of past years are adjusted for any expected change in future. The number of years is decided on the basis of judgement and negotiation. For averaging the past profit, either simple average or weighted average may be employed depending upon the circumstances. If there exists clear increasing or decreasing trend of profits, it is better to give more weight to the profits of the recent years than those of earlier years. But, if there is no clear trend of profit, it is better to go by simple average.

Super Profit Basis:

Super Profit-Actual Profit-Normal Profit

Actual Profit is average maintainable profit

Normal Profit=Normal rate of Return (NRR) x Capital Employed

Calculation of super profit:

(i) Identify the capital employed by the partnership firm;

(ii) Identify the average profit earned by the partnership firm based on past few years' figures;

(iii) Determine normal rate of return prevailing in the locality of similar firms;

(iv) Apply normal rate of return on capital employed to arrive at normal profit;

(v) Deduct normal profit from the average profit of the firm. If the average profit of the firm is more than the normal profit, there exists super profit and goodwill.

Number of Years Purchase Method	Goodwill is generally valued by multiplying the amount of super profit by certain number of years depending upon the expectation about the maintenance of such profit in future.
Annuity Method	The major drawback of number of years purchase method is that time value of money is not considered.
Capitalization Basis	value of whole business is determined applying normal rate of return. If such value (arrived at by applying normal rate of return) is higher than the capital employed in the business, then the difference is goodwill. The steps to be followed under this method are given below: a. Determine the normal rate of return. b. Find out the average profit of the partnership firm for which goodwill is to be determined. C. Determine the capital employed by the partnership firm for which goodwill is to be determined. d. Find out normal value of the business by dividing average profit by normal rate of return. e. Deduct average capital employed from the normal value of the business to arrive at goodwill. **Goodwill Normal Capital-Actual Capital** **Normal capital = Average Profit/NRR**

Unit – 3 Admissions Of A New Partner

Revaluation Account Or Profit And Loss Adjustment Account

The entries to be passed are:

Revaluation Account Dr. To Assets Account (Individually which show a decrease) To the Liabilities Accounts (Individually which have to be increased)	*with the reduction in the value of the assets;* *with the increase in the liabilities.*
Assets Account (Individually) Dr. Liabilities Accounts Dr. To Revaluation Account	*with the increase in the value of the of assets.* *with the reduction in the amount liabilities.*
Revaluation Account Dr. To Capital A/cs of the old partners Or Capital A/cs of the old partners Dr. To Revaluation Account	*with the profit in the old profit sharing ratio.* *with the loss in old profit sharing ratio.*

Memorandum Revaluation Account

Any increase in the value of assets and/or decrease in the liabilities is credited to Memorandum Revaluation Account.	
Assets Accounts Dr. Liabilities Accounts Dr. To Memorandum Revaluation A/c	*(with increase in the value of individual assets)* *(With decrease in the value of individual liabilities)*
Any decrease in the value of assets and/or increase in the liabilities is debited to Memorandum Revaluation Account. With the increase in the value of the of assets. the reduction in the amount liabilities.	

Memorandum Revaluation A/c Dr. To Assets Accounts To Liabilities Accounts	 *(with increase in the value of individual assets)* *(with decrease in the value of individual liabilities)*
If the credit side of the Memorandum Revaluation Account is more than the debit side, there is a profit. This profit should be transferred to old Partner's Capital Accounts in the old profit-sharing ratio.	
Memorandum Revaluation A/c Dr. To Old Partners' Capital A/c	
If the debit side of the Memorandum Revaluation Account is more than the credit side, there is a loss which is transferred to old Partner's Capital Accounts in the old profit sharing ratio.	
Old Partners' Capital A/c Dr. To Memorandum Revaluation Account	
The profit on revaluation is to be transferred to all Partners' Capital Accounts in the new profit-sharing ratio.	
Memorandum Revolution Account Dr. To All Partners' Capital Accounts (New profit and loss sharing ratio)	
The loss on revaluation should be transferred to all Partners' Capital Accounts in the new profit-sharing ratio.	
All Partners' Capital Accounts Dr. (New profit and loss sharing ratio) To Memorandum Revaluation Account	

<u>**Hidden Goodwill**</u>

The value of goodwill has to be inferred as follows:

Particulars	₹
Incoming partner's capital x Reciprocal of share of incoming partner	**

Less: Total capital after taking into consideration the capital brought in by incoming partner	**
Value of Goodwill	**

Unit – 4 Retirements Of A Partner

Ratio between Remaining Partners

	New Ratio	Gaining or Benefit Ratio
When new ratio is given	As given in the examination problem	New Ratio minus Old ratio
When the new Ratio is not given	The same old ratios between them	The same old ratios between them
When gaining or benefit ratio is given	Old ratio + Gaining ratio	

Final Payment To A Retiring Partner

The following adjustments are necessary in the Capital A/c:

- Transfer of reserve
- Transfer of goodwill
- Transfer of profit/loss on revaluation

After adjustment, the Capital Account balance standing to the credit of the retiring partner represents amount to be paid to him.

The continuing partners may discharge the whole claim at the time of retirement.
Retiring Partner's Capital A/c Dr. To Bank A/c
Sometimes the retiring partner agrees to retain some portion of his claim in the partnership as loan.
Retiring partner's Capital A/c Dr.

To Retiring Partner's Loan A/c To Bank A/c

Joint Life Policy

When premium paid is treated as an expense	It is closed every year by transferring to profit and loss account. In this case complete amount received from the insurance company either on a surrender of policy or on the death of the partner becomes a gain.
	(a) On payment of premium Joint Life Policy Insurance Premium A/c Dr. To Bank A/c
	(b) On charging to Profit and Loss Account Profit and Loss Account Dr. To Joint Life Policy Insurance Premium A/c
	(c) On maturity of the Policy Insurance Company/ Bank Account Dr. To Partners' Capital A/cs (individually) (Including the account of the representative of a deceased partner)
When premium paid is treated as an asset	(1) Insurance premium paid is first debited to life policy account and credited to bank account. (2) At the end of the year the amount in excess of surrender value is treated as a loss and is transferred to Profit and Loss Account. (3) The amount received from the insurance company in excess of the surrender value results in a gain at the time

	of receipt of such amount which is transferred to Capital Accounts of the partners in the profit-sharing ratio.
Creation of Joint Policy Reserve A/c	(1) Premium paid is debited to policy account and credited to bank account. (2) At the end of the year, amount equal to premium is transferred from Profit and Loss Appropriation Account to Policy Reserve Account. (3) Policy account is brought down to its surrender value by debiting the life policy reserve account with amount which exceeds the surrender value of the policy. (4) On the death of a partner Joint Life Policy Reserve Account is transferred to Joint Life Policy Account and then the balance is transferred to Partners' Capital Accounts.

Separate Life Policy

All the partners may take individual life policies for each of them by paying the premium from the firm. In the event of retirement, the retired partner is entitled for the proportionate amount of the life policies of all the partners.

Example: Sona, Gabbu and Amit are partners Profit sharing ratio is 3:1:1

	Sona	Gabbu	Amit
Policy	1,00,000	2,00,000	3,00,000
Surrender Value	10,000	20,000	30,000

If Amit retires, then, Amit will get ₹60,000 × 1/5 = 12,000

Unit – 5 Death Of A Partner

Amount Payable To Legal Representatives Of Dead Partner

When the partner dies the amount payable to him/her is paid to his/her legal representatives. The representatives are entitled to the followings:

The amount standing to the credit to the capital account of the deceased partner → Interest on capital, if provided in the partnership deed upto the date of death: → Share of goodwill of the firm; → Share of undistributed profit or reserves; → Share of profit on the revaluation of assets and liabilities; → Share of profit upto the date of death; → Share of Joint Life Policy.

Calculation of profit upto the date of death of a partner.

Such Profit is calculated through P&L Suspense account. After ascertaining the amount due to the deceased partner, it should be credited to his Executor's Account.

If the death of a partner occurs during the year, the representatives of the deceased partner are entitled to his/her share of profits earned till the date of his/her death. Such profit is ascertained by any of the following methods:

Time Basis	It is assumed that profit has been earned uniformly throughout the year. Example: The total profit of previous year is ₹ 2,25,000 and a partner dies three months after the close of previous year, the profit of three months is 31,250 i.e. 1,25,000 x 3/12, if the deceased partner took 2/10 share of profit, his/her share of profit till the date of death is 6,250 i.e. * 31,250 × 2/10

Turnover or Sales Basis	The profit up to the date of death is estimated on the basis of the sale of the last year. Profit is assumed to be earned uniformly at the same rate. Example: Arun, Tarun and Neha are partners sharing profits in the ratio of 3:2:1. Neha dies on 31st May 2020. Sales for the year 2019-2020 amounted to 4,00,000 and the profit on sales is 60,000. Accounts are closed on 31 March every year. Sales from 1st April 2020 to 31st May 2020 is 1,00,000. Calculate the deceased partner's share in the profit upto the date of death. Solution: Profit from 1st April 2020 to 31st May 2020 on the basis of sales: If sales are 4,00,000, profit is 60,000 If the sales are 1,00,000 profit is: 60,000/4,00,000 x 1,00,000= 15,000 Neha's share = 15,000 x 1/6 = 2,500

Special Transactions In Case Of Death

Joint Life Policy

Joint Life Policy

- **Premium Method**
  - If Joint Life Policy does not appear in the Balance Sheet, then the firm will gain on the death of a partner.
- **Surrender Value Method**
  - If Joint Life Policy appears in the Balance Sheet at surrender value, then the firm will gain on the death of a partner.
- **Joint Life Policy Reserve Method**
  - If Joint Life Policy appears in the Balance Sheet at surrender value along with Joint Life Policy Reserve, then the firm will gain on the death of a partner and reserve will be distributed among partners.

Separate Life Policy

Bank A/c To Separate Life Policy of Deceased partner A/c (Policy value received on death of a partner)	Dr.	*(Assured value)*
Separate Life Policy of Deceased Partner A/c Separate Life Policy of Remaining Partners A/c To Executor's A/c To Remaining partners A/c (Being the total of assured value of deceased partner's life policy and surrender value of other partners' life policy(s) distributed in the profit and loss sharing ratio)	Dr. Dr.	*(Assured value)* *(Surrender value)* *(Total value distributed in profit sharing ratio)* *(Total value distributed in profit sharing ratio)*

Payment Of Deceased Partner's Share

The basic distinction between retirement and death of a partner relates to finalisation of amount payable to the Executor of the deceased partner. Although, revaluation of goodwill is done in the same way as it has been done in case of retirement, in addition, the executor of the deceased partner is entitled to share of profit upto the date of death.

Unit – 6 Dissolution of Partnership Firms and LLP

DISSOLUTION PROCEDURE

A. Writing off book Value of assets and liabilities

1. Transfer all assets to realization A/c.

Realization (loss) A/c Dr. [Book Value]

To Assets A/c

Note: - Cash /Bank balance not to be transferred to Realization A/c

2. (I) Transfer all outside Liability to Realization A/c

Liability A/c Dr. [Book Value]

To realization A/c

(II) Inside liabilities to Partner Capital A/c

Reserves /profits A/c Dr.

To Partners Capital A/c

B. Realize all assets and pay off liabilities.

1. When Assets are sold to Outsider

Cash A/c Dr. [Realizable Value]

To Realization A/c

2. When Assets are takeover by Partners.

Partner Capital A/c Dr. [Realizable Value]

To realization A/c

3. When Liabilities are paid through cash.

Realization A/c Dr. [Realizable Value]

To Cash A/c

4. When partner takeover the liabilities

Realization A/c Dr. [Realisable Value]

To Partner Capital A/c

C. Recognizing Dissolution expenses and transferrring the profit / loss to partners

1. Expenses of dissolution.

Realization A/c Dr.

To Cash A/c

D. Transferring the profit/loss on dissolution to partners Capital A/c.

Realization A/c Dr.

To Partners Capital A/c

(For Profit)

Partner Capital A/c Dr.

to Realization a/c

(For Loss)

E. Settlement of Partners Capital A/c

Partners Capital A/c Dr.	xx	
to Cash A/c		xx

{For Payment made to Partners}

Cash A/c Dr.

to Partners capital A/c Dr.

{For Payment Received by Partners}

Garner Vs. Murray

Insolvent Partner:- A partner who has a debt balance and is unable to contribute his share in the firm.

Under Garner Vs. Murray Rule, the deficiency of insolvent partner is first calculated . This deficiency is then shared by solvent partners having credit balance in their **capital ratio**.

Note:- Solvent partner having debit balance will not share the deficiency of insolvent partner.

Capital Accounts

Fixed Capital Method

Opening balance of capital account will be considered to calculate the Capital Ratio

Fluctuating Capital Method

Opening balance of capital
+/- <u>All Current Year Adjustments</u>
Balance of Capital to Calculate <u>Capital Ratio</u>

Note:- Don't consider realization profit/losses to calculate Balance of Capital.

Garner Vs Murray rule is not applicable when:-

1. There are only two partner.
2. All partners are insolvent

When all partners are insolvent:-

- This means that the creditors/ liabilities of the firm.
- In Such a case, **don't transfer the creditor to realization A/c.**
- After paying the available amount ,calculate the deficiency [amount still payable] to the partners.
- This deficiency will then be written off against the partners capital A/c and then the accounts will then be closed.

Piecemeal Distribution

- Maximum loss Method.
- Highest Relative Capital

➢ Maximum Loss Method

- ✓ In this method, any realization is considered the final amount realized.
- ✓ This is then deducted from the total capital to calculate maximum loss.
- ✓ This maximum loss is distributed amongst all partners in Profit Sharing Ratio.
- ✓ This gives the final amount payable to all partners.
- ✓ If, however, amount is receivable from any partner, it will be considered as deficit and distributed amongst remaining partners in capital ratio.
- ✓ This finally gives us amount payable to partners.
- ✓ for any further realization , the same steps are repeated

➢ Highest Relative Capital Method

- ➢ In this method , payment is first made to the partner who has the highest relative capital amongst all the partners.
- ➢ Highest Relative Capital is calculated as follows:-

1) First divide the capital of al partners with their respective profit sharing ratio.
2) This will provide capital contribution /share of profit.
3) Taking the lowest capital contribution /share of profit as per base calculated adjusted capital of all partners.
4) Comparing the actual and adjusted capital of all partners, calculate the excess capital contribution of partners ,if any.
5) Now repeat the same process from point 1 , only for the partners who have contributed excess capital until we arrive at final excess capital contributed any single partners.
6) The partner who has the final excess capital will be paid first and so on.

10 Company Accounts

Unit – 1 Introduction to Company Accounts

The word 'Company', in everyday usage, implies an assemblage of persons for social purpose, companionship or fellowship. As a form of organisation, the word 'company' implies a group of people who voluntarily agree to form a company.

Salient Features Of A Company

Incorporated Association → Separate Legal Entity → Perpetual Existence → Common Seal → Limited Liability → Distinction between Ownership and Management → Not a citizen → Transferability of Shares → Maintenance of Books → Periodic Audit → Right of Access to Information

Types of Companies

Government Company	Section 2(45) of the Companies Act, 2013, "Government company" means Any company in which not less than fifty-one per cent of the paid-up share capital is held by the Central Government, or by any State Govt or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.
Foreign	Section 2 (42) of the Companies Act, 2013, "Foreign company" means any

Company	company or body corporate incorporated outside India which - (a) Has a place of business in India whether by itself or through an agent physically or through electronic mode; and (b) Conducts any business activity in India in any other manner.
Private Company	Section 2(68) of the Companies Act, 2013 defines 'Private company' as a company which by its articles, i. Restrict the right to transfer its shares; ii. Except in case of One Person Company limits the number of its members to two hundred: Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this sub-clause, be treated as a single member: Provided further that— (A) Persons who are in the employment of the company; and (B) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased, shall not be included in the number of members; and (iii) Prohibits any invitation to the public to subscribe for any securities of the company. Shares of a Private Company are not listed on Stock Exchange
Public Company	Section 2(71) of the Companies Act, 2013 defines Public Company as a Company which a is not a private company; provided that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles.
One Person Company	Section 2 (62) of the Companies Act, 2013 defines "One Person Company" as a company which has only one person as a member.

Small Company	Section 2(85) of the Companies Act, 2013 defines "Small company" means a company, other than a public company (i) paid-up share capital of which does not exceed 2 crores rupees or such higher amount as may be prescribed which shall not be more than ten crores rupees; and (ii) turnover of which as per its last profit and loss account for the immediately preceding financial year does not exceed twenty crore rupees or such higher amount as may be prescribed which shall not be more than hundred crore rupees Provided that nothing in this clause should apply to: (A) a holding company or a subsidiary company (B) a company registered under section 8 (C) a company or body corporate governed by any special Act
Listed Company	Section 2 (52) of the Companies Act, 2013,''listed company" means a compar which has any of its securities listed on any recognised stock exchange.
Unlimited Company	Section 2 (92) means a company not having any limit on the liability of its members.
Company limited by Shares	Section 2(22) means a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them.
Company limited by Guarantee	Section 2(21) of the Companies Act, 2013, "company limited by guarantee" means a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up.
Holding Company	Section 2 (46) in relation to one or more other companies, means a company of which such companies are subsidiary companies.
Subsidiary	Section 2(87) "subsidiary company" as a company in which the holding

Company	company: (i) Controls the composition of the Board of Directors; or (ii) Exercises or controls more than one-half of the total share capital eithe at its own or together with one or more of its subsidiary companies. A company shall be deemed to be a subsidiary company of the holding company even if there is indirect control through the subsidiary company(ies control over the composition of a subsidiary company's Board of Directors means exercise of some power to appoint or remove all or a majority of the directors of the subsidiary company.

Preparation Of Financial Statements

Section 129 of the Companies Act, 2013, the financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the notified accounting standards and shall be in the form or forms as may be provided for different class or classes of companies, as prescribed in Schedule III.

Financial Statements as per Section 2(40) of the Companies Act, 2013, inter-alia include –

i. A balance sheet as at the end of the financial year;

ii. A profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;

iii. cash flow statement for the financial year;

iv. A statement of changes in equity, if applicable; and

v. (any explanatory not annexed to, or forming part of, any document referred to in sub-clause (i) to subclause (iv):

Provided that the financial statement, with respect to One Person Company, small company and dormant company, may not include the cash flow statement.

Part I – Form Of Balance Sheet

Name of the Company…………………..

Balance Sheet as at……………………

(₹' in ……………)

Particulars		Notes No.	Figures as at end of the current reporting period	Figures as at end of the previous reporting period
	EQUITY AND LIABILITIES			
1.	**Shareholders' funds**			
	a. Share capital (A)		xx	xx
	b. Reserves and Surplus (B)		xx	xx
	c. Money received against share warrants		xx	xx
2.	**Share application money pending allotment**			
3.	**Non-current liabilities**			
	a. Long-term borrowings (C)		xx	xx
	b. Deferred tax liabilities (Net)		xx	xx
	C. Other long term liabilities		xx	xx
	d. Long-term provisions (D)		xx	xx
4.	**Current liabilities**			
	a. Short-term borrowings (E)		xx	xx
	b. Trade Payables		xx	xx
	c. Other current liabilities (F)		xx	xx
	d. Short-term provisions		xx	xx
Total			xx	xx
	ASSETS			
1.	**Non-current assets**			
	a. i. Property, Plant and Equipment		xx	xx
	ii. Intangible assets (H)		xx	xx

	iii. Capital Work-in-progress		xx	xx
	iv. Intangible assets under development		xx	xx
	b. Non-current investments (1)		xx	xx
	c. Deferred tax assets (Net)		xx	xx
	d. Long-term loans and advances (J)		xx	xx
	e. Other non-current assets		xx	xx
2.	**Current assets**			
	a. Current investments (K)		xx	xx
	b. Inventories (L)		xx	xx
	C.Trade receivables		xx	xx
	d. Cash and cash equivalents (M)		xx	xx
	e. Short-term loans and advances		xx	xx
	f. Other current assets		xx	xx
Total			xx	xx

PART II – Form Of STATEMENT OF PROFIT AND LOSS

Name of the Company……………………

Profit and Loss Statement for the year ended …………………… (₹₹ in………..)

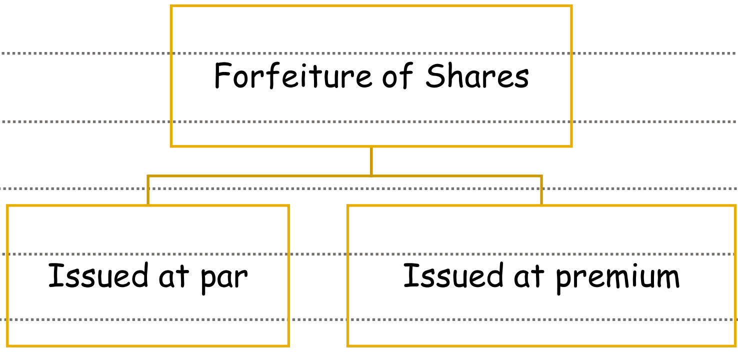
Particulars		**Notes No.**	**Figures as at end of the current reporting period**	**Figures as at end of the previous reporting period**
I.	**Revenue from operations**		xx	xx
II.	Other income		xx	xx
III.	**Total Revenue (I + II)**		xx	xx
IV.	*Expenses:*			
	Cost of materials consumed		xx	xx

	Purchases of Stock-in-Trade		xx	xx
	Changes in inventories of finished goods, Work-in-		xx	xx
	Progress and Stock-in-Trade		xx	xx
	Employee benefits expense		xx	xx
	Finance costs		xx	xx
	Depreciation and amortization expense		xx	xx
	Other expenses		xx	xx
Total expenses			**xx**	**xx**
V.	Profit before exceptional and extraordinary			
	and tax (III-IV)		xx	xx
VI.	Exceptional items		xx	xx
VII.	Profit before extraordinary items and tax			
	(V-VI)		xx	xx
VIII.	Extraordinary Items		xx	xx
IX.	Profit before tax (VII-VIII)		xx	xx
X.	Tax expense:			
	(1) Current tax		xx	xx
	(2) Deferred tax		xx	xx
XI.	Profit (Loss) for the period from continuing			
	operations (VII-VIII)		xx	xx
XII.	Profit/(Loss) from discontinuing operations		xx	xx
XIII.	Tax expense of discontinuing operations		xx	xx
XIV.	Profit/(Loss) from discontinuing operations			
	(after tax) (XII-XIII)		xx	xx
XV.	Profit (Loss) for the period (XI + XIV)		xx	xx
XVI.	Earnings per equity share:			
	(1) Basic		xx	xx

	(2) Diluted		xx	xx

Unit – 2: Issue, Forfeiture & Re-Issue of Shares

Shares forfeiture: -



❖ Issued at Par: -

Share Capital Ac. Dr. 10- → Amount called up

To Share forfeiture Ac ₹6 → Amount received

To Calls in arrears Ac ₹4 → Amount not yet received

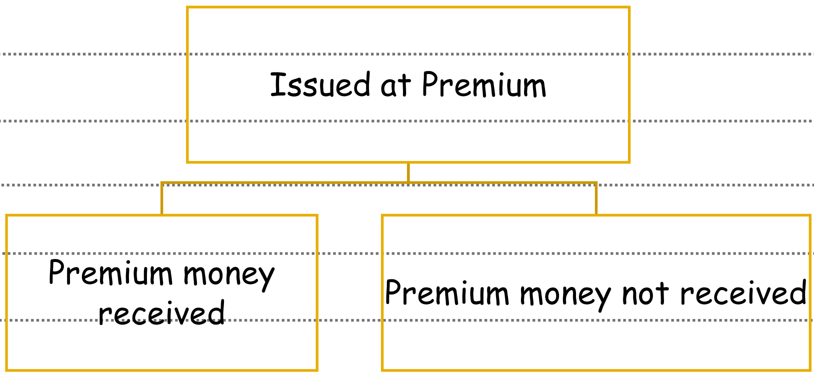
Example: - FV = ₹10

Called up = ₹10

Application 3 ⎫
Allotment = ₹3 ⎭ received

1st call 4- → not yet received.

❖ Issued at Premium: -



❖ Premium money received

❖ Ignore premium amount during forfeiture

Share capital Ac. Dr.₹10- → Amount called up

To Share forfeiture Ac. ₹6 → Amount received

To Calls in arrears Ac. ₹4 → Amount not yet received

Example: - FV = 10

Premium = 2

Fully Called up:

Application = 3 - → Received

Allotment = 5 → Received

1st call= 4 → Not received

❖ This is because the premium is already credited (as profit) during share issue entry, hence need to credit again

❖ **Premium money not received**

➢ Effect of premium amount will be shown

Share capital Ac. Dr. ₹10- → Amount called up

Securities Premium Ac. Dr.₹2 → Premium money

To Share forfeiture Ac. ₹6- → Amount received

To Calls in arrears Act ₹4 → Amount not yet received

Example: - FV = 10

Premium = 2

Fully Called up:

Application = ₹3 → Received

Allotment ₹5 = (including premium)

1st call ₹4 Not received

❖ **Adjustment of Excess amount received during Application: -**

❖ Such amount is first adjusted against CAPITAL amount due and only then adjusted against premium amount

Example: - Application = 2000

Shares allotted = 600

Application = 3

Allotment 5 (including premium = 2)

1st call = ₹4

Total application money = 2000x3 = ₹6000

Total shares allotted = 6000x3 = ₹1800

Excess money= ₹4200

Application = ₹3 → Received

Allotment = 5 (including premium) → not received

1st call = 4 → not received

Adjustment: - Excess Money: 4200

	Capital	Premium
Share Allotment: - 600×3 =	1800	600×2= 1200
Excess money adjustment =	1800	
(Bal: 4200-1800 = 2400)		
Share 1st call: - 600×4 =	2400	1200
Excess money adjusted =	2400	
(Bal: 2400-2400 = 0)		

Hence premium money is not received

Journal Entry: -

Share capital (600×10)	Dr.	6000	
Securities Premium	Dr.	1200	
To Share Forfeiture			6000

To Calls in arrears 1200

(Share allotment)

❖ Re-Issue of Forfeited Shares: -

➢ Points to Remember: -

1. Reissue price + Forfeited amount Calls in arrears from original allotee.
2. Balance of share forfeiture Loss on reissue; excess amount transferred to Capital Reserve.
3. Loss on reissue debited to shares forfeitures a/c.
4. Reissue price > Face value; excess amount transferred to Securities Premium a/c.
5. When only part of forfeited shares is reissued then profit (share forfeiture a/c) proportionate to only such part is transferred to Capital Reserve a/c.
6. The balance of share forfeiture a/c relating to the shares not reissued will continue to be visible in shares forfeiture a/c. Balance of share forfeiture a/c is shown as a part of Share Capital.

Example 1: - Face value = 10

Application = 3 } Amount received
Allotment 3 }
1st call 4- → Not received

Share Forfeited and received @ 8/share Fully paid up.

1.Share Capital A/c Dr. 10 → Called up
To Share Forfeiture A/c 6 → Amount received
To Share 1st call A/c 4 → Amount not yet received

2. Bank A/c Dr. 8 → Amount received
Share Forfeiture A/c Dr. 2 → Discount on reissue
To Share Capital A/c 10 → Face value

3. Share Forfeiture A/c Dr. 4 $\Big\}$ Final profit transferred to
To Capital Reserve A/c 4 Capital Reserve

- **Example 2:** Face value = 10

Application= 3 Amount received
Allotment = 3
1st call 4- Not received

500 Shares forfeited for non-payment of 1st call.

300 of these Shares were reissued @ 8/share Fully paid up.

1. Share Capital A/c (500 x 10)	Dr.	5000	
To Share Forfeiture A/c (500 x 6)			3000
To Share 1st call A/c (500 x 4)			2000
2.Bank A/c (300 x 8)	Dr.	2400	
Share Forfeiture A/c (300 x 2)	Dr.	600	
To Share Capital A/c (300 x 10)			3000
3.Share Forfeiture A/c	Dr.	1200	
To Capital Reserve A/c			1200
(1800-600)			

Unit – 3: Issue of Debentures

Debentures

Section 2 (30) of the Companies Act, 2013 defines debentures as "Debenture" includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not

Feature Of Debentures

1. It is a document which evidences a loan made to a company.
2. It is a fixed interest-bearing security where interest falls due on specific dates.
3. Interest is payable at a predetermined fixed rate, regardless of the level of profit.
4. The original sum is repaid at a specified future date or it is converted into shares or other debentures.
5. It may or may not create a charge on the assets of a company as security.
6. It can generally be bought or sold through the stock exchange at a price above or below its face value.

Distinction between Debentures and Shares

Debentures	Shares
Debenture holders are the creditors of the company.	Shareholders company are the owners of the Company.
Debenture holders have no voting rights and consequently, do not pose any threat to the existing control of the company	Shareholders have voting rights and consequently, control the total affairs of the company
Debenture interest is paid at a pre-Determined fixed rate. It is payable, wheth there is any profit or not. Debentures rank ahead of all types of shares for payment of the interest due on them.	Dividend on equity shares is paid at a variable rate which is vastly affected by the profits of the company (however, dividend on preference shares is paid at a fixed rate).

Interest on debentures is the charges again profits and they are deductible as an expens in determining taxable profit of the compan	Dividends are appropriation of profits and these are not deductible in determining taxable profit of the company.
There are different kinds of debentures Secured/ Unsecured; Redeemable/ Irredeemable; Registered / Bearer; Convertible/ Non-convertible, etc	There are only two kinds of shares– Equity Shares and Preference Shares.
In the Company's Balance Sheet, Debenture: are shown under "Long Term Borrowings	In the Company's Balance Sheet, shares are shown under "Shareholder's Fund" detailed in 'Share Capital' of Notes to Accounts
Debentures can be converted into other debentures or shares as per the terms of issue of debentures.	Shares cannot be converted into other shares in any circumstances
Debentures cannot be forfeited for non- payment of call money.	Shares can be forfeited for non-payment of allotment and call moneys.
At the time of liquidation, debenture holders are paid-off before the shareholders.	At the time of liquidation shareholders are paid at last, after paying debenture holders, Trade payable, etc.

Type Of Debentures

On the basis of: -

(1) Security; (2) Convertibility; (3) Permanence; (4) Negotiability; and (5) Priority

1. Security

(a) Secured Debentures: These debentures are secured by a charge upon some or all assets of the company.

There are two types of charges: (i) Fixed charge; and (ii) Floating charge.

(i) A fixed charge is a mortgage on specific assets. These assets cannot be sold without the consent of the debenture holders. The sale proceeds of these assets are utilized first for repaying debenture holders.

(ii) A floating charge generally covers all the assets of the company including future one.

(a) **Unsecured or "Naked" Debentures:** These debentures are not secured by any charge upon any assets. A company merely promises to pay interest on due dates and to repay the amount due on maturity date. These types of debentures are **very risky** from the view point of investors

2. Convertibility

(a) **Convertible Debentures**: These are debentures which will be converted into equity shares (either at par or premium or discount) after a certain period of time from the date of its issue. These debentures may be fully or partly convertible. In future, these debenture holders get a chance to become the shareholders of the company.

(b) **Non-Convertible Debentures**: These are debentures which cannot be converted into shares in future. As per the terms of issue, these debentures are repaid.

3. Permanence

(a) **Redeemable Debentures**: These debentures are repayable as per the terms of issue, for example, after 8 years from the date of issue.

(b) **Irredeemable Debentures**: These debentures are not repayable during the life time of the company. These are also called **perpetual debentures.** These are repaid only at the time of liquidation.

4. Negotiability

(a) **Registered Debentures**: These debentures are payable to a registered holder whose name, address and particulars of holding is recorded in the Register of Debenture holders. They are not easily transferable. The provisions of the Companies Act, 2013 are to be complied with for effecting transfer of these debentures. Debenture interest is paid either to the order of registered holder as expressed in the warrant issued by the company or the bearer of the interest coupons.

(b) **Bearer Debentures**: These debentures are transferable by delivery. These are negotiable instruments payable to the bearer. No kind of record is kept by the company in respect of the holders of such debentures. Therefore, the interest on it is paid to the holder irrespective of any identity. No transfer deed is required for transfer of such debentures.

5. Priority

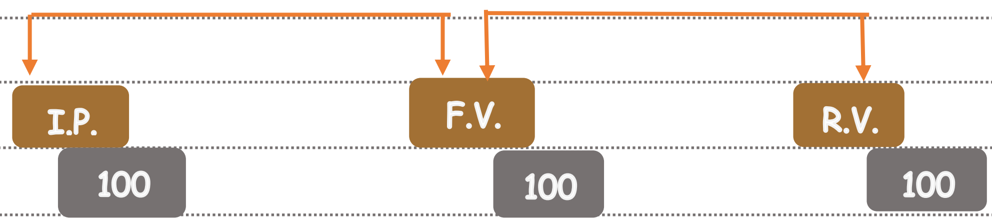
(a) **First Mortgage Debentures**: These debentures are payable first out of the property charged.

(b) **Second Mortgage Debentures**: These debentures are payable after satisfying the first mortgage debentures.

Accounting

I. When Debentures are issued at Par & Redeemed at Par

Issue *Redemption*

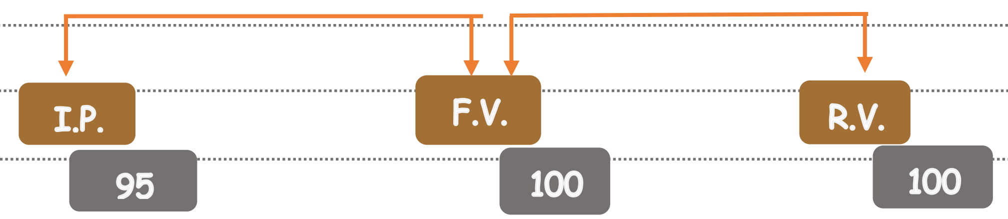


Bank A/c Dr. 100

To __ % Debentures A/c 100

II. When Debentures are issued at Discount & Redeemed at Par

Issue *Redemption*



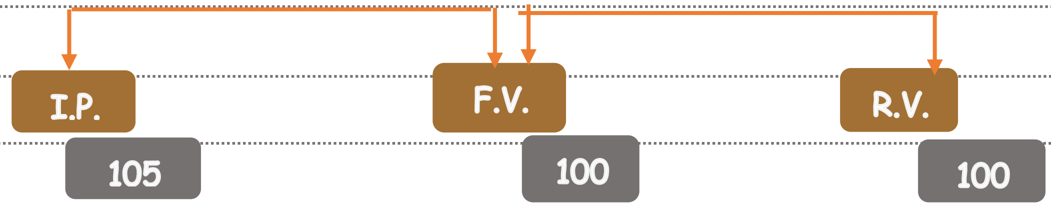
Bank A/c Dr. 95

Discount on issue of Deb. 5

To __ % Debentures A/c 100

III. When Debentures are issued at Premium & Redeemed at Par

Issue ***Redemption***



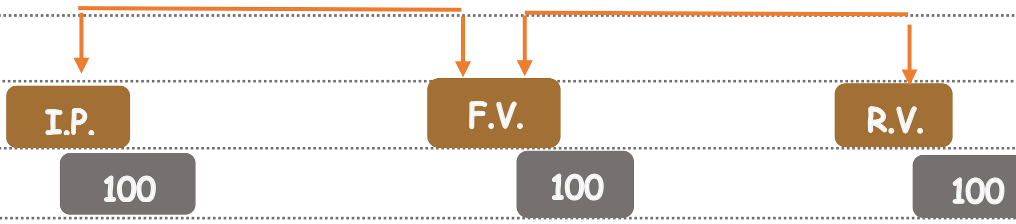
Bank A/c Dr. 105

To __ % Debentures A/c 100

To Security Premium 5

IV. When Debentures are issued at Par & Redeemed at Premium

Issue ***Redemption***



Bank A/c Dr. 100

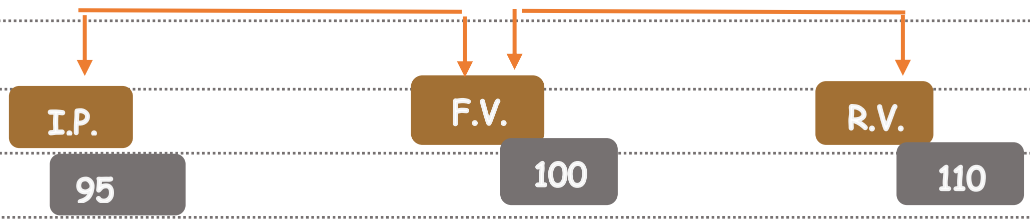
To __ % Debentures A/c 100

Loss on issue of Deb. Dr. 10

To Deb. Red. Premium 10

V. When Debentures are issued at Discount & Redeemed at Premium

Issue ***Redemption***



Bank A/c Dr.	95	Loss on issue of Deb. Dr.	10
Discount on issue of Deb.	5	To Deb. Red. Premium	10
To ___ % Debentures A/c	100		

Vi. When Debentures are issued at Premium & Redeemed at Premium

Issue ***Redemption***

I.P. 105 F.V. 100 R.V. 110

Bank A/c Dr.	105	Loss on issue of Deb. Dr.	10
To ___ % Debentures A/c	100	To Deb. Red. Premium	10
To Security Premium	5		

Debenture issue as Collateral Security

Method I

Don't treat as liability at the time of issue.
Hence no entry needs to be made.

Method II

Treat as liability at the time of issue.
Hence, Entry will be: -
Debenture Suspense A/c Dr.
To % Debenture A/c

If initial liability is Paid

% Debenture A/c Dr.
To Debenture Suspense A/c

If initial liability is not Paid

Initial Liability A/c Dr.
To Debenture Suspense A/c

Unit 4 Accounting For Bonus & Right Issue

Accounting for Bonus & Right Issue

- The process of bonus issue is called capitalization of reserves.
- This is done so that the capital base of the company adequately represents the fixed assets (PPE).

There are two types of bonus issue which will be discussed in this chapter:

1. Bonus shares issued against existing equity shares.
2. Bonus call made to convert partly paid-up shares into fully paid up.

1. Bonus shares issued against existing equity shares.

1. In order to issue a bonus share, the existing equity share should be fully paid up.
2. The reserves that can be used for issuing bonus shares are:

1. Capital Redemption Reserves.
2. Securities Premium.
3. Free Reserves:
    1) Profit & Loss A/c
    2) General Reserve
    3) Dividend Equalization Reserves
4. Capital Reserve, if realised in cash and authorised by AOA.

Note: Any reserve formed by revaluation of assets i.e., a revaluation reserve or Capital reserve not realised in cash cannot be used for the purpose of bonus issue.

Meanings- Capital Redemption Reserves: This reserve can be used only for the purpose of bonus issue. Hence, always use this reserve first for issuing bonus shares.

Securities Premium

Non listed Company | **Listed Company**

Free Reserves

Reserves which are available for distribution as dividend. The following reserves can be used for the purpose of payment of dividend:

1. Profit & loss balance.
2. General Reserves.
3. Dividend Equalization Reserves

Conditions to be complied

As per Company's Act,2013, the following conditions need to be complied with for the purpose of bonus issue:

1. Bonus issue should be authorized by AOA.
2. Bonus issue should be approved by shareholders in the AGM.
3. There should be no default in repayment of principle or payment of interest to loans /public deposits.
4. There should be no default in payment of statutory dues to employees.
5. Bonus shares should not be issued in lieu of dividend.

As per ICDR, the following condition needs to complied with for the purpose of bonus issue:

The company should make a provision of bonus shares on convertible debentures or preference shares before bonus shares are issued to Equity Shareholders.

Journal Entry

Particular	Debit	Credit
1. Capital Redemption Reserves Dr. Securities Premium Dr. Free Reserves Dr. Capital reserves (Cash) Dr. To bonus to equity Shareholders.		
2. Bonus to Equity Shareholders Dr. To Equity Share Capital		

2.Bonus call made to convert partly paid-up shares into Fully Paid-up shares

Only free reserves can be used for the purpose of making a bonus call. This means CRR, Securities Premium, capital reserves realized in cash cannot be used for this purpose.

Journal Entry

Particular	Debit	Credit
1. Equity Share Call/ A/c Dr. To Equity Share Capital		
2. Bonus to Equity Shareholders Dr. To Equity Share Call		
3. Free Reserves Dr. To Bonus to Equity Shareholders		

Unit 5: Redemption of Preference Share

Redemption of Preference Share

- Only fully paid-up preference shares can be redeemed.
- Preference Shares can be redeemed in the following ways:

  i) Out of proceeds of fresh issue.

  ii) Out of Existing Funds.

Out of Existing Funds

- ❖ Only free reserves can be used for this purpose.
- ❖ Free Reserves: - Reserves which are available for distribution as dividend.

  These comprise of: -

  a. General Reserve.

  b. Balance of P&L

  c. Dividend Equalisation Reserve.
- ❖ As per Company Act, 2013, in order to redeem preference shares out of existing funds, a company should:

- Transfer nominal value of shares to be redeemed from it (Free Reserves) to Capital Redemption Reserve (CRR)

Free Reserves $\xrightarrow{\hspace{3cm}}$ **Capital Redemption Reserve**

Nominal value of shares to be redeemed

Example

Preference Shares to be redeemed = 10,000 shares Nominal Value = ₹ 100/ Share. Redemption Value = ₹ 100/ Share. Calculate amount to be transferred to CRR if redemption is out of existing funds.

Solution: - Transfer to CRR = Nominal value of shares to be redeemed.

x = 10,000 * 100 x = 10,00,000/-

Example

Preference Shares to be redeemed = 10,000 shares Nominal Value = ₹ 100/ Share. Redemption Value = ₹ 110/ Share. Calculate amount to be transferred to CRR if redemption is out of existing funds.

Solution: - Transfer to CRR = Nominal value of shares to be redeemed.

$$x = 10,000 * 100 \quad x = 10,00,000/-$$

Note:-Redemption value of Shares is immaterial. Amount to be transferred to CRR is always based on the nominal value of shares.

Journal Entry

Date	Particular		
(i)	General Reserve A/c P & L A/c Dividend Equalization Reserve A/c To Capital Redemption Reserve.	Dr. Dr. Dr.	**(Nominal Value of Shares Redeemed)**
(ii)	__ % Preference Share Capital A/c Premium on redemption A/c To Preference Shareholders A/c	Dr.[Nominal Value] Dr.[Premium, if any] [Redemption Value]	
(iii)	Preference Shareholders A/c To Bank A/c	Dr. [Redemption Value]	
(iv)	Securities Premium A/c To Premium on Redemption A/c (As per ICAI Module, Profit & Loss A/c may be used, but as per Section 133, General Reserve A/c may be used.)	Dr.	

Out of Proceeds of Fresh Issue

- Fresh issue cannot of the same type of Shares to be redeemed.
- Fresh Issue of debentures is not considered here.
- How much of fresh Issue is required: -

Proceeds of fresh issue = Nominal Value of Shares to be redeemed.

Proceeds of fresh issue = Nominal Value of Shares to be Redeemed

Proceeds of fresh issue = It can be calculated in the following's ways.

Fresh issue is at Par / premium → Proceeds = Par Value

Fresh issue is at Discount → Proceeds = Issue Price

Notes: - No Amount is to be transferred to CRR in this method.

Example

- Preference Shares to be redeemed = 10,000 shares
- Nominal Value = ₹ 100/ Share.
- Redemption Value = ₹ 100/ Share.
- Equity Shares are issued at ₹ 10/ Share (Nominal Value = ₹ 10/ Share.)

Calculate no. of equity Shares to be issued for the purpose of redemption.

Solution: - Proceeds of Fresh Issue = nominal Value of Shares to be redeemed.

x = 10,000 *100

x = 10,00,000

Number of Equity Shares = Total Proceeds / Proceeds per Share.

= 10,00,000 / 10 = 1,00,000 Shares.

Example

- Preference Shares to be redeemed = 10,000 shares
- Nominal Value = ₹ 100/ Share.
- Redemption Value = ₹ 110/ Share.
- Equity Shares are issued at ₹ 12/ Share (Nominal Value = ₹ 10/ Share.)

Calculate no. of equity Shares to be issued for the purpose of redemption.

Solution: - Proceeds of Fresh Issue = nominal Value of Shares to be redeemed.

x = 10,000 *100

x = 10,00,000

Number of Equity Shares = Total Proceeds / Proceeds per Share.

= 10,00,000 / 10 = 1,00,000 Shares.

Notes: - Cashflow = 1,00,000 x 12 =12,00,000/-

However, proceeds are always restricted to only nominal value.

Hence, proceeds = 1,00,000 x 10 = ₹ 10,00,0000

Example

- Preference Shares to be redeemed = 10,000 shares
- Nominal Value = ₹ 100/ Share.
- Redemption Value = ₹ 120/ Share.
- Equity Shares are issued at ₹ 9/ Share (Nominal Value = ₹ 10/ Share.)

Calculate no. of equity Shares to be issued for the purpose of redemption.

Solution: - Proceeds of Fresh Issue = nominal Value of Shares to be redeemed.

x = 10,000 *100

x = 10,00,000

Number of Equity Shares = Total Proceeds / Proceeds per Share.

= 10,00,000 / 9 = 1,11,112 Shares.

Journal Entry

Date	Particular
(i)	Bank A/c Dr. [Issue Price] To Equity Share Capital A/c [Face Value] To Securities Premium [Premium ,if any]
(ii)	___ % Preference Share Capital A/c Dr.**[Nominal Value]** Premium on redemption A/c Dr. **[Premium, if any]** To Preference Shareholders A/c **[Redemption Value]**
(iii)	Preference Shareholders A/c Dr. **[Redemption Value]** To Bank A/c

(iv)	Securities Premium A/c Dr. To Premium on Redemption A/c (As per ICAI Module, Profit & Loss A/c may be used, but as per Section 133, General Reserve A/c may be used.)

Combination of Above 2 methods.

Free Reserves *+ Proceeds of Fresh Issue = Nominal Value of Shares to be redeemed.

***Transfer to CRR**

Example

- Preference Shares to be redeemed = 10,000 shares
- Nominal Value = ₹ 100/ Share.
- Redemption Value = ₹ 110/ Share.
- Equity Shares are issued at ₹ 12/ Share (Nominal Value = ₹ 10/ Share.)
- Balance of Free Reserves are as follows: -

1) Profit & loss A/c	₹ 50,000
2) General Reserves	₹ 2,00,000
3) Securities Premium	₹ 1,00,000
4) Dividend Equalization reserve	₹ 1,00,000

Calculate no. of equity Shares to be issued for the purpose of redemption & amount transferred to CRR.

Solution: Free Reserves + Proceeds of Fresh Issue = Nominal Value of Shares to be redeemed.

4,50,000 + x = 10,000 * 100

x = 5,50,000/-

Number of Equity Shares = Total Proceeds / Proceeds per Share

= 5,50,000/ 1

= 55,000 Shares.

Unit 6 Redemption Of Debentures

Rule 18(1) of companies (Share Capital and Debenture) Rules 2014

1. Before issue of prospectus or offer letter a company should appoint a debenture trustee.

2. Company should execute debenture trust deed within 60 days of allotment of debenture.

3. Maximum life of SECURED DEBENTURES should not exceed 10 years.

Exception: -

A. Company involved in setting up Infrastructure Projects
B. Infrastructure Finance company.
C. Infrastructure Debt Fund - NBFC.
D. Companies permitted by CG/RBI/NHB

} **Maximum Life – 30 years**

4. No limit for unsecured debentures.

5 Secured debentures should be secured by: - **1. Movable Assets**
2. Immovable Assets

- charge on such assets should be created in favour of debenture trustee:
- such assets can be of: - **1. The Company itself**
2.It's Holding Company
3. It's Subsidiary Company
4. It's Associate Company

Debentures may be redeemed by :-

- Giving a specific Notice
- Annual Drawing
- After a certain Number of years
- Any Time after fixed No. of years

Methods of redemption of debentures

- Payment in lumpsum
- Payment in installment
- Purchase in Open market for immediate cancellation
- By conversion into shares

Journal Entries

1. Redemption by payment in Lumpsum / Instalments

i. Amount payable to Debenture holders

% Debentures a/c	Dr.	100	100
Premium on redemption a/c	Dr.		5
To, debenture holders a/c		100	105

ii. Amount paid to Debenture holders

Debenture holder's a/c	Dr.	100/105
To, Bank a/c		100/105

iii. Amount Transferred to DRR

P&L/GR/DER a/c	Dr.
To, DRR	

iv. Premium on redemption written off

Securities Premium a/c	Dr.	5	
To, Premium on redemption			5

2. Redemption by purchase from open market for immediate cancellation

i. When debentures are purchased from open market

own Debentures a/c	Dr.	48	
To, Bank			48

ii. Own debentures cancelled off against % debentures

%. Debentures a/c	Dr.	100	
To own debentures			98
To, profit cancellation (P&L)			2

iii. Amount transferred to DRR

P&L/GR/DER a/c	Dr.		
To DRR			

3. By conversion into Equity Shares

i. Amount payable to debenture holders

%. Debentures a/c	Dr.	100	
Premium on redemption		5	
To, Debenture holders			105

ii. Issue of Equity Shares (FV=10, IP = 15)

Debenture holder a/c	Dr.	105	
To, Equity share Capital a/c **(PV)**			70
To, Securities Premium a/c **(5)**			35

iii. Premium on redemption w/off

Securities Premium a/c	Dr.	5	
To Premium on redemption			5

Debenture Redemption Reserve / Debenture Redemption Investment Rule

18(7) Of Companies (Shares & Debenture) Amendment Rules 019

	-Banks -AIFI regulated by RBI	Other financial Institutions	Listed No.			Unlisted No.		
			NBFC	HFC	Others	NBFC	HFC	Others

DRR	X	Same as NBFC ↓ X	X	X	X	X	X	10%
DRI	X	Same as NBFC Listed Unlisted 15% X	15%	15%	15%	X	X	15%

DRR

- **Who has to create**: Unlisted others
- **How Much**: 10% of debentures outstanding
- **Created out of**: Free reserves
- **When should DRR be created**: Any time before redemption

DRI — **Investment**

- **Who has to create**: -Listed company -Unlisted others
- **How Much**: 15% of debentures Maturing at the end of current FY.
- **out of**: Bank Bal.
- **When should amount to invested**: on or before 30th April of the Fy. at the end of which debentures are to be redeemed.