Skillshort

Self-Study Preparation Pack

CMA INTERMEDIATE

Paper 6: Financial Accounting (FA)

Chapter-wise Detailed Notes

For the December 2026 term (Sat 12 Dec 2026, 2–5 pm) and June 2027 · ICMAI Syllabus 2022 · Accounting Standards (AS) with comparative Ind AS provisions

100 marks · 3 hours | Q1: 15 MCQs × 2 = 30 | Any 5 of Q2–Q8 × 14 = 70 | Mostly numerical | All examples verified in Python

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This subject pack has 6 parts

1 Chapter-wise notes | 2 Important topics & weightage | 3 Past papers: trends & links

4 Mock tests + solutions | 5 Chapter practice questions | 6 Last-week plan & strategy

Prepared by Skillshort for self-study. Original explanations and questions; not an official ICAI/ICMAI/ICSI publication. Items marked VERIFY should be checked against the latest official material.

How to use these notes

These notes follow the **ICMAI Syllabus 2022 module order** (9 modules in 6 sections). Each chapter gives formats, rules, journal entries and solved examples. Work every example on paper, then solve the related set in file 05. The formula sheet at the end is for last-week revision.

Paper at a glance

Item	Detail
Marks / time	100 marks, 3 hours, offline, 2:00–5:00 pm
Section A (compulsory)	Q1 – **15 MCQs × 2 marks = 30**; mostly short numericals (provisions, bills due dates, consignment commission, goodwill, NPO subscriptions, AS)
Section B	**Any 5 of Q2–Q8**, 14 marks each = 70 – nearly all numerical except Q7–Q8 (AS theory and short notes)
ICMAI study weightage	A Accounting fundamentals **15%** · B Bills, consignment, joint venture **10%** · C Final accounts (commercial, NPO, incomplete records) **20%** · D Partnership **20%** · E Lease, branch, departmental, insurance claims, hire purchase **15%** · F Accounting Standards **20%**
Accounting Standards in the syllabus	AS 1, AS 10, AS 11, AS 12, AS 16, AS 22 – with comparative provisions under **Ind AS**

EXAM TIP **How marks are given in accounting answers**

Every working note earns marks. Show the **format** (ledger account, statement), the **working notes** numbered W1, W2..., and the **final answer** clearly. A wrong opening figure carried through correctly still earns most of the marks.

Chapter 1: Accounting Fundamentals – Frameworks, Principles, Capital and Revenue

1.1 Meaning and scope of accounting

Accounting is the art of recording, classifying and summarising, in a significant manner and in terms of money, transactions and events which are, at least in part, of a financial character, and interpreting the results (AICPA definition). In modern terms, accounting is an **information system** that identifies, measures, records and communicates financial information to users for decision-making.

Functions (scope) of accounting

1. **Recording** – journal and subsidiary books (book-keeping).
2. **Classifying** – posting to ledger accounts.
3. **Summarising** – trial balance, Profit & Loss Account, Balance Sheet.
4. **Analysing and interpreting** – ratios, trends.
5. **Communicating** – reports to owners, lenders, government and others.
6. **Meeting legal requirements** – Companies Act, tax laws, GST.

Accounting cycle: Transaction → Source document (voucher) → Journal / subsidiary books → Ledger → Trial balance → Adjustments → Financial statements → Closing entries.

Book-keeping vs Accounting vs Accountancy	Meaning
Book-keeping	Recording and classifying – the routine, clerical part
Accounting	Book-keeping + summarising, analysing, interpreting, communicating
Accountancy	The body of knowledge (theory, standards, techniques) behind accounting

Sub-fields: financial accounting (external users), cost accounting (cost per unit, cost control), management accounting (internal decisions), social responsibility accounting, human resource accounting.

Limitations of accounting: records only monetary items; based on historical cost (ignores price-level changes); involves estimates and judgement (depreciation, provisions); can be manipulated (window dressing); does not show the real worth of the business.

> EXAM TIP **Examiners like "Explain four functions / limitations of accounting" (4 marks). Write a heading + one-line explanation for each point.**

1.2 Accounting concepts, principles and conventions

Fundamental accounting assumptions (AS 1): going concern, consistency and accrual. If any of these is **not followed**, the fact must be **disclosed**; if they are followed, no disclosure is needed.

Concept	Meaning	Example
Business entity	Business is separate from the owner	Owner's personal electricity bill is drawings, not business expense
Money measurement	Only events that can be measured in money are recorded	Quarrel among managers is not recorded
Going concern	Business will continue for the foreseeable future	Fixed assets shown at cost less depreciation, not at sale value
Accounting period	Life of business divided into periods (usually 1 year, 1 April – 31 March)	Final accounts prepared yearly
Cost concept	Assets recorded at the price paid (historical cost)	Land bought for ₹10 lakh stays at ₹10 lakh even if market value rises
Dual aspect	Every transaction has two effects – debit and credit	Assets = Liabilities + Capital
Realisation / revenue recognition	Revenue is recognised when earned (goods delivered, service performed), not when cash is received	Credit sale in March is March's revenue

Concept	Meaning	Example
Matching	Expenses of a period are matched with the revenue of the same period	Outstanding wages added to wages of the year
Accrual	Record revenue and expense when they arise, not when cash moves	Rent due but unpaid is an expense
Objective evidence	Entries supported by vouchers and documents	Cash memo, invoice

- **Consistency:** the same method is followed year after year (e.g. same depreciation method) so results are comparable. A change is allowed only if required by law or a standard or for better presentation, and its effect must be disclosed.
- **Conservatism (prudence):** "anticipate no profit but provide for all possible losses". Closing stock at **cost or net realisable value, whichever is lower**; provision for doubtful debts.
- **Materiality:** items that would influence a user's decision must be disclosed; trivial items (e.g. a stapler) can be expensed.
- **Full disclosure:** all significant information must be disclosed in the financial statements or notes (contingent liabilities, accounting policies).

MEMORY TRICK **"C-C-M-F" – Consistency, Conservatism, Materiality, Full disclosure = the 4 conventions.**

Qualitative characteristics of financial statements (Framework): **understandability, relevance, reliability, comparability** (also materiality as part of relevance, and true and fair view). Reliability needs faithful representation, substance over form, neutrality, prudence and completeness.

COMMON MISTAKE **True/false favourite – "Materiality depends only on the amount" → False. Materiality depends on amount and nature of the item, size of business, level of information and the decision-maker.**

MEMORY TRICK **Entity concept = owner and business separate (capital is a liability for the business). Matching = expense with revenue. Don't mix them – examiners have tested this swap.**

1.3 Capital and revenue expenditure and receipts

Capital expenditure	Revenue expenditure	Deferred revenue expenditure
Benefit lasts more than one year	Benefit consumed within the year	Revenue in nature, but benefit spread over a few years
Acquires or improves a fixed asset or increases earning capacity	Maintains the earning capacity	Heavy advertisement campaign for a new product
Shown in the Balance Sheet	Debited to Trading/P&L A/c	Written off over 3–5 years (under AS, now mostly expensed immediately)
Purchase of machinery, installation, legal charges for buying land	Wages, rent, repairs, depreciation	–

Tricky items:

- Wages paid for installing a new machine → **capital** (added to machinery).
- Repairs to a second-hand machine bought, **before first use** → **capital**.
- Replacement of a worn-out part (normal repair) → revenue.
- Cost of extension of building → capital; white-washing → revenue (first white-washing of a new building → capital).
- Legal expenses for a suit to protect title of property → **capital**; legal expenses for recovery of debts → revenue.
- **Capital receipt** – capital introduced, loan taken, sale of fixed asset. **Revenue receipt** – sales, commission, interest received.

Capital vs revenue receipts and profits

Point	Capital receipt	Revenue receipt
Nature	Non-recurring; from sources other than operations	Recurring; from normal operations

Point	Capital receipt	Revenue receipt
Examples	Capital introduced, loans raised, sale proceeds of fixed assets	Sales, fees, commission, interest, rent received
Treatment	Balance Sheet (liability / reduction of asset)	Credited to P&L
Profit	**Capital profit** (e.g. profit on sale of land) → capital reserve / P&L shown separately	**Revenue profit** – normal trading profit

WORKED EXAMPLE Classify (exam style)

(i) ₹25,000 spent on repairs before using a second-hand car → **capital** (makes asset usable).

(ii) Insurance claim received for stock destroyed by fire → **revenue receipt** (stock is a revenue item).

(iii) ₹2,00,000 spent on a new road to the factory → **capital**.

(iv) Legal fees ₹50,000 paid to defend a suit about the title of the factory land → **capital** (protects a capital asset).

(v) Compensation received for loss of use of a leased property → capital receipt (in substance, for loss of a source of income) VERIFY.

1.4 Contingent assets and contingent liabilities

Liability – a present obligation from past events, settlement expected to result in an outflow of resources.
Provision – a liability that can be measured only by using a substantial degree of estimation (AS 29).

Contingent liability – (a) a possible obligation arising from past events whose existence will be confirmed only by uncertain future events not wholly within the control of the entity; or (b) a present obligation not recognised because an outflow is not probable or the amount cannot be measured reliably.

Contingent asset – a possible asset from past events, existence confirmed only by uncertain future events.

Item	Recognise in books?	Disclose?
Provision (probable outflow, reliable estimate)	**Yes**	Yes
Contingent liability	**No**	Yes – in notes (unless remote)
Contingent asset	**No**	Not in financial statements (may be in the Board's report)

Examples of contingent liabilities: claims against the company not acknowledged as debt, guarantees given, bills discounted but not yet matured, disputed tax demands under appeal, uncalled liability on partly paid shares.

REMEMBER **Liability vs contingent liability: a liability is a present obligation that is certain and recorded; a contingent liability is possible / uncertain and only disclosed.**

1.5 Accounting policies

Accounting policies are the specific accounting principles and the methods of applying them adopted by an enterprise in preparing and presenting financial statements (e.g., method of depreciation, valuation of inventories – FIFO/weighted average, treatment of goodwill, valuation of investments, recognition of revenue).

Selection of policies – the major considerations are **prudence, substance over form and materiality**, so that the statements show a true and fair view.

When can a policy be changed? Only if the change is required by (1) **statute**, (2) an **accounting standard**, or (3) it results in a **more appropriate presentation** of the financial statements. Disclose the change and its effect (with amount, if ascertainable).

Accounting policy vs accounting estimate: a change in the **method** of depreciation is treated as a **change in estimate** under AS 10 (revised) and applied prospectively; change from FIFO to weighted average for inventory is a **change in policy**.

EXAM TIP **A favourite question: "Define accounting policy; when can it be changed?" – learn the 3 conditions and 3 selection considerations word-perfect.**

1.6 Accounting as a measurement discipline – valuation principles, estimates

Accounting **measures** business events in money. Three elements of measurement: **identification** of objects/events, selection of a **standard or scale** (money), and **quantification** (valuation).

Generally accepted valuation principles (bases):

Basis	Meaning (assets)	Meaning (liabilities)
Historical cost	Cash paid / fair value of consideration at acquisition	Proceeds received in exchange for the obligation
Current cost	Cash needed to acquire the same or equivalent asset **now**	Undiscounted cash needed to settle the obligation now
Realisable (settlement) value	Cash that could be obtained now by selling the asset in an orderly disposal	Undiscounted cash expected to settle the liability in the normal course
Present value	Discounted future net cash inflows the asset will generate	Discounted future net cash outflows to settle

Accounting estimates: many items cannot be measured precisely – useful life and residual value of assets, provision for doubtful debts, NRV of inventory, warranty provisions, provision for tax. Estimates must be reasonable and revised when circumstances change; revision is **prospective** (current and future periods).

WORKED EXAMPLE **Valuation bases**

A machine bought 3 years ago for ₹10 lakh (historical cost) would cost ₹14 lakh today (current cost), could be sold for ₹6 lakh (realisable value), and will generate future cash flows whose discounted value is ₹8 lakh (present value).

1.7 Accounting standards – concepts and objectives

Accounting Standards (AS) are written policy documents issued by an expert accounting body (ICAI, through its **Accounting Standards Board – ASB**, set up in 1977) and notified by the Government, covering recognition, measurement, presentation and disclosure of transactions in financial statements.

Objectives: to harmonise diverse accounting policies, reduce alternatives, improve comparability and reliability, and help users understand financial statements.

Advantages: reduces variations in treatment; ensures disclosures beyond law; facilitates comparison between firms and over time; improves credibility.

Limitations: reduce flexibility (rigidity); choosing among alternatives is still difficult; cannot override the statute (law prevails).

Procedure for issuing an AS (standard setter): identify area → study group → exposure draft → comments from public and bodies → revised draft considered by ASB → Council of ICAI approves → for companies, notified by Central Government (in consultation with NFRA) under Section 133 of the Companies Act, 2013.

Ind AS: Indian Accounting Standards converged with **IFRS**, notified under the Companies (Indian Accounting Standards) Rules, 2015 – mandatory for listed companies and unlisted companies with net worth ≥ ₹250 crore (phased roadmap from 2016-17) and optional for others. Other companies follow AS notified under the Companies (Accounting Standards) Rules, 2021.

AS no.	Title
AS 1	Disclosure of Accounting Policies
AS 2	Valuation of Inventories
AS 3	Cash Flow Statements
AS 4	Contingencies and Events after the Balance Sheet Date
AS 5	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

AS no.	Title
AS 9	Revenue Recognition
AS 10	Property, Plant and Equipment
AS 13	Accounting for Investments
AS 26	Intangible Assets
AS 29	Provisions, Contingent Liabilities and Contingent Assets

1.8 The four frameworks of accounting

Framework	Meaning
Conceptual	The concepts, conventions and principles (going concern, accrual, consistency, prudence, materiality) and the Framework for Preparation and Presentation of Financial Statements
Legal	Laws governing accounts – Companies Act, 2013 (s. 128–138, Schedule III), Income-tax Act, LLP Act, Banking Regulation Act, Insurance Act
Institutional	Professional bodies and standard setters – ICAI, ICMAI, NFRA, the Accounting Standards Board
Regulatory	Regulators that prescribe or enforce accounting and disclosure – MCA (Companies (AS) Rules, Ind AS Rules), SEBI (LODR), RBI, IRDAI

1.9 Provisions for bad and doubtful debts and discounts

- **Bad debts** written off are debited to P&L. **Provision for doubtful debts** (PDD) is created on debtors **after** deducting bad debts written off.
- **Provision for discount on debtors** is calculated on debtors **after deducting bad debts and the new PDD** (good debtors only).
- **Provision for discount on creditors** (reserve for discount on creditors) is credited to P&L – it is against the prudence concept, so it is rarely made.
- P&L charge = bad debts + new provision − old provision (if old provision exceeds, the excess is credited).

WORKED EXAMPLE Provisions (verified)

Debtors after writing off bad debts ₹80,000. PDD 5% = **₹4,000**. Provision for discount 2% on (80,000 − 4,000) = **₹1,520**. Debtors in the balance sheet = 80,000 − 4,000 − 1,520 = **₹74,480**.

Chapter 2: Accounting Cycle, Journal, Ledger, Trial Balance and Rectification

2.1 Transactions, events and vouchers

A **transaction** is an exchange of value measurable in money (sale, purchase, payment). An **event** is a happening that may or may not be a transaction (e.g., loss by fire is an event that affects accounts). Every entry must be supported by a **voucher** (cash memo, invoice, receipt, debit/credit note).

2.2 Double entry and rules of debit and credit

Every transaction has two aspects of **equal amount** – one account is debited and another credited. Developed by Luca Pacioli (1494).

Traditional (English) approach	Rule
Personal account (persons, firms, companies, banks; also representative personal – outstanding/prepaid)	Debit the **receiver**, credit the **giver**
Real account (assets – cash, machinery, goods, goodwill)	Debit **what comes in**, credit **what goes out**
Nominal account (expenses, losses, incomes, gains)	Debit all **expenses and losses**, credit all **incomes and gains**

Modern (accounting equation) approach	Increase	Decrease
Assets	Debit	Credit
Expenses / losses	Debit	Credit
Liabilities	Credit	Debit
Capital	Credit	Debit
Revenue / gains	Credit	Debit

EXAM TIP **"DEAD CLIC" – Debit: Expenses, Assets, Drawings; Credit: Liabilities, Income, Capital (for increases).**

2.3 Journal – book of original entry

Each transaction is first recorded in the **journal** in date order: Date | Particulars | L.F. | Debit ₹ | Credit ₹, followed by a **narration**.

WORKED EXAMPLE **Journal entries (selected)**

(1) Started business with cash ₹50,000 and furniture ₹20,000: Cash A/c Dr 50,000; Furniture A/c Dr 20,000; To Capital A/c 70,000.

(2) Goods sold to Mohan ₹12,000 at 10% trade discount, terms 2% cash discount if paid within 7 days: Mohan A/c Dr 10,800; To Sales A/c 10,800 (trade discount is never recorded).

(3) Mohan pays within 7 days: Cash A/c Dr 10,584; Discount Allowed A/c Dr 216; To Mohan A/c 10,800.

(4) Goods withdrawn by owner for personal use ₹3,000 (cost): Drawings A/c Dr 3,000; To Purchases A/c 3,000.

(5) Goods distributed as free samples ₹1,500: Advertisement A/c Dr 1,500; To Purchases A/c 1,500.

(6) Goods lost by fire ₹8,000, insurance claim admitted ₹6,000: Loss by Fire A/c Dr 2,000; Insurance Claim A/c Dr 6,000; To Purchases A/c 8,000.

(7) Bad debt recovered ₹900 (written off last year): Cash A/c Dr 900; To Bad Debts Recovered A/c 900.

REMEMBER **Trade discount is deducted on the invoice and not recorded; cash discount is recorded (discount allowed = expense, discount received = income).**

Subsidiary books (special journals): Cash book, Purchases book, Sales book, Purchases returns (returns outward) book, Sales returns (returns inward) book, Bills receivable book, Bills payable book, and the **Journal proper** (opening and closing entries, adjustments, rectification, credit purchase of assets).

GST in journal entries (examiner's favourite)

When goods are bought or sold with GST, record the tax separately. Intra-state = **CGST + SGST**; inter-state = **IGST**.

```
Purchased goods ₹1,50,000 less 10% trade discount, CGST & SGST 6% each, on credit from Sonu:
  Purchases A/c                Dr  1,35,000
  Input CGST A/c               Dr      8,100
  Input SGST A/c               Dr      8,100
      To Sonu                                  1,51,200
  (Being goods purchased on credit; trade discount 10% deducted; GST @12%)
Sold goods ₹80,000 to Kiran (inter-state), IGST 18%, cash received:
  Cash A/c                     Dr     94,400
      To Sales A/c                              80,000
      To Output IGST A/c                        14,400
```

COMMON MISTAKE **Writing "CGST A/c" without "Input" on purchases, or "Output" on purchases – examiners cut marks for this. Input = asset (credit available); Output = liability.**

REMEMBER **GST is charged on the price after trade discount. Cash discount offered for prompt payment is ignored while computing GST at invoicing (unless stated otherwise).**

2.4 Ledger – posting and balancing

The ledger is the **principal book** in which all accounts are kept. Journal entries are **posted** to the respective accounts. Each account is balanced at the end of the period:

- Debit side larger → **debit balance** (assets, expenses, drawings, debtors).
- Credit side larger → **credit balance** (liabilities, capital, incomes, creditors).
- Nominal accounts are closed by transfer to the Trading or Profit & Loss Account; real and personal accounts are carried forward (balance c/d, b/d).

Rules of posting from the journal: (1) open a separate account for each item; (2) the account debited in the journal is debited in the ledger with the **name of the other account** ("To ..." on the debit side, "By ..." on the credit side); (3) write the date, journal folio and amount; (4) balance accounts at period end – "To Balance c/d" / "By Balance b/d".

2.5 Trial balance

A **statement** (not an account) listing the debit and credit balances of all ledger accounts on a date, to check the **arithmetical accuracy** of posting.

Errors NOT revealed by a trial balance:

1. **Errors of omission** – a transaction completely omitted.
2. **Errors of commission** that affect both sides equally (e.g. wrong amount in the journal itself).
3. **Errors of principle** – capital vs revenue confusion (repair debited to Machinery A/c).
4. **Compensating errors** – one error cancels another.
5. Posting to the **wrong account on the correct side** (e.g. Ram's account instead of Rahim's).

Errors revealed: posting to the wrong side, wrong totalling or balancing, posting one side only, wrong amount in posting, omission of a balance from the trial balance.

COMMON MISTAKE **"Agreement of trial balance proves the accounts are correct" – wrong. It is only proof of arithmetical accuracy.**

Methods of preparing a trial balance: (1) **Balance method** (most common – only balances), (2) **Total (gross) method** – totals of both sides of each account, (3) **compound** method (both).

Suspense account: if the trial balance does not agree and the books must be closed, the difference is placed in a **Suspense A/c** temporarily until errors are located.

2.6 Subsidiary books (special journals)

Recording every transaction in one journal is slow. Transactions of the same nature are recorded in **subsidiary books**; totals are posted periodically.

Book	What is recorded	Posting
Purchases book	Only **credit purchases of goods** (meant for resale)	Each supplier credited; monthly total debited to Purchases A/c
Sales book	Only **credit sales of goods**	Each customer debited; total credited to Sales A/c
Purchases returns (returns outward) book	Goods returned to suppliers – supported by **debit notes**	Suppliers debited; total credited to Purchases Returns A/c
Sales returns (returns inward) book	Goods returned by customers – supported by **credit notes**	Customers credited; total debited to Sales Returns A/c
Bills receivable book	Bills received from debtors	Customers credited; total debited to B/R A/c
Bills payable book	Bills accepted in favour of creditors	Creditors debited; total credited to B/P A/c
Cash book	All cash (and bank) receipts and payments	Acts as both journal and ledger
Journal proper	Opening, closing, adjustment, rectification, transfer entries, credit purchase/sale of assets, entries not fitting elsewhere	Individual posting

Advantages of subsidiary books: division of work, saving of time, specialisation and efficiency, easy reference, better internal control and fewer errors, quick information (e.g., total credit sales).

Format of a purchases book (columns): Date | Name of supplier & particulars (items, qty × rate, less trade discount, add packing/GST) | Invoice no. | L.F. | Details ₹ | Amount ₹.

WORKED EXAMPLE Purchases book (exam style)

2 Dec: from Gupta & Co.: 100 plates @ ₹150 = 15,000; 500 bowls @ ₹50 = 25,000; total 40,000; less trade discount 10% = 4,000 → 36,000; add packing ₹2 per plate + ₹1 per bowl = 200 + 500 = 700 → **₹36,700**.

8 Dec: from Ajanta & Co.: 200 boxes of spoons @ ₹50 = 10,000; 40 boxes of forks @ ₹250 = 10,000; total 20,000; less 8% = 1,600 → **₹18,400**.

Total of purchases book posted to Purchases A/c (Dr) = ₹55,100 (+ further entries). Cash purchases and purchase of assets (e.g., a computer for office) are **not** entered in the purchases book.

COMMON MISTAKE **Entering a credit purchase of furniture/machinery in the purchases book – it goes to the journal proper. Similarly, packing charges added on the invoice are part of the purchase amount.**

2.7 Cash book

The cash book is both a **book of original entry** and a **ledger account** (Cash A/c / Bank A/c). Debit = receipts, credit = payments.

Type	Columns	Note
Simple cash book	Cash only	Like a cash account
Two-column cash book	Cash + Bank (or Cash + Discount)	Contra entries marked "C"
Three-column cash book	Discount + Cash + Bank	Discount columns are **not balanced**; their totals go to Discount Allowed (Dr) and Discount Received (Cr)

Type	Columns	Note
Petty cash book	Small expenses; **imprest system** – petty cashier gets a fixed float, reimbursed periodically for the amount spent	Analytical columns: postage, stationery, travelling, sundries

Contra entry: a transaction affecting both cash and bank columns (cash deposited into bank, cash withdrawn from bank for office use) – recorded on both sides with "C" in L.F.; no ledger posting needed.

WORKED EXAMPLE Three-column cash book items

(1) Received a cheque from Raman ₹9,800 in full settlement of ₹10,000 and deposited the same day → Bank column Dr 9,800; Discount (Dr side) 200.

(2) Paid Shyam by cheque ₹4,900, discount received ₹100 → Bank column Cr 4,900; Discount (Cr side) 100.

(3) Withdrew ₹5,000 from bank for office use → Cash Dr 5,000 / Bank Cr 5,000 (contra "C").

(4) A cheque received earlier from Raman ₹9,800 is dishonoured → Bank Cr 9,800; Raman is debited ₹10,000 and the discount of ₹200 is cancelled (Discount Allowed credited).

EXAM TIP **Bank column can have a credit balance (overdraft); the cash column can never have a credit balance.**

2.8 Rectification of errors

Classification of errors:

- **Clerical errors:** errors of omission (complete or partial), commission (wrong amount, wrong account, wrong side, wrong totalling), compensating.
- **Errors of principle:** violation of accounting principles (capital ↔ revenue).

Rectification before preparing the trial balance:

- One-sided errors → corrected by a note/entry in the affected account (no journal).
- Two-sided errors → journal entry.

Rectification after the trial balance (when the difference has been put in a Suspense A/c):

- Every error is rectified by a journal entry; the one-sided part goes to **Suspense A/c**.

Rectification in the next accounting year: errors affecting nominal accounts are rectified through **Profit and Loss Adjustment A/c** (prior-period item).

WORKED EXAMPLE Rectification with Suspense A/c

The trial balance does not agree; the debit side is short by ₹540, so Suspense A/c is **debited** ₹540 to make it agree. Errors found later:

(a) Sales book overcast by ₹500 → Sales A/c Dr 500; To Suspense 500.

(b) Purchase of furniture ₹2,000 entered in Purchases book → Furniture A/c Dr 2,000; To Purchases A/c 2,000 (no suspense – both sides affected).

(c) Credit sale to Amit ₹820 posted to Amit's account as ₹280 → Amit A/c Dr 540; To Suspense 540.

(d) Discount received ₹100 not posted to Discount A/c → Suspense Dr 100; To Discount Received 100.

(e) Return inward ₹200 from Bimal posted to the debit of Bimal's account → Suspense Dr 400; To Bimal 400.

Suspense A/c: Dr – balance b/d 540, Discount received 100, Bimal 400 = 1,040. Cr – Sales 500, Amit 540 = 1,040. Suspense closes to **nil** ✔ – all errors found.

EXAM TIP **For each error, write "what was done" and "what should have been done", then the rectifying entry is just the difference. This avoids confusion with sides.**

Rectification in the next accounting year (P&L Adjustment A/c)

If errors of the previous year are found after the final accounts are closed, nominal-account corrections are made through **Profit and Loss Adjustment A/c**; real and personal accounts are corrected directly. The balance of P&L Adjustment A/c is transferred to **Capital A/c** (sole proprietor) – students often forget this transfer.

WORKED EXAMPLE **Next-year rectification**

In 2024-25 the **debit** side of the TB was short by ₹1,560, so Suspense A/c was **debited** ₹1,560 and the accounts were closed. In 2025-26 these errors were found: (a) sales book **overcast** by ₹1,000; (b) purchase of machinery ₹2,500 debited to Purchases A/c; (c) ₹280 paid to Ravi (creditor) was posted to the **credit** of his account.

(a) P&L Adjustment A/c Dr 1,000; To Suspense A/c 1,000 (last year's sales and profit were overstated).

(b) Machinery A/c Dr 2,500; To P&L Adjustment A/c 2,500 (last year's purchases overstated → profit understated).

(c) Ravi A/c Dr 560; To Suspense A/c 560 (cancel wrong credit 280 + give correct debit 280).

Suspense A/c: Dr balance b/d 1,560 = Cr 1,000 + 560 → **closes** ✔.

P&L Adjustment A/c: Cr 2,500 − Dr 1,000 = **credit ₹1,500** (net prior-period profit) → P&L Adjustment A/c Dr 1,500; To Capital A/c 1,500.

EXAM TIP **Always draw the Suspense A/c after rectification – if it does not close to nil, re-check the side of each one-sided error.**

Chapter 3: Cash Book, Bank Book and Bank Reconciliation Statement

3.1 Meaning and need

A business records its bank transactions in the **bank column of the cash book**; the bank records them in the customer's account and sends a **pass book / bank statement**. On a given date the two balances often differ. A **Bank Reconciliation Statement (BRS)** is a statement prepared to reconcile (explain) the difference and to check the accuracy of both records. It is **not an account** and no entry is posted from it.

Customer's cash book	Bank's pass book
Deposits are **debited** (bank owes us)	Deposits are **credited** (bank owes customer)
Favourable balance = **debit** balance	Favourable balance = **credit** balance
Overdraft = **credit** balance	Overdraft = **debit** balance

3.2 Causes of difference

A. Timing differences

1. Cheques **issued but not yet presented** for payment.
2. Cheques **deposited but not yet collected / credited** by the bank.

B. Items recorded by the bank but not yet in the cash book (known only on receiving the statement)

3. Bank charges, interest on overdraft, commission → debited in pass book.
4. Interest on deposits, dividends collected by bank, direct deposits (NEFT/UPI) by customers → credited in pass book.
5. Direct payments by bank under standing instructions (insurance premium, EMI, electricity bill).
6. Cheques deposited but **dishonoured**.

C. Errors – in the cash book (wrong amount, wrong side, wrong totalling) or by the bank (wrong debit/credit to our account).

3.3 Methods of preparing BRS

1. **Without amending the cash book:** start with either balance, add / subtract each item.
2. **Amended cash book method** (preferred by examiners when items of type B are many): first correct the cash book for all items recorded only by the bank (B and cash-book errors); then prepare the BRS from the **amended balance** with only timing differences and bank errors.

Starting point: Cash book debit balance (favourable)	Effect
Cheques issued but not presented	**Add**
Interest / dividend credited by bank, direct deposits not in cash book	**Add**
Cheques deposited but not credited	**Less**
Bank charges, direct payments, dishonoured cheques not in cash book	**Less**
Result	Balance as per **pass book** (credit)

MEMORY TRICK **"Start → ask: did this item make the pass book balance higher than the cash book? If yes – add." Works for every item, every starting point.**

3.4 Worked example

WORKED EXAMPLE **BRS with amended cash book**

Bank column of the cash book of M/s Rao showed a **debit balance of ₹45,000** on 31 March 2026. On comparison with the bank statement:

(i) Cheques issued ₹12,000 not yet presented. (ii) Cheques ₹8,500 deposited but not yet credited. (iii) Bank charges ₹300 not in cash book. (iv) Interest ₹900 credited by the bank. (v) A customer deposited ₹4,000 directly. (vi) A cheque of ₹2,000 deposited earlier was dishonoured – not recorded.

Amended cash book: 45,000 − 300 + 900 + 4,000 − 2,000 = **₹47,600 (Dr)**.

BRS as on 31 March 2026: Balance as per amended cash book 47,600; add cheques issued not presented 12,000 = 59,600; less cheques deposited not credited 8,500 → **Balance as per pass book ₹51,100 (Cr)**.

Check without amendment: 45,000 + 12,000 − 8,500 − 300 + 900 + 4,000 − 2,000 = 51,100 ✔.

3.5 Overdraft situations

If the cash book shows a **credit** balance (overdraft) of, say, ₹20,000, treat it as **negative**: start with (20,000) and apply the same add/less logic; the answer will be the overdraft as per pass book (a debit balance). Write "Overdraft as per pass book" in the final line.

COMMON MISTAKE **Adding "cheques issued but not presented" when starting from an overdraft as per pass book – the logic flips. Always convert overdraft to a negative number and use the same table.**

EXAM TIP **BRS appears in almost every CMA Inter FA paper (Q2). Show the amended cash book in "T" form, then the BRS in statement form.**

Chapter 4: Depreciation and Amortisation

4.1 Tangible vs intangible assets

Tangible assets (Property, Plant & Equipment – AS 10) have physical existence (land, buildings, machinery, vehicles). **Intangible assets** (AS 26) are identifiable non-monetary assets without physical substance (patents, copyrights, software, trademarks, licences). The systematic allocation of cost is called **depreciation** for tangible assets and **amortisation** for intangibles; for natural resources it is **depletion**.

Point	Tangible	Intangible
Existence	Physical	No physical substance
Allocation	Depreciation	Amortisation
Standard	AS 10	AS 26 (rebuttable presumption: useful life ≤ 10 years from available-for-use date)
Examples	Plant, furniture	Patent, software

Depreciation is the **systematic allocation of the depreciable amount of an asset over its useful life**. Depreciable amount = Cost – Residual value.

Causes: wear and tear by use, passage of time, obsolescence (new technology), depletion (mines, oil wells), accidents.

Objectives: matching cost with revenue, showing the true value of assets, providing funds for replacement, correct tax computation.

Point	Straight-line method (SLM)	Written-down value method (WDV)
Base	Original cost (depreciable amount)	Book value at the start of each year
Annual charge	Same every year	Decreases every year
Asset value	Can become zero	Never becomes zero
Suitable for	Assets with uniform use – furniture, leasehold	Assets with higher repairs later – plant, vehicles
Tax	–	Income-tax Act uses WDV on block of assets

SLM formula: Depreciation = (Cost – Residual value) ÷ Useful life. **Rate** = Annual depreciation ÷ Cost × 100.

WDV rate formula: r = 1 – (Residual value ÷ Cost)^(1/n).

Units of production method: Depreciation per unit = (Cost – Residual value) ÷ Total estimated units; charge = units produced × rate.

Sum-of-years'-digits: charge for a year = Depreciable amount × remaining life ÷ sum of years' digits.

WORKED EXAMPLE SLM and WDV compared

Machine bought 1 April 2023 for ₹1,00,000 + installation ₹10,000. Residual value ₹10,000, life 5 years. WDV rate 20%.

SLM: (1,10,000 – 10,000)/5 = **₹20,000 every year**.

WDV: Year 1 = 1,10,000 × 20% = 22,000 (book value 88,000); Year 2 = 17,600 (70,400); Year 3 = 14,080 (56,320).

WORKED EXAMPLE Sale of an asset and profit/loss

Machine cost ₹60,000 on 1 April 2023, SLM 10% p.a. Sold on 30 September 2025 for ₹42,000. Books closed 31 March.

Depreciation 2023-24: 6,000; 2024-25: 6,000; 2025-26 (6 months): 3,000. Total 15,000.

Book value on sale = 60,000 – 15,000 = 45,000. Sale ₹42,000 → **loss on sale ₹3,000** (debited to P&L).

Two ways of recording depreciation:

1. Charging to the asset account (Depreciation A/c Dr; To Asset A/c).

2. Creating a **provision for depreciation / accumulated depreciation** account (Depreciation A/c Dr; To Provision for Depreciation A/c) – the asset stays at original cost.

REMEMBER **Change in method of depreciation is a change in accounting estimate under AS 10 – applied prospectively (from the current year), not retrospectively.**

4.2 Factors in measuring depreciation

(1) **Cost** of the asset (purchase price + duties + non-refundable taxes + directly attributable costs – site preparation, freight, installation, professional fees; less trade discounts), (2) **useful life**, (3) **residual value**. Land usually has an unlimited life and is not depreciated.

4.3 Part disposal with WDV (frequent exam question)

WORKED EXAMPLE **Part sale of machinery**

On 1 April 2024 Machinery A/c showed ₹4,86,000 (WDV, 10% p.a.). This includes a machine bought on 1 April 2022 for ₹1,00,000, which was sold on 1 October 2024 for ₹60,000. Books closed on 31 March.

Book value of sold machine on 1 April 2024 = 1,00,000 × 0.9 × 0.9 = **₹81,000**.

Depreciation for 6 months on it = 81,000 × 10% × 6/12 = ₹4,050 → book value on sale ₹76,950 → **loss on sale ₹16,950**.

Depreciation on the remaining machinery = (4,86,000 − 81,000) × 10% = ₹40,500. Total depreciation for 2024-25 = 4,050 + 40,500 = **₹44,550**.

Balance on 31 March 2025 = 4,05,000 − 40,500 = **₹3,64,500**.

Machinery A/c: Dr Balance b/d 4,86,000. Cr Bank 60,000; Depreciation 44,550; P&L (loss) 16,950; Balance c/d 3,64,500. Total 4,86,000 ✔.

4.4 Change in depreciation method

Under AS 10, the depreciation method must be reviewed at least at each financial year-end; a change (e.g., WDV → SLM) is a **change in accounting estimate** – applied **prospectively**: the carrying amount on the date of change is depreciated over the remaining useful life by the new method. No retrospective adjustment.

WORKED EXAMPLE **WDV to SLM**

Machine cost ₹5,00,000 on 1 April 2023, WDV @ 20%. From 1 April 2025 the company switches to SLM; remaining useful life 4 years, nil residual value.

Carrying amount on 1 April 2025 = 5,00,000 × 0.8 × 0.8 = ₹3,20,000. SLM charge from 2025-26 = 3,20,000 ÷ 4 = **₹80,000 per year**.

REMEMBER **Old textbooks (old AS 6) required retrospective recomputation. That is no longer applicable. Mention "AS 10 – prospective" in your answer.**

4.5 Amortisation of intangibles

Intangibles with a finite life are amortised on a systematic basis (usually SLM) over the best estimate of useful life; the method should reflect the pattern of economic benefits. Example: software costing ₹6,00,000 with a useful life of 3 years → ₹2,00,000 amortisation per year.

EXAM TIP **Depreciation must be charged even in a loss year – it is a charge against profit, not an appropriation.**

Chapter 5: Bills of Exchange including Accommodation Bills

5.1 Meaning

Bill of exchange (Section 5, Negotiable Instruments Act, 1881): an instrument in writing containing an **unconditional order**, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer.

Promissory note (Section 4): an instrument in writing (not a bank note or currency note) containing an **unconditional undertaking**, signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person or to the bearer.

Point	Bill of exchange	Promissory note
Nature	Order to pay	Promise to pay
Parties	Three – drawer, drawee (acceptor), payee	Two – maker, payee
Acceptance	Needed	Not needed
Drawn by	Creditor	Debtor
Noting / protest on dishonour	Required for foreign bills	Not required

Parties: Drawer (creditor who draws), Drawee (debtor who accepts – then called acceptor), Payee (who receives payment – may be the drawer or a third party), Endorser / endorsee.

5.2 Term, due date and days of grace

- **Term** = period after which payment is due (e.g., 3 months after date).
- **Days of grace: 3 days** are added to the nominal due date (except bills payable on demand / at sight).
- If the due date falls on a **public holiday**, the bill is due on the **preceding** business day; if an emergency holiday is declared under the NI Act, the next working day VERIFY.

WORKED EXAMPLE Due date

Bill dated 1 January 2026, payable 3 months after date → nominal due date 1 April 2026 + 3 days of grace = **4 April 2026**. A bill dated 31 January for one month → 28 February (last day of the month) + 3 = **3 March**.

5.3 Options with the drawer (holder)

1. **Retain** till maturity and present for payment.
2. **Discount** with the bank (bank deducts discount = Bill amount × rate × unexpired period).
3. **Endorse** to a creditor.
4. **Send to bank for collection.**

Event	Drawer's books (B/R)	Drawee's books (B/P)
Bill accepted	B/R Dr; To Drawee	Drawer Dr; To B/P
Discounted	Bank Dr, Discount Dr; To B/R	–
Endorsed to creditor X	X Dr; To B/R	–
Sent for collection	Bills for Collection Dr; To B/R	–
Honoured (retained)	Bank Dr; To B/R	B/P Dr; To Bank
Dishonoured (retained)	Drawee Dr; To B/R; Drawee Dr; To Bank (noting charges)	B/P Dr; To Drawer; Noting charges Dr; To Drawer
Dishonoured (discounted)	Drawee Dr; To Bank (amount + noting)	same as above
Dishonoured (endorsed)	Drawee Dr; To X (amount + noting)	same as above
Retired under rebate	Bank Dr, Rebate Dr; To B/R	B/P Dr; To Bank, To Rebate

Event	Drawer's books (B/R)	Drawee's books (B/P)
Renewal	Cancel old: Drawee Dr; To B/R; interest: Drawee Dr; To Interest; new: B/R Dr; To Drawee	Mirror
Insolvency of acceptor	Drawee Dr; To B/R ...; later Bank (dividend) + Bad debts Dr; To Drawee	Drawer Dr; To Deficiency / Capital (on settlement)

WORKED EXAMPLE **Discounting, dishonour and renewal**

Amit drew a bill on Bina for ₹40,000 for 3 months on 1 January 2026; Bina accepted. Amit discounted it at 12% p.a. On maturity it was dishonoured; noting charges ₹200. Bina paid ₹10,200 in cash and accepted a new bill for the balance with interest at 12% p.a. for 2 months.

Discount = 40,000 × 12% × 3/12 = ₹1,200. Interest on renewal = 30,000 × 12% × 2/12 = ₹600. New bill = **₹30,600**.

Amit's journal: (1) B/R Dr 40,000; To Bina 40,000. (2) Bank Dr 38,800; Discount on Bills Dr 1,200; To B/R 40,000. (3) Bina Dr 40,200; To Bank 40,200. (4) Cash Dr 10,200; To Bina 10,200. (5) Bina Dr 600; To Interest 600. (6) B/R Dr 30,600; To Bina 30,600.

Bina's account in Amit's books: Dr 40,000 + 40,200 + 600 = 80,800; Cr 40,000 + 10,200 + 30,600 = 80,800 ✔.

5.4 Accommodation bills

Bills drawn and accepted **without any trade transaction**, only to help each other raise funds (by discounting). The proceeds are shared in an agreed ratio; **discount is shared in the same ratio**; at maturity each party remits his share to the acceptor, who honours the bill.

WORKED EXAMPLE **Accommodation bill**

For mutual accommodation, Aman drew a bill of ₹30,000 on Gagan for 3 months; Gagan accepted. Aman discounted it for ₹29,400 and sent half the proceeds (₹14,700) to Gagan. Each bears discount of ₹300. Before maturity, Aman remits ₹15,000 to Gagan, who meets the bill. Net effect: each used ₹14,700 and paid ₹15,000 – the ₹300 difference is each one's share of discount.

EXAM TIP **Accommodation bills with insolvency are a regular Q3 item. Write entries in both books if asked, and always show the computation of due date, discount and interest.**

Chapter 6: Consignment and Joint Venture

6.1 Consignment

A **consignment** is an arrangement where a **consignor** (owner) sends goods to a **consignee** (agent) who sells them on behalf of the consignor for a **commission**. Ownership remains with the consignor until sale – it is **not a sale**.

Point	Consignment	Sale
Ownership	Remains with consignor	Passes to buyer
Relationship	Principal and agent	Seller and buyer
Risk	Consignor's	Buyer's (after sale)
Unsold goods	Can be returned	Cannot be returned (normally)
Document	**Proforma invoice** and **account sales**	Invoice

Types of commission:

- **Ordinary commission** – on total sales.
- **Del credere commission** – extra commission to the consignee for bearing the risk of **bad debts** on credit sales (so bad debts are borne by the consignee).
- **Over-riding commission** – extra commission for selling above a fixed price or for promoting a new product.

Value of unsold stock = **Cost price of goods + proportionate non-recurring expenses incurred up to the consignee's godown** (consignor's freight, insurance, loading, unloading and the consignee's freight/octroi/landing charges). **Recurring expenses** (godown rent, selling expenses, insurance of godown) are **not** added.

WORKED EXAMPLE Consignment account

Mr A of Kolkata consigned 1,000 units at cost ₹100 each to B of Patna. A paid freight ₹5,000. B paid unloading and octroi ₹3,000 and godown rent ₹2,000. B sold 800 units at ₹150 each. Commission 5% on sales + 2% del credere.

Non-recurring expenses = 5,000 + 3,000 = 8,000. Value of unsold stock (200 units) = 200 × 100 + 8,000 × 200/1,000 = 20,000 + 1,600 = **₹21,600**.

Commission = 1,20,000 × 7% = 8,400.

Consignment A/c: Dr – Goods sent on consignment 1,00,000; Cash (freight) 5,000; B (unloading, octroi and godown rent) 5,000; B (commission) 8,400 → total 1,18,400. Cr – B (sales) 1,20,000; Stock on consignment 21,600 → total 1,41,600.

Profit on consignment = 1,41,600 − 1,18,400 = ₹23,200 (transferred to P&L A/c).

Check: sales 1,20,000 − cost of 800 units 80,000 − non-recurring expenses on sold units (8,000 × 800/1,000) 6,400 − godown rent 2,000 − commission 8,400 = **₹23,200** ✔.

Sometimes goods are sent at a price **above cost** (invoice price) to keep the cost secret from the consignee. The **loading** (excess of invoice price over cost) must be removed through a **Stock Reserve / Consignment Stock Reserve** entry:

- On goods sent: Consignment A/c Dr; To Goods Sent on Consignment A/c (at invoice price) – then Goods Sent on Consignment A/c Dr; To Consignment A/c (loading).
- On unsold stock: Consignment A/c Dr (loading on closing stock) and carry stock in the balance sheet at cost.

FORMULA **Loading on invoice price = Invoice price × Loading% on cost ÷ (100 + Loading% on cost). Example: invoiced at cost + 25%, invoice value ₹1,25,000 → loading = 1,25,000 × 25/125 = ₹25,000.**

Loss caused by accident, theft or fire. Value it like unsold stock (cost + proportionate non-recurring expenses up to that point) and credit Consignment A/c; debit Insurance Claim (amount admitted) and P&L (balance). **Normal loss** (evaporation, drying) is not separately recorded – it is spread over the good units by increasing the cost per unit of remaining stock.

WORKED EXAMPLE **Stock on consignment at cost and at invoice price**

1,000 statues at cost ₹800, invoice price ₹1,000; consignor's freight ₹10,000; 900 sold; consignee's selling expenses ₹9,000 (non-recurring for stock). Closing stock 100 units: at **cost** = 100 × (800 + 10) = ₹81,000; at **invoice price** = 100 × 1,000 + 100 × 10 = **₹1,01,000** (stock reserve 20,000 eliminated). Selling expenses are **not** added to stock.

REMEMBER **Del credere commission** is paid to the consignee for bearing the risk of bad debts – then the consignee maintains the **consignment debtors account** and bad debts are his loss.

6.2 Joint venture

- A **joint venture** is a temporary partnership of two or more persons (co-venturers) for a specific purpose, without a firm name; it ends when the venture is complete. The **Indian Partnership Act** applies in general.

Method	Accounts opened
Separate set of books	**Joint Venture A/c, Joint Bank A/c and Co-venturers' Personal A/cs**
Each co-venturer keeps records of all transactions	Joint Venture with B A/c (in A's books) and vice versa
Each co-venturer records only his own transactions	**Memorandum Joint Venture A/c** + Joint Venture with co-venturer A/c

WORKED EXAMPLE **Goods taken over by a co-venturer**

A purchased goods ₹85,000. B sold goods costing ₹80,000 for ₹1,00,000 (profit 25% on cost). Unsold goods at cost = ₹5,000 taken over by A at the same profit % → 5,000 × 1.25 = **₹6,250**.

Chapter 7: Final Accounts of Commercial Organisations (Non-corporate)

7.1 Elements of financial statements

Element	Meaning
Asset	Resource controlled by the enterprise from past events, expected to give future economic benefits
Liability	Present obligation from past events, settlement expected to cause an outflow of resources
Equity (capital)	Residual interest in assets after deducting liabilities
Income	Increase in economic benefits (inflows / increase in assets / decrease in liabilities) other than capital contributions
Expense	Decrease in economic benefits other than distributions to owners

At the end of the year, a trader prepares (1) **Manufacturing A/c** (if he manufactures), (2) **Trading A/c** to find **gross profit**, (3) **Profit & Loss A/c** to find **net profit**, and (4) **Balance Sheet** to show the financial position on the last date.

7.2 Closing (adjustment) entries

Adjustment	Entry
Closing stock	Closing Stock A/c Dr; To Trading A/c
Outstanding expense	Expense A/c Dr; To Outstanding Expense A/c
Prepaid expense	Prepaid Expense A/c Dr; To Expense A/c
Accrued income	Accrued Income A/c Dr; To Income A/c
Income received in advance	Income A/c Dr; To Income Received in Advance A/c
Depreciation	Depreciation A/c Dr; To Asset A/c
Interest on capital	Interest on Capital A/c Dr; To Capital A/c
Interest on drawings	Drawings / Capital A/c Dr; To Interest on Drawings A/c
Transfer of expenses	Trading / P&L A/c Dr; To Expense A/cs
Transfer of net profit	P&L A/c Dr; To Capital A/c
Transfer of drawings	Capital A/c Dr; To Drawings A/c

Shows the **cost of goods manufactured (produced)**.

Debit side	Credit side
Opening work-in-progress	Closing work-in-progress
Raw materials consumed (Opening stock + Purchases – Returns – Closing stock + Carriage inward)	Sale of scrap
Direct wages, direct expenses (royalty on production, power and fuel)	**Cost of goods produced** – transferred to Trading A/c
Factory overheads – factory rent, factory lighting, depreciation of plant, repairs of factory, works manager's salary	

Debit side	Credit side
Opening stock	Sales less returns inward
Purchases less returns outward	Closing stock
Direct expenses – carriage inward, freight, wages, customs duty, dock charges, octroi, gas, fuel and power (for a trader)	Gross loss (if any)
Gross profit (transferred to P&L A/c)	

FORMULA **Gross profit = Net sales − Cost of goods sold. COGS = Opening stock + Net purchases + Direct expenses − Closing stock.**

- **Debit:** office and administration expenses (salaries, rent, rates and taxes, printing, postage, telephone, audit fees), selling and distribution expenses (carriage outward, advertisement, commission, bad debts, discount allowed, salesmen's salary), financial expenses (interest on loan, bank charges), depreciation, losses (loss by fire, loss on sale of assets).
- **Credit:** gross profit, discount received, commission received, rent received, interest received, bad debts recovered, profit on sale of assets.
- Balance = **net profit** (added to capital) or **net loss**.

Liabilities	Assets
Capital (opening + net profit + additional capital − drawings)	Goodwill, land and building, plant and machinery, furniture (fixed assets less depreciation)
Long-term loans	Investments
Creditors, bills payable, outstanding expenses, income received in advance, bank overdraft	Closing stock, debtors less provision, bills receivable, prepaid expenses, accrued income, cash at bank, cash in hand

7.3 Adjustments – the scoring area

Adjustment	Effect 1	Effect 2
Closing stock (given outside TB)	Credit Trading A/c	Asset side of Balance Sheet
Outstanding expenses	Add to the expense (Dr side of Trading/P&L)	Liability side
Prepaid expenses	Deduct from the expense	Asset side
Accrued income	Add to the income (Cr P&L)	Asset side
Income received in advance	Deduct from the income	Liability side
Depreciation	Debit P&L	Deduct from the asset
Bad debts (further)	Debit P&L	Deduct from debtors
Provision for doubtful debts	P&L: new bad debts + new provision − old provision	Deduct new provision from debtors (after further bad debts)
Provision for discount on debtors	Debit P&L	Deduct from debtors (after bad debts and doubtful debts provision)
Interest on capital	Debit P&L	Add to capital
Interest on drawings	Credit P&L	Deduct from capital
Goods taken by owner	Deduct from purchases	Add to drawings
Goods lost by fire (insured)	Credit Trading A/c with the full loss; debit P&L with the uninsured part	Insurance claim receivable – asset side
Manager's commission on net profit	Debit P&L	Outstanding liability

FORMULA **Manager's commission**

On net profit **before** charging commission = NP × rate / 100.

On net profit **after** charging commission = NP before commission × rate / (100 + rate).

Example: NP before commission ₹1,10,000, 10% after charging → 1,10,000 × 10/110 = **₹10,000**.

WORKED EXAMPLE **Bad debts and provision for doubtful debts**

Debtors in trial balance ₹52,000. Bad debts in TB ₹1,500. Old provision for doubtful debts ₹2,600. Adjustments: further bad debts ₹2,000; maintain provision at 5% on debtors; provision for discount 2%.

Debtors after further bad debts = 52,000 − 2,000 = 50,000. New PDD = 5% × 50,000 = 2,500. Provision for discount = 2% × (50,000 − 2,500) = 950.

P&L debit: bad debts 1,500 + 2,000 + new PDD 2,500 − old PDD 2,600 = **₹3,400**; provision for discount **₹950**.

Balance Sheet debtors: 52,000 − 2,000 − 2,500 − 950 = **₹46,550**.

WORKED EXAMPLE **Short final accounts with adjustments**

Trial balance of Sri Sen as on 31 March 2026 (₹): Capital 2,00,000 (Cr); Drawings 24,000; Opening stock 40,000; Purchases 3,10,000; Sales 4,60,000; Returns inward 10,000; Wages 30,000; Carriage inward 6,000; Salaries 36,000; Rent 18,000; Debtors 60,000; Creditors 45,000; Furniture 50,000; Cash 1,21,000 (total each side ₹7,05,000).

Adjustments: closing stock ₹55,000; outstanding salary ₹4,000; prepaid rent ₹3,000; depreciation on furniture 10%; goods ₹5,000 taken by the owner.

Trading A/c: Dr – Opening stock 40,000; Purchases 3,10,000 − 5,000 = 3,05,000; Wages 30,000; Carriage 6,000; GP 1,24,000 (balancing). Cr – Net sales 4,50,000; Closing stock 55,000. Total 5,05,000.

P&L A/c: GP 1,24,000 − Salaries 40,000 − Rent 15,000 − Depreciation 5,000 = **Net profit ₹64,000**.

Balance sheet: Capital 2,00,000 + 64,000 − Drawings (24,000 + 5,000) = 2,35,000; Creditors 45,000; Outstanding salary 4,000 → total **₹2,84,000**. Assets: Furniture 45,000; Closing stock 55,000; Debtors 60,000; Prepaid rent 3,000; Cash 1,21,000 → total **₹2,84,000**. ✔

COMMON MISTAKE **Items inside the trial balance appear once in final accounts; adjustments given outside appear twice (two effects). If closing stock is inside the trial balance (adjusted purchases), it goes only to the Balance Sheet.**

7.4 Manufacturing entity – cost per unit (exam favourite)

WORKED EXAMPLE **Manufacturing account with cost per unit**

A factory produced 10,000 units in 2025-26. Opening WIP ₹20,000; closing WIP ₹30,000; raw materials consumed ₹2,40,000; direct wages ₹1,10,000; factory overheads ₹70,000; sale of scrap ₹5,000.

Cost of production = 20,000 + 2,40,000 + 1,10,000 + 70,000 − 5,000 − 30,000 = **₹4,05,000**; cost per unit = **₹40.50**.

If 9,000 units are sold and there is no opening finished stock, closing finished goods = 1,000 × 40.50 = ₹40,500 (or NRV if lower).

COMMON MISTAKE **Taking scrap sale to P&L instead of reducing factory cost, and forgetting to adjust WIP in the manufacturing account.**

Chapter 8: Financial Statements of Not-for-Profit Organisations

Clubs, charitable trusts, schools, hospitals, libraries and societies that work for the **welfare of members or society, not for profit**. Their surplus is not distributed but added to the **capital fund (general fund)**.

Final accounts of an NPO: (1) Receipts and Payments Account, (2) Income and Expenditure Account, (3) Balance Sheet.

Point	Receipts & Payments A/c	Income & Expenditure A/c
Nature	**Real account** – summary of cash book	**Nominal account** – like P&L
Items	All receipts and payments – capital and revenue, of any period	Only **revenue** items of the **current year**
Basis	Cash basis	Accrual basis
Opening balance	Starts with opening cash/bank balance	No opening balance
Closing balance	Closing cash/bank balance	**Surplus** (excess of income) or **deficit**
Sides	Debit – receipts; credit – payments	Debit – expenditure; credit – income

Profit & Loss A/c vs Income & Expenditure A/c

Point	Profit and Loss A/c	Income and Expenditure A/c
Prepared by	Trading/profit-making entities	NPOs (clubs, societies, hospitals)
Result	Net profit / net loss	**Surplus / deficit** (excess of income over expenditure)
Transfer of result	Capital A/c	**Capital (general) fund**
Trading A/c before it	Yes	Separate trading account only for activities like canteen/bar

Item	Treatment
Subscriptions	Revenue income of the year – adjust for outstanding and advance
Entrance / admission fees	Usually revenue income (small, recurring); may be capitalised if the rules say so
Life membership fees	**Capital receipt** – added to capital fund (or a Life Membership Fund)
General donation (small)	Revenue income
Specific donation (e.g. for building)	**Capital receipt** – Building Fund on liability side
Legacy (by will)	Capital receipt – added to capital fund
Sale of old newspapers / sports material	Revenue income
Sale of fixed asset	Not income; profit/loss on sale goes to I&E A/c
Endowment fund	Capital – liabilities side; income from its investments goes to the fund or I&E as per terms
Prize fund / match fund	Specific fund – expenses on the purpose are deducted from the fund; excess expense goes to I&E

WORKED EXAMPLE **Subscriptions for the year 2025-26**

Subscriptions received during the year ₹60,000 (including ₹4,000 for 2024-25 and ₹3,000 for 2026-27). Outstanding for 2025-26 on 31 March 2026: ₹5,000. Outstanding on 31 March 2025 was ₹6,000 (of which ₹4,000 received; ₹2,000 written off this year).

Income for 2025-26 = 60,000 − 4,000 − 3,000 + 5,000 = **₹58,000**.

(₹2,000 of the old dues is written off – debit I&E A/c as a loss or reduce from the capital fund, as the question requires.)

EXAM TIP **When the opening capital fund is not given, prepare an opening balance sheet – capital fund = opening assets - opening liabilities.**

8.1 Full illustration

WORKED EXAMPLE **R&P → I&E and Balance Sheet**

Green Club – Receipts & Payments A/c for 2025-26 (₹): Receipts – balance b/d (cash) 12,000; subscriptions 1,10,000 (including ₹6,000 for 2024-25 and ₹4,000 for 2026-27); entrance fees 20,000; donation for building fund 50,000; sale of old furniture 3,000 (book value 5,000); interest on investments 6,000. Payments – salaries 48,000; rent 24,000; purchase of sports equipment 30,000; electricity 9,000; investments 60,000; balance c/d 30,000.

Additional: subscription outstanding for 2025-26 ₹8,000; outstanding salary ₹4,000; accrued interest ₹1,500; equipment (opening ₹40,000) depreciated @ 10% on closing balance; **entrance fees to be capitalised 50%**. Opening subscription outstanding ₹6,000. Opening capital fund to be found.

Opening balance sheet (1 April 2025): cash 12,000 + subscription outstanding 6,000 + equipment 40,000 + furniture 5,000 = **Capital fund ₹63,000** (no liabilities given).

Subscription income = 1,10,000 − 6,000 − 4,000 + 8,000 = **₹1,08,000**.

I&E A/c (Income): subscription 1,08,000; entrance fees (50%) 10,000; interest 6,000 + 1,500 = 7,500 → total **₹1,25,500**.

Expenditure: salaries 48,000 + 4,000 = 52,000; rent 24,000; electricity 9,000; loss on sale of furniture 2,000; depreciation 10% × (40,000 + 30,000) = 7,000 → total **₹94,000**. **Surplus = ₹31,500**.

Balance sheet (31 March 2026): Liabilities – capital fund 63,000 + 31,500 + 10,000 (capitalised entrance fees) = 1,04,500; building fund 50,000; subscription in advance 4,000; outstanding salary 4,000 → **₹1,62,500**. Assets – equipment 63,000; investments 60,000; accrued interest 1,500; subscription outstanding 8,000; cash 30,000 → **₹1,62,500** ✔.

REMEMBER Donation for a **specific purpose** (building fund) is capitalised as a fund; **general donations** of large amounts may be capitalised or treated as income as per policy; legacies are capitalised.

EXAM TIP Examiners also ask R&P from I&E (reverse). Work backwards: cash items in R&P, non-cash items (depreciation, outstanding, prepaid) excluded.

Chapter 9: Accounts from Incomplete Records

A system in which **only personal accounts and the cash book** are kept; real and nominal accounts are not maintained. Used by small traders. **Not a complete system** – trial balance cannot be prepared, and true profit cannot be found directly.

Features: no double entry for all transactions, mixing of private and business transactions, personal accounts kept, profit found by comparing capital.

Limitations: no arithmetical check, fraud and errors hard to detect, no proper valuation of assets, not acceptable to tax authorities for many cases, cannot be used by companies.

1. Prepare an **opening statement of affairs** to find opening capital (assets – liabilities).
2. Prepare a **closing statement of affairs** to find closing capital.
3. Prepare a **statement of profit or loss**:

Particulars	₹
Closing capital	xxx
Add: drawings during the year	xxx
Less: additional capital introduced	(xxx)
= Adjusted closing capital	xxx
Less: opening capital	(xxx)
Profit / (Loss) for the year	xxx
Less: interest on capital, salary to proprietor (if any adjustments)	

WORKED EXAMPLE **Profit by statement of affairs**

Opening capital ₹1,20,000. Closing assets ₹2,10,000, closing liabilities ₹50,000 → closing capital ₹1,60,000. Drawings ₹24,000. Fresh capital introduced ₹10,000.

Profit = 1,60,000 + 24,000 − 10,000 − 1,20,000 = **₹54,000**.

Point	Statement of affairs	Balance sheet
Records	Incomplete	Complete double entry
Basis	Estimates and personal knowledge	Ledger balances
Purpose	To find capital	To show financial position
Capital	Balancing figure	Taken from capital account

Missing figures are found by preparing **memorandum accounts**:

- **Total Debtors A/c** → find credit sales (balancing figure): Opening debtors + credit sales + dishonoured bills = Cash received + discount + returns + bad debts + B/R received + closing debtors.
- **Total Creditors A/c** → find credit purchases.
- **Bills Receivable / Bills Payable A/c** → bills received / accepted.
- **Cash A/c** → missing cash sales, cash purchases, drawings or opening cash.
- Then prepare the Trading and P&L A/c and Balance Sheet in the normal way. Gross profit ratio given in the question helps find missing sales or stock.

FORMULA **Sales = Cost of goods sold ÷ (1 − GP rate on sales). If GP is 25% on cost, GP on sales = 25/125 = 20%.**

9.1 Finding missing figures – the four T-accounts

Missing figure	Prepare
Credit sales	**Total Debtors A/c**: Opening debtors + Credit sales + B/R dishonoured = Cash received + Discount + Returns + Bad debts + B/R received + Closing debtors

Missing figure	Prepare
Credit purchases	**Total Creditors A/c**
Bills received/issued	Bills Receivable / Bills Payable A/c
Opening/closing cash, drawings	Cash Book summary

WORKED EXAMPLE Credit sales from Total Debtors A/c

Opening debtors ₹60,000; closing debtors ₹75,000; cash received from debtors ₹2,40,000; discount allowed ₹4,000; returns inward ₹6,000; bad debts ₹2,000.

Credit sales = 75,000 + 2,40,000 + 4,000 + 6,000 + 2,000 − 60,000 = **₹2,69,000**.

NOTE The GP ratio is often used to find missing sales/purchases (as in the formula box above).

Chapter 10: Partnership – Admission, Retirement and Death of a Partner

10.1 Meaning of partnership

A partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all (Section 4, Indian Partnership Act, 1932). The persons are called **partners** and together they are called a **firm**. The name under which the business is carried on is the **firm name**.

- **Essential features:** agreement (oral or written), business, sharing of profits, mutual agency (each partner is an agent of the firm and of the other partners), minimum two partners.
- **Maximum partners:** 50 (Section 464 of the Companies Act, 2013 read with Rule 10 of the Companies (Miscellaneous) Rules, 2014). An association above this limit must register as a company.
- **Liability:** unlimited, joint and several. A creditor can recover the whole debt from any one partner.
- **Registration** is optional but an unregistered firm cannot file a suit against third parties to enforce a contract (Section 69).

10.2 Partnership deed

The written agreement among partners is called the **partnership deed**. It usually contains: name and address of firm and partners, nature of business, capital of each partner, profit-sharing ratio, interest on capital and drawings, salary or commission to partners, rules for admission, retirement and death, method of goodwill valuation, and settlement of accounts on dissolution.

Provisions of the Act when the deed is silent (Section 13)

Matter	Rule when no agreement exists
Profit-sharing ratio	Equal
Interest on capital	Not allowed
Interest on drawings	Not charged
Salary / commission to partner	Not allowed
Interest on partner's loan to firm	6% per annum (allowed even if there is a loss)
Admission of new partner	Only with consent of all existing partners

REMEMBER Interest on capital is paid only out of profits

Even when the deed allows interest on capital, it is an **appropriation** of profit. If the firm makes a loss, no interest on capital is given. If profit is less than the interest, the profit is shared in the ratio of interest. Interest on a partner's **loan** is a **charge** and is paid even in a loss year.

10.3 Fixed and fluctuating capital

Basis	Fixed capital method	Fluctuating capital method
Accounts kept	Two accounts per partner: Capital A/c and Current A/c	Only one Capital A/c
Capital balance	Remains same unless fresh capital is introduced or withdrawn permanently	Changes every year
Adjustments (interest, salary, drawings, share of profit)	Go to Current A/c	Go to Capital A/c
Debit balance	Current A/c may show debit balance	Capital A/c rarely shows debit balance

10.4 Profit and Loss Appropriation Account

This account is an extension of the Profit and Loss Account. It shows how the net profit is distributed among partners.

Debit side	Credit side
Interest on capital	Net profit b/d (from P&L A/c)
Partner's salary / commission	Interest on drawings
Transfer to reserve	
Share of profit to partners (balancing figure)	

Interest on drawings

- **Fixed amount drawn on the first day of every month:** interest for 6.5 months.
- **Drawn on the last day of every month:** 5.5 months.
- **Drawn in the middle of every month:** 6 months.
- **Drawn at the start of each quarter:** 7.5 months; at the end of each quarter: 4.5 months.
- **Uneven dates:** use the **product method** – multiply each drawing by months remaining till year-end, add products, and charge interest for one month on the total.

WORKED EXAMPLE Appropriation of profit

A and B are partners sharing 3:2. Capitals: A ₹2,00,000, B ₹1,00,000. Interest on capital 10% p.a., B gets a salary of ₹2,000 per month, A gets 5% commission on net profit after charging such commission. Net profit before these items: ₹1,26,000. Drawings: A ₹24,000, B ₹12,000; interest on drawings 6% (average 6 months).

Interest on capital: A ₹20,000, B ₹10,000 = ₹30,000. Salary B = ₹24,000.

Interest on drawings: A = 24,000 × 6% × 6/12 = ₹720; B = ₹360. Total ₹1,080.

Profit after interest and salary but including interest on drawings = 1,26,000 + 1,080 − 30,000 − 24,000 = ₹73,080.

A's commission = 73,080 × 5/105 = ₹3,480. Divisible profit = ₹69,600: A 3/5 = ₹41,760, B 2/5 = ₹27,840.

Guarantee of profit

When a partner (often a new partner) is guaranteed a minimum profit, the deficiency is borne by the guaranteeing partners in the agreed ratio (or their profit ratio if not stated). Example: C is guaranteed ₹30,000; his actual share is ₹22,000; the deficiency of ₹8,000 is borne by A and B.

Past adjustments

If interest on capital or salary was omitted in earlier years, make a single adjusting entry through the partners' capital or current accounts. Prepare a table: what was credited, what should have been credited, net effect for each partner. Only the net effect is passed.

10.5 Goodwill

Goodwill is the value of the reputation of a firm that enables it to earn more than normal profit. It is an intangible asset.

Method	Working
Average profit	Average profit × number of years' purchase
Weighted average profit	Σ(profit × weight) ÷ Σ weights × years' purchase
Super profit	(Average profit − Normal profit) × years' purchase
Annuity of super profit	Super profit × present value annuity factor
Capitalisation of average profit	(Average profit × 100 ÷ normal rate) − Net assets
Capitalisation of super profit	Super profit × 100 ÷ normal rate

FORMULA Normal profit

Normal profit = Capital employed × Normal rate of return ÷ 100. Capital employed = Total assets (excluding goodwill and fictitious assets) − Outside liabilities.

10.6 Change in profit-sharing ratio among existing partners

- **Sacrificing ratio** = Old ratio − New ratio (for partners who give up share).
- **Gaining ratio** = New ratio − Old ratio (for partners who gain).
- The gaining partner compensates the sacrificing partner for goodwill: debit gaining partner's capital, credit sacrificing partner's capital.
- Accumulated profits, reserves and revaluation results are distributed in the **old** ratio.

10.7 Admission of a partner

A new partner gets (a) a share in future profits and (b) a right in the firm's assets. He usually brings capital and a premium for goodwill.

Steps on admission

1. Calculate new ratio and sacrificing ratio.
2. Treatment of goodwill (AS 26 does not allow recording of self-generated goodwill; so premium method is preferred).
3. Revaluation of assets and liabilities through Revaluation A/c; profit or loss shared by old partners in old ratio.
4. Distribution of accumulated profits, reserves, losses among old partners in old ratio.
5. Capital brought in by the new partner; adjustment of capitals if required.

Calculating new ratio

WORKED EXAMPLE New ratio

A and B share 3:2. C is admitted for 1/5 share, which he takes from A and B in their old ratio. Remaining share = 4/5. A's new = 3/5 × 4/5 = 12/25; B = 2/5 × 4/5 = 8/25; C = 5/25. New ratio 12:8:5.

If C takes 1/5, wholly from A: A = 3/5 − 1/5 = 2/5, B = 2/5, C = 1/5 → 2:2:1.

Goodwill on admission – premium method

- Premium brought in cash: Dr Cash; Cr Premium for Goodwill A/c; then Dr Premium for Goodwill; Cr old partners (sacrificing ratio).
- New partner unable to bring premium: Dr New partner's current/capital A/c; Cr sacrificing partners.
- Existing goodwill in books is first written off among old partners in old ratio.
- **Hidden goodwill:** if the new partner's capital implies a higher total value of the firm, the difference is hidden goodwill. Total capital implied by C's capital – actual capitals of all partners (after adjustments, excluding goodwill) = goodwill.

WORKED EXAMPLE Hidden goodwill

A and B have capitals of ₹1,50,000 and ₹1,00,000 after all adjustments. C brings ₹1,00,000 for 1/4 share. Implied total capital = 1,00,000 × 4 = ₹4,00,000. Actual total = 1,50,000 + 1,00,000 + 1,00,000 = ₹3,50,000. Hidden goodwill = ₹50,000; C's share = ₹12,500 debited to C, credited to A and B in sacrificing ratio.

Revaluation Account

Debit (losses)	Credit (gains)
Decrease in value of assets	Increase in value of assets
Increase in liabilities	Decrease in liabilities
Unrecorded liabilities	Unrecorded assets
Profit transferred to old partners (balancing)	Loss transferred to old partners (balancing)

Memorandum revaluation account is used when partners want the assets to continue at old book values in the balance sheet. The first part records the changes; the second part reverses them in the new ratio.

10.8 Retirement of a partner

On retirement the outgoing partner is entitled to his capital, share of reserves, share of revaluation profit, share of goodwill, and share of profit up to the date of retirement. The remaining partners gain his share in the **gaining ratio**.

- Goodwill: Dr remaining partners (gaining ratio); Cr retiring partner (his share).
- Amount due may be paid immediately or transferred to a **Retiring Partner's Loan A/c** and paid in instalments with interest. Under Section 37, if no settlement is made, the retiring partner (or his estate) can claim either a share of profits made after retirement attributable to his share of assets, or interest at **6% p.a.** on his share, at his option.

WORKED EXAMPLE Retirement

A, B and C share 2:2:1. B retires. Goodwill of firm ₹60,000. New ratio of A and C will be 3:2. Gaining ratio: A = 3/5 − 2/5 = 1/5; C = 2/5 − 1/5 = 1/5 → 1:1. B's share of goodwill = 60,000 × 2/5 = ₹24,000, debited ₹12,000 each to A and C.

10.9 Death of a partner

Treatment is the same as retirement except the amount goes to the **executors' account**. Additional items:

- **Profit up to date of death:** based on last year's profit (time basis) or sales basis. Dr P&L Suspense A/c; Cr deceased partner's capital.
- **Joint life policy (JLP):** the policy amount received is credited to all partners including the deceased in the profit ratio (if treated as expense), or the surrender value approach as per question.
- **Interest on capital** up to date of death if the deed allows.

EXAM TIP Profit up to date of death – sales basis

If sales up to date of death are ₹4,00,000 and last year's profit was 10% of sales, profit to date = ₹40,000. Deceased's share is credited from P&L Suspense A/c.

10.10 Joint life policy

A **joint life policy (JLP)** is taken on the joint lives of partners; the amount is payable on the **death of any partner** or on maturity. It helps the firm pay a deceased partner's dues. Three methods of accounting for premiums:

Method	Accounting
1 Premium charged as expense	Premium debited to P&L each year; on death, the **policy amount** received is credited to all partners (including the deceased) in the **old profit-sharing ratio**
2 Policy shown at surrender value	Premium debited to JLP A/c; at year end the excess over **surrender value** is written off to P&L; JLP appears in the balance sheet at surrender value
3 JLP Reserve (Fund)	Premium debited to JLP A/c; an equal amount is transferred from P&L Appropriation to **JLP Reserve**; both are adjusted to surrender value; on death the reserve and policy are closed and the balance is distributed in the old ratio

WORKED EXAMPLE Death of a partner and JLP (verified)

A, B and C share profits 3:2:1. C dies; the JLP of ₹2,00,000 is received (premiums charged to P&L). Credit to capitals: A ₹1,00,000, B ₹66,667, C ₹33,333. Journal: Bank Dr 2,00,000; To JLP A/c 2,00,000; JLP A/c Dr 2,00,000; To A, B, C Capital (3:2:1).

10.11 Retiring partner's dues unsettled – Section 37

Where a partner retires (or dies) and the firm continues business **without final settlement**, the outgoing partner (or his estate) is entitled, at his option, to (a) **interest at 6% p.a.** on the amount due to him, **or** (b) the **share of profits** earned after retirement that is attributable to the use of his share of the firm's property (in the ratio of capitals unless otherwise agreed).

WORKED EXAMPLE Section 37 option (verified)

C retires on 30 September; his unsettled capital is ₹40,000. Capitals of A and B are ₹60,000 and ₹1,00,000. Profit for the 6 months after retirement is ₹30,000. (a) Interest = 40,000 × 6% × 6/12 = **₹1,200**. (b) Share of profit = 30,000 × 40,000 ÷ 2,00,000 = **₹6,000**. C will choose **₹6,000**.

Chapter 11: Dissolution, Piecemeal Distribution, Amalgamation and Conversion of Firms; LLP Accounting

11.1 Dissolution of partnership vs dissolution of firm

Dissolution of partnership	Dissolution of firm
Change in the relationship (admission, retirement, death)	Business of the firm comes to an end
Firm continues	Firm closes
Books are not closed	All books are closed
No court involvement	May be by court order

Modes of dissolution of firm (Sections 40–44)

- **By agreement** (Section 40).
- **Compulsory dissolution** (Section 41): all but one partner insolvent, or the business becomes illegal.
- **On happening of contingencies** (Section 42): expiry of term, completion of venture, death or insolvency of a partner (subject to contract).
- **By notice** in a partnership at will (Section 43).
- **By court** (Section 44): insanity, permanent incapacity, misconduct, persistent breach, transfer of interest, perpetual losses, just and equitable ground.

11.2 Order of settlement of accounts (Section 48)

1. Losses, including deficiencies of capital, are paid first out of profits, then out of capital, and lastly by partners individually in their profit-sharing ratio.
2. Assets of the firm, including sums contributed by partners to make up deficiency, are applied in this order:

- first, to pay debts of the firm to third parties;
  - next, to pay each partner rateably what is due for **advances** (loans), as distinguished from capital;
  - next, to pay each partner rateably what is due on account of capital;
  - the residue is divided among partners in profit-sharing ratio.

11.3 Accounts prepared on dissolution

Realisation Account

Debit	Credit
All assets at book value (except cash, bank, fictitious assets and partner's loan to the firm)	All outside liabilities at book value
Payment of liabilities	Cash realised from sale of assets
Realisation expenses (paid by firm)	Assets taken over by partners
Profit on realisation (transferred to partners)	Loss on realisation (transferred to partners)

- **Partner's loan** is not transferred to Realisation A/c; it is paid separately after outside liabilities.
- **Fictitious assets** (P&L debit balance, deferred revenue expenditure) are written off to partners' capitals in the old ratio.
- **Reserves** are credited to partners' capitals in the old ratio.
- When a partner agrees to pay a liability: Dr Realisation; Cr partner's capital.
- When an asset is taken over by a creditor in settlement: no entry for the asset; only the balance paid in cash is recorded.

WORKED EXAMPLE Realisation

Assets (except cash) book value ₹3,00,000 realised ₹2,70,000. Creditors ₹80,000 paid ₹78,000. Expenses ₹4,000. Realisation loss = (3,00,000 + 78,000 + 4,000) − (80,000 + 2,70,000) = ₹32,000, shared in profit ratio.

11.4 Insolvency of a partner – Garner v Murray (1904)

When a partner becomes insolvent and his capital account shows a debit balance he cannot pay, the deficiency must be borne by the solvent partners. Under the rule in **Garner v Murray**:

- Solvent partners bring cash equal to their share of **realisation loss** only (in profit ratio).
- The deficiency of the insolvent partner is borne by solvent partners in the ratio of their **capitals standing just before dissolution** (fixed capital) or after adjusting reserves, drawings, etc. but before realisation loss (fluctuating capital).
- A partner with a debit balance in capital before dissolution does not bear any part of the deficiency.

NOTE Garner v Murray in India

The rule is not part of the Indian Partnership Act. Section 48 suggests the loss should be shared in profit ratio. Indian universities follow Garner v Murray in problems unless the agreement says otherwise. Always state your assumption.

WORKED EXAMPLE Insolvent partner

X, Y, Z share equally. Capitals before dissolution: X ₹60,000, Y ₹40,000, Z ₹5,000 (debit balance after drawings). Realisation loss ₹30,000. Z is insolvent and pays nothing.

Each partner's share of loss = ₹10,000. X and Y bring ₹10,000 each in cash.

Z's deficiency = 5,000 + 10,000 = ₹15,000. X and Y bear it in capital ratio 60:40 → X ₹9,000, Y ₹6,000.

11.5 Piecemeal distribution

When assets are realised gradually, cash is distributed to partners in instalments. Two methods are used:

(a) Maximum possible loss method

At each instalment, assume the remaining assets will realise nothing. Compute the maximum loss, distribute it among partners in profit ratio, and pay each partner only the balance that stays positive. If a partner shows a negative balance, it is absorbed by the others in their capital ratio (Garner v Murray) or profit ratio as stated.

(b) Surplus capital (proportionate capital) method

1. Divide each partner's capital by his profit share to get **capital per unit of profit**.
2. The lowest value becomes the base. Compare and find the **surplus** capital of each partner over the base.
3. Repeat to rank partners. Cash available after paying outside liabilities and partner's loans is paid first to the partner with the highest surplus, until capitals become proportionate to profit ratio; then in profit ratio.

WORKED EXAMPLE Surplus capital method

P, Q share 3:2. Capitals P ₹90,000, Q ₹40,000.

Capital per unit of profit: P = 90,000/3 = 30,000; Q = 40,000/2 = 20,000. Base = 20,000.

Proportionate capital of P = 20,000 × 3 = ₹60,000. Surplus of P = ₹30,000.

First ₹30,000 available goes to P alone; thereafter cash is paid in 3:2.

11.6 Order of payment in piecemeal distribution

1. Realisation expenses (or keep a provision for them).
2. Outside creditors (secured creditors from the asset concerned; preferential creditors first).
3. Partners' loans (rateably).

4. Partners' capitals – by the chosen method.

> **COMMON MISTAKE** **Do not pay capital before partner's loan**
>
> Students often pay a partner's capital along with his loan. The loan must be fully paid to all partners first.

11.7 Conversion (sale) of partnership firm into a company

When a firm is converted into a company, the company purchases the business. In the firm's books:

1. Transfer all assets (except those not taken over) to Realisation A/c and liabilities to its credit side.
2. Credit Realisation A/c with **purchase consideration**; Dr company.
3. Receive shares, debentures and cash from the company.
4. Pay liabilities not taken over and expenses.
5. Distribute shares among partners and close capital accounts.

Purchase consideration

- **Lump sum method:** stated in question.
- **Net assets method:** agreed value of assets taken over – liabilities taken over.
- **Net payment method:** sum of all payments in shares, debentures and cash.

> **WORKED EXAMPLE** **Distribution of shares**
>
> PC = ₹6,00,000 paid as 50,000 equity shares of ₹10 each and the balance in cash. Partners A and B share profits 3:2 and their final claims are ₹3,90,000 and ₹2,10,000. Unless stated, shares are distributed in profit ratio: A 30,000 shares (₹3,00,000), B 20,000 shares (₹2,00,000). Cash: A gets ₹90,000, B ₹10,000.

In the company's books

Business Purchase A/c is debited and the vendor (firm) credited with PC. Assets and liabilities are recorded at agreed values; excess of PC over net assets = goodwill; shortfall = capital reserve. Shares issued at premium credit the Securities Premium A/c.

11.8 Amalgamation of partnership firms

Steps: (1) In each old firm, prepare a **Revaluation A/c** for agreed values of assets and liabilities and distribute the result in the old ratio; (2) raise **goodwill** of each firm (or adjust through capitals); (3) distribute **reserves and accumulated profits**; (4) close the books of each firm by transferring assets and liabilities to the new firm (Realisation-style or Firm's A/c); (5) the **new firm** opens its books with the combined assets, liabilities and partners' capitals, and adjusts capitals to the agreed ratio by bringing in or withdrawing cash (or through current accounts). Assets not taken over are taken by partners in their old ratio.

11.9 Accounting for LLPs

- An LLP keeps books on **accrual and double-entry** basis at its registered office; financial year ends 31 March.
- Partners' capital is called **contribution** (cash, property or services); a **partners' current account** records drawings, interest and share of profits.
- Profit is shared as per the **LLP agreement** (equally if there is no agreement – First Schedule). Remuneration and interest to partners are appropriations as per the agreement.
- On admission, retirement and death, the same revaluation and goodwill entries as a partnership are used; changes in contribution are filed with the Registrar (Form 4/Form 3).
- The LLP prepares a **Statement of Account and Solvency** (Form 8) within 6 months of the year end and an annual return (Form 11) within 60 days.

Chapter 12: Lease Accounting (AS 19)

12.1 Finance and operating leases

A **lease** is an agreement by which the **lessor** conveys to the **lessee** the right to use an asset for an agreed period in return for payments. A **finance lease** transfers substantially all the **risks and rewards** of ownership; an **operating lease** is any other lease (often short-term and cancellable).

NOTE Indicators of a finance lease (AS 19)

(1) ownership passes to the lessee by the end of the lease term; (2) lessee has an option to buy at a price expected to be sufficiently lower than fair value (bargain purchase option); (3) lease term covers the **major part of the economic life**; (4) **present value of minimum lease payments (MLP)** at inception amounts to substantially all of the fair value; (5) the asset is of a specialised nature.

12.2 Accounting in the books of lessee and lessor

Type	Lessee	Lessor
Finance lease	Recognise the asset and a liability at the **lower of fair value and PV of MLP** (discounted at the interest rate implicit in the lease); split each payment into **finance charge** (constant periodic rate on outstanding liability) and **principal**; **depreciate** the asset (over useful life if ownership passes, otherwise the shorter of lease term and useful life)	Recognise a **receivable** equal to the **net investment** in the lease; recognise **finance income** at a constant rate on the net investment; initial direct costs included in the receivable
Operating lease	Lease payments charged to P&L on a **straight-line basis** over the lease term (unless another systematic basis is more representative)	Asset stays in the lessor's books and is depreciated; lease income on a straight-line basis

WORKED EXAMPLE Finance lease in the books of the lessee (verified)

Machine: fair value ₹2,60,000; annual lease rent ₹1,00,000 payable at the end of each of 3 years; implicit rate 10% (PVF 0.9091, 0.8264, 0.7513). PV of MLP = **₹2,48,685** < fair value → asset and liability recognised at ₹2,48,685.

Year	Opening liability	Interest 10%	Rent paid	Principal	Closing liability
1	2,48,685	24,868	1,00,000	75,132	1,73,553
2	1,73,553	17,355	1,00,000	82,645	90,908
3	90,908	9,092*	1,00,000	90,908	Nil

Note: year-3 interest is a balancing figure (rounding). Depreciation on SLM over 3 years = 2,48,685 ÷ 3 = ₹82,895 a year.

12.3 Sale and leaseback

Leaseback is	Treatment of the difference between sale price and carrying amount
Finance lease	Do **not** recognise profit or loss immediately; **defer and amortise** it over the lease term in proportion to depreciation
Operating lease at fair value	Recognise profit or loss **immediately**
Operating lease, sale price **below** fair value	Recognise immediately, except where the loss is compensated by future rentals below market – then defer and amortise over the period of use
Operating lease, sale price **above** fair value	Excess over fair value is **deferred** and amortised over the period of use
Fair value below carrying amount	Recognise the loss (carrying amount – fair value) **immediately**

12.4 Ind AS 116 – comparative note

Under **Ind AS 116** the lessee uses a **single model** – it recognises a **right-of-use asset** and a **lease liability** for all leases (except short-term leases of 12 months or less and low-value assets). Lessor accounting remains a finance/operating classification. AS 19 keeps the finance/operating distinction for lessees.

Chapter 13: Branch (including Foreign Branch) and Departmental Accounts

13.1 Branch accounts – meaning and types

A **branch** is a division of a business located away from the head office (HO) that sells the same goods or offers the same services.

Type	Books kept	Method
Dependent branch	No full books; HO keeps the accounts	Debtors method, stock & debtors method, final accounts method, wholesale branch method
Independent branch	Branch keeps its own full books	Incorporation of branch trial balance at year-end
Foreign branch	Own books in foreign currency	Conversion as per AS 11 / Ind AS 21

13.2 Dependent branch – Debtors method

The HO opens a **Branch A/c** for each branch. It is a nominal account and its balance shows branch profit or loss.

Debit side of Branch A/c	Credit side of Branch A/c
Opening stock, debtors, petty cash, fixed assets	Opening creditors, outstanding expenses (if any)
Goods sent to branch	Cash received from branch (cash sales + collections)
Cash sent for expenses (rent, salary)	Goods returned by branch
Closing creditors	Closing stock, debtors, petty cash, prepaid, fixed assets
Net profit (balancing)	Net loss (balancing)

Goods sent at invoice price

When goods are invoiced at a price above cost, an adjustment is needed so that branch profit is not inflated. HO passes entries to remove the loading:

- Dr Goods sent to branch; Cr Branch A/c — with loading on goods sent.
- Dr Branch A/c; Cr Branch Stock Reserve — with loading on opening stock (reverse) and Dr Branch Stock Reserve; Cr Branch A/c on closing stock.

√x FORMULA Loading

If invoice price is cost + 25%, loading = Invoice price × 25 ÷ 125 = 1/5 of invoice price.

If invoice price is cost + 33⅓%, loading = 1/4 of invoice price.

WORKED EXAMPLE Debtors method with loading

Goods sent at cost + 25%: ₹2,50,000 (invoice). Opening stock at invoice ₹50,000, closing stock at invoice ₹62,500. Cash remitted by branch ₹2,80,000. Branch expenses paid by HO ₹20,000.

Branch A/c Dr: Opening stock 50,000 + Goods sent 2,50,000 + Expenses 20,000 + Stock reserve on closing (62,500 × 1/5) 12,500 = 3,32,500.

Cr: Remittance 2,80,000 + Closing stock 62,500 + Stock reserve on opening (50,000 × 1/5) 10,000 + Loading on goods sent (2,50,000 × 1/5) 50,000 = 4,02,500.

Branch profit = 4,02,500 − 3,32,500 = ₹70,000.

13.3 Stock and debtors method

Used when the HO wants close control. Accounts opened: Branch Stock A/c (at invoice price), Branch Debtors A/c, Branch Expenses A/c, Branch Adjustment A/c (gross profit), Branch P&L A/c, Goods Sent to Branch A/c.

- **Branch Stock A/c** at invoice price acts as a memorandum trading account. A shortage appears as a balancing figure on the credit side.
- **Branch Adjustment A/c** records loading. Gross profit = loading on goods sold (balance).
- Normal loss: invoice value to Branch Adjustment (loading) and cost to Branch P&L.

13.4 Final accounts method

A Branch Trading and P&L Account is prepared in memorandum form to find branch profit. Used when the HO wants a branch-wise trading result.

13.5 Independent branch

The branch keeps a **Head Office A/c** in its books and the HO keeps a **Branch A/c**. At year-end the balances must agree after adjusting items in transit.

Reconciliation items

Item	Adjustment
Goods in transit (sent by HO, not received by branch)	In HO books: Dr Goods in transit; Cr Branch
Cash in transit	In HO books: Dr Cash in transit; Cr Branch
Depreciation on branch fixed assets kept in HO books	Branch: Dr Depreciation; Cr HO
Expenses of branch paid by HO	Branch: Dr Expense; Cr HO
Inter-branch transactions	Routed through HO

EXAM TIP Golden rule for in-transit items

Adjustments for items in transit are made in the books of the **receiving** office (usually HO in exams), unless the question says otherwise.

13.6 Foreign branch – conversion of trial balance

Under **AS 11** (Effects of Changes in Foreign Exchange Rates), a foreign branch that is an integral foreign operation is converted as follows:

Item	Rate used
Fixed assets and depreciation	Historical rate (date of purchase)
Monetary items (cash, debtors, creditors, loans)	Closing rate
Revenue items (sales, purchases, expenses)	Average rate
Opening stock / closing stock	Rate at opening date / closing rate (or historical)
HO A/c	Actual amount in HO books (rupee value of Branch A/c)
Goods from HO	Actual rupee amount recorded in HO

Difference on conversion goes to **Exchange Difference A/c** in the P&L. For a non-integral operation, assets and liabilities are converted at closing rate, income and expenses at average or actual rate, and differences go to a Foreign Currency Translation Reserve. (Under Ind AS 21 the concept is "functional currency".)

13.7 Departmental accounts

A business with several departments under one roof prepares departmental accounts to find the profit of each department.

Basis of apportionment of common expenses

Expense	Basis
Rent, rates, building repairs, lighting	Floor area occupied
Power	Horse-power × hours used
Selling expenses, advertisement, discount allowed, bad debts	Sales

Expense	Basis
Carriage inward, discount received	Purchases
Wages, staff welfare, canteen	Number of workers or wages
Insurance of stock	Average stock
Depreciation, insurance of machinery	Value of machines
General administration	Equally or on sales / time spent

Inter-departmental transfers

Goods transferred from one department to another are recorded at cost or at selling price. If at a price including profit, the unrealised profit in closing stock of the receiving department must be eliminated by a **stock reserve**.

WORKED EXAMPLE **Unrealised profit on inter-department transfer**

Dept A transfers goods to Dept B at cost + 20%. Closing stock of B includes ₹36,000 of such goods. Unrealised profit = 36,000 × 20/120 = ₹6,000. It is debited to the General P&L A/c (or to Dept A) and credited to Stock Reserve.

If both departments transfer goods, compute unrealised profit for each using the receiving department's stock and the transferring department's GP rate.

Chapter 14: Insurance Claims for Loss of Stock and Loss of Profit

14.1 Insurance claims for loss of stock

A business insures stock against fire, flood or theft. When stock is destroyed, the claim is calculated from the books by preparing a **Memorandum Trading Account** from the start of the year to the date of loss.

Steps

1. Find the GP ratio from the previous year's trading account (adjusted for abnormal items).
2. Prepare Memorandum Trading A/c from start of year to date of fire: opening stock + purchases + direct expenses − sales = closing stock before fire (using GP ratio).
3. Stock destroyed = Stock at date of fire − salvage (stock saved).
4. Apply the **average clause** if the policy has one.

FORMULA Average clause

Claim = Loss of stock × (Policy amount ÷ Value of stock at date of fire).

The average clause applies only when the stock is under-insured (policy < stock value).

WORKED EXAMPLE Claim for loss of stock

Opening stock ₹80,000; purchases to date of fire ₹3,20,000; sales to date ₹4,00,000; GP 25% on sales. Stock saved ₹20,000. Policy ₹1,00,000 with average clause.

COGS = 4,00,000 × 75% = 3,00,000. Stock at date of fire = 80,000 + 3,20,000 − 3,00,000 = ₹1,00,000.

Loss = 1,00,000 − 20,000 = ₹80,000. Policy (1,00,000) = stock value, so no average reduction. Claim = ₹80,000.

If the policy were ₹75,000: Claim = 80,000 × 75,000 ÷ 1,00,000 = ₹60,000.

Abnormal items in stock

If stock includes slow-moving or abnormal items with a lower GP, prepare the Memorandum Trading A/c in two columns: normal and abnormal items.

Loss of profit (consequential loss) policy

It covers the loss of gross profit due to reduced turnover during the **indemnity period** after a fire, plus increased cost of working.

Term	Meaning
Indemnity period	Period after fire during which business is affected (maximum as per policy, often 12 months)
Short sales	Standard turnover − actual turnover in indemnity period
Standard turnover	Turnover in the corresponding period of the previous year, adjusted for trend
Rate of GP	(Net profit + insured standing charges) ÷ turnover
Increased cost of working	Extra expense incurred to reduce the short sales (allowed up to the GP saved on extra sales)
Average clause	Claim × (Sum insured ÷ GP on annual turnover)

FORMULA Loss of profit claim

Claim = GP on short sales + allowable increased cost of working − savings in standing charges, then apply average clause if under-insured.

14.2 Loss of profit claim – full computation

A **loss of profit** policy covers the loss of **gross profit** due to reduction in turnover and the **increased cost of working** during the **indemnity period** (the period after the fire during which results are affected, up to the maximum stated in the policy).

The definitions are in the table above; the computation runs as follows.

Loss of profit claim = short sales × GP rate + allowable ICOW − savings in insured standing charges; then apply the average clause

Average clause = claim × sum insured ÷ (annual turnover × GP rate), if the sum insured is lower

WORKED EXAMPLE Loss of profit claim (verified)

Last year: turnover ₹20,00,000, net profit ₹1,50,000, insured standing charges ₹2,50,000 → GP rate = 4,00,000 ÷ 20,00,000 = **20%**. Trend +10%. Turnover in the corresponding period last year ₹6,00,000 → standard turnover ₹6,60,000; actual turnover in the indemnity period ₹2,40,000 → short sales **₹4,20,000**. ICOW ₹30,000 generated extra turnover of ₹1,50,000 (economic limit 1,50,000 × 20% = ₹30,000 – allowed in full). Savings in standing charges ₹6,000. Annual turnover (12 months before the fire) ₹20,00,000 + 10% = ₹22,00,000; sum insured ₹3,60,000.

Claim before average = 4,20,000 × 20% + 30,000 − 6,000 = **₹1,08,000**. GP on annual turnover = 22,00,000 × 20% = 4,40,000 > sum insured → average applies: 1,08,000 × 3,60,000 ÷ 4,40,000 = **₹88,364**.

Chapter 15: Hire Purchase and Instalment Sale Transactions

15.1 Meaning

A **hire purchase** agreement is one under which goods are delivered to the hirer on payment of an initial down payment and the balance in instalments. The hirer gets possession at once, but **ownership passes only on payment of the last instalment**. The Hire Purchase Act, 1972 was passed but never brought into force and was later repealed; so the terms of the contract govern the transaction.

- **Hire vendor:** the seller; **hirer:** the buyer.
- Each instalment = part of cash price + interest.
- If the hirer defaults, the vendor can repossess the goods and keep instalments already paid as hire charges.

Hire purchase vs instalment system

Basis	Hire purchase	Instalment (deferred payment)
Ownership	Passes on payment of last instalment	Passes at the time of agreement
Nature	Contract of hire with option to buy	Contract of sale
Default	Vendor can repossess	Vendor can only sue for balance
Right to resell by buyer	Not before full payment	Yes
Depreciation	Charged by hirer (on full cash price)	Charged by buyer

15.2 Calculation of interest

When cash price, rate and instalments are given

Work backwards: interest is charged on the outstanding cash price at the beginning of each period.

WORKED EXAMPLE Interest schedule

Cash price ₹1,00,000. Down payment ₹25,000. Balance paid in 3 annual instalments of ₹30,000 each with interest 10% p.a.

Year 1: Outstanding = 75,000. Interest = 7,500. Instalment 30,000 → principal 22,500. Closing = 52,500.

Year 2: Interest = 5,250. Principal = 24,750. Closing = 27,750.

Year 3: Interest = 2,775. Principal = 27,750, so the last instalment = ₹30,525. (Exams usually round the last instalment so the balance becomes nil – always show the working.)

When cash price is not given

Use the annuity factor: Cash price = Down payment + Instalment × PV annuity factor. Or work backward from the last instalment: interest in the last instalment = Instalment × r ÷ (100 + r).

WORKED EXAMPLE Cash price not given

Down payment ₹20,000; three annual instalments of ₹22,000 at 10%.

Work backwards. Balance just before 3rd instalment = 22,000 × 100/110 = ₹20,000.

Balance just before 2nd instalment = (20,000 + 22,000) × 100/110 = ₹38,182.

Balance just after down payment = (38,182 + 22,000) × 100/110 = ₹54,711.

Cash price = 20,000 + 54,711 = ₹74,711. Interest: Year 1 = 5,471; Year 2 = 3,818; Year 3 = 2,000.

15.3 Books of the hirer

Asset accrual method (full cash price method) – most common

Event	Entry
Asset acquired	Dr Asset (full cash price); Cr Hire Vendor

Event	Entry
Down payment	Dr Hire Vendor; Cr Bank
Interest due	Dr Interest; Cr Hire Vendor
Instalment paid	Dr Hire Vendor; Cr Bank
Depreciation	Dr Depreciation; Cr Asset
Closing	Interest and depreciation transferred to P&L

Interest suspense method

The total interest is debited to an Interest Suspense A/c at the beginning; each year's share is transferred to the Interest A/c.

15.4 Books of the hire vendor

Event	Entry
Sale on HP	Dr Hirer; Cr HP Sales (cash price)
Down payment received	Dr Bank; Cr Hirer
Interest due	Dr Hirer; Cr Interest
Instalment received	Dr Bank; Cr Hirer

15.5 Default and repossession

- **Complete repossession:** the vendor takes back all goods. Hirer closes the asset account: Dr Hire Vendor (balance due); Cr Asset (book value after depreciation); difference is profit or loss on surrender.
- **Partial repossession:** the vendor takes back part of the goods and leaves the rest. Hirer transfers the book value of the repossessed part to the vendor's account; loss = book value of goods taken back − agreed value credited.

WORKED EXAMPLE Partial repossession

Hirer bought 3 machines at ₹50,000 each. Depreciation 10% WDV. After 2 years he defaults; the vendor takes back 1 machine and values it at cost less 25% depreciation p.a. WDV.

Book value of 1 machine after 2 years = 50,000 × 0.9 × 0.9 = ₹40,500.

Vendor's value = 50,000 × 0.75 × 0.75 = ₹28,125. Loss on repossession = ₹12,375.

15.6 Hire purchase trading account (small value goods)

When many small articles are sold on hire purchase, a business prepares a **Hire Purchase Trading Account** using the **stock and debtors method** or the **debtors method**.

Stock and debtors method

Account	Purpose
HP Stock A/c	Goods with customers, at HP price
HP Debtors A/c	Instalments due but not received
HP Adjustment A/c	Loading (profit) included in HP price; closing stock reserve

FORMULA Loading

Loading in HP price = HP price × Profit ÷ HP price. Stock reserve on closing HP stock = HP stock × Loading %.

15.7 Instalment purchase system

Under the instalment system ownership passes immediately. Entries are similar to HP, but the asset is recorded at cash price and the seller is a creditor. On default, the seller cannot take back goods; he only sues for the balance.

15.8 Ind AS view (brief)

Under Ind AS 116 (Leases), most hire purchase arrangements are treated like financing: the asset is recognised at present value and interest is charged using the effective interest method. Under the older AS 19, a hire purchase was treated like a finance lease. Exam problems still use the cash price method above.

Chapter 16: Introduction to Accounting Standards – GAAP, AS and Convergence to Ind AS

16.1 Meaning and objectives

Accounting Standards (AS) are written policy documents issued by an expert accounting body (the institute's Accounting Standards Board) or by Government, covering the **recognition, measurement, presentation and disclosure** of accounting transactions and events in financial statements.

Objectives: to harmonise diverse accounting policies, to reduce alternatives, to improve comparability, reliability and transparency of financial statements, and to reduce the scope for "creative accounting".

Benefits	Limitations
Uniformity and comparability across entities	Difficulty in choosing between alternatives – standards may be rigid
Reduce scope for manipulation	Cannot override the statute (law prevails over AS)
Better disclosure beyond legal requirement	Limited to material items; cannot cover every situation
Credibility with investors, lenders, regulators	Frequent changes increase compliance cost

16.2 Process of formulation of AS (standard setter)

1. The **Accounting Standards Board (ASB)** identifies the area and forms a **study group**.
2. The study group prepares a **preliminary draft**, considering IFRS/IAS, Indian laws and practices.
3. The draft is circulated to Council members, and to specified bodies (MCA, RBI, SEBI, CBDT, C&AG, IRDAI, industry bodies etc.) for comments.
4. The ASB finalises an **Exposure Draft (ED)** and issues it for **public comments**.
5. Comments are considered; the ASB finalises the draft and submits it to the **ICAI Council**.
6. The Council approves (or modifies) and the AS is **issued**. For companies, the Central Government notifies standards under **section 133** of the Companies Act, 2013 after consulting the **National Financial Reporting Authority (NFRA)**.

REMEMBER **For companies, AS are notified by the Central Government**

The Companies (Accounting Standards) Rules, **2021** (notified 23 June 2021) contain AS 1 to AS 29 (excluding withdrawn AS 6 and AS 8) for companies that do not follow Ind AS. For non-company entities, AS issued by ICAI apply.

16.3 Ind AS, IFRS – convergence vs adoption, carve-outs

IFRS are issued by the **International Accounting Standards Board (IASB)** of the IFRS this level. India chose to **converge** (not adopt) with IFRS and issued **Indian Accounting Standards (Ind AS)**, notified by MCA through the Companies (Ind AS) Rules, 2015.

Convergence	Adoption
Standards are drafted in line with IFRS but modified to suit local laws and conditions	IFRS are taken as issued by IASB, without changes
Departures (carve-outs/carve-ins) allowed	No departures
India's approach (Ind AS)	e.g., EU listed companies, Australia

Carve-outs are departures from IFRS in Ind AS that remove or modify an IFRS requirement; **carve-ins** add options not in IFRS. **Objectives of carve-outs:** to suit the Indian legal and economic environment, to avoid conflict with laws (e.g., Companies Act), and to address the preparedness of Indian industry.

WORKED EXAMPLE **Typical carve-outs (for theory answers)**

- Ind AS 103: bargain purchase gain recognised in **capital reserve** (IFRS 3: in profit or loss).
- Ind AS 1: breach of a loan covenant – loan need not be classified as current if the lender agrees, before approval of statements, not to demand payment (IFRS: agreement must be before the reporting date).
- Ind AS 28: uniform accounting policies "unless impracticable".

Need for convergence with global standards: globalisation of business, cross-border capital raising, one set of high-quality standards reduces cost of capital, comparability for foreign investors, reduced cost of preparing multiple sets of statements, better quality of financial reporting.

Chapter 17: Specified Accounting Standards (AS 1, 10, 11, 12, 16, 22) with Ind AS Comparison

17.1 AS 1 – Disclosure of Accounting Policies

Accounting policies are the specific accounting principles and methods of applying them adopted in preparing financial statements (e.g., inventory valuation method, depreciation method, revenue recognition).

- **Fundamental accounting assumptions:** going concern, consistency, accrual. If followed, no disclosure is needed; **if not followed, the fact must be disclosed**.
- **Considerations in selecting policies: prudence, substance over form, materiality**.
- All **significant** accounting policies must be disclosed **at one place** as part of the financial statements.
- Disclosure of a wrong or inappropriate treatment **does not cure it**.
- A **change** in policy with material effect must be disclosed with the amount of the effect, where ascertainable; if not ascertainable, that fact.

17.2 AS 10 – Property, Plant and Equipment

PPE are tangible items held for use in production/supply of goods or services, rental or administrative purposes, and expected to be used for **more than one period**. Recognised when future benefits are probable and cost is reliably measurable. Spare parts, stand-by and servicing equipment are PPE when they meet the definition; otherwise inventory.

Elements of cost: purchase price (incl. import duties and non-refundable taxes, after trade discounts and rebates; **GST input credit availed is excluded**), directly attributable costs (site preparation, delivery, installation, professional fees, employee benefits of construction, **testing costs net of proceeds from items produced during testing**), and the **initial estimate of dismantling and site restoration** (decommissioning) cost.

- **Not part of cost:** opening a new facility, introducing a new product (advertising), conducting business in a new location or with a new class of customer (training), administration and general overheads, costs after the asset is capable of operating as intended (initial operating losses), relocation costs, **income/expenses of incidental operations** (e.g., using a site as a car park before construction – to P&L).
- **Self-constructed asset:** same principles; abnormal waste and internal profits excluded.
- **Exchange of assets:** cost = fair value of asset given up (unless the exchange lacks commercial substance or fair values are not reliable → carrying amount of asset given up).
- **Subsequent costs:** day-to-day servicing → P&L; replacement of parts and **major inspections** → capitalised if criteria met, with derecognition of the carrying amount of the replaced part/previous inspection.
- **Component approach:** each part with a cost significant to the total is **depreciated separately**.
- **Measurement after recognition: cost model** or **revaluation model** for an entire class. Revaluation increase → credited to **revaluation surplus** (unless reversing a previous decrease charged to P&L); decrease → P&L (unless reversing a previous surplus). Surplus may be transferred directly to retained earnings when realised (or yearly, the difference between depreciation on revalued and original cost).
- **Depreciation:** systematic allocation of depreciable amount (cost – residual value) over useful life; begins when the asset is **available for use**; does not stop when the asset is idle. Residual value, useful life and method are **reviewed at least at each financial year-end**; changes are **changes in estimates** (AS 5) applied prospectively. **Land** is generally not depreciated (except quarries, landfill).
- **Derecognition:** gain/loss = net disposal proceeds – carrying amount, to P&L (gains are not revenue). Assets retired from active use and held for disposal are carried at lower of carrying amount and NRV.

WORKED EXAMPLE **Machine with government grant and GST**

Machine invoice ₹7,35,000 including GST 5% (₹35,000, full ITC available); freight ₹15,000; installation ₹25,000; trial-run materials ₹10,000 with net sale of trial output ₹4,000. Cost = 7,00,000 + 15,000 + 25,000 + 10,000 – 4,000 = **₹7,46,000**. GST ₹35,000 is excluded as ITC is availed.

17.3 AS 16 – Borrowing Costs

Borrowing costs = interest and other costs incurred in connection with borrowing: interest on loans and overdrafts, amortisation of discounts/premiums and ancillary costs, finance charges on finance leases, and **exchange differences on foreign currency borrowings to the extent they are regarded as an adjustment to interest cost**.

Qualifying asset = an asset that necessarily takes a **substantial period of time** (ordinarily **12 months** or more, unless a shorter period is justified) to get ready for its intended use or sale.

- **Specific borrowings:** capitalise **actual borrowing costs – income on temporary investment** of those borrowings.
- **General borrowings:** capitalise **expenditure on the asset × capitalisation rate** (weighted average borrowing cost of general borrowings outstanding), limited to actual borrowing costs incurred.
- **Commencement:** when (i) expenditure is being incurred, (ii) borrowing costs are being incurred, and (iii) activities necessary to prepare the asset are in progress.
- **Suspension:** during **extended periods** in which active development is interrupted (not during a temporary delay that is a necessary part of the process, e.g., high water level for a bridge).
- **Cessation:** when **substantially all** activities necessary to prepare the asset are complete; if completed in parts and each part is usable, capitalisation ceases part by part.

Exchange difference treated as borrowing cost =

interest on foreign loan at a comparable local rate – actual interest in ₹ (limited to the actual exchange loss)

WORKED EXAMPLE Specific and general borrowings

Construction of a factory (qualifying asset) throughout 2025-26. Specific 12% loan ₹40,00,000 taken 1 April 2025; ₹10,00,000 of it was temporarily invested for 6 months at 8% (income ₹40,000). On 1 October 2025 a further ₹20,00,000 was spent from general borrowings: 10% loan ₹50,00,000 and 12% loan ₹30,00,000 outstanding all year.

Specific: 4,80,000 – 40,000 = ₹4,40,000. Capitalisation rate = (5,00,000 + 3,60,000) ÷ 80,00,000 = 10.75%. General: 20,00,000 × 10.75% × 6/12 = ₹1,07,500. **Total capitalised ₹5,47,500.**

17.4 AS 11 – The Effects of Changes in Foreign Exchange Rates

Monetary items: money held and assets/liabilities to be received/paid in fixed or determinable amounts of money (cash, receivables, payables, loans). **Non-monetary:** PPE, inventories, investments in equity, advances for goods.

Stage	Rule
Initial recognition	Exchange rate on the **date of the transaction** (average rate for a week/month acceptable if rates do not fluctuate significantly)
Each balance-sheet date	**Monetary** items at the **closing rate**; non-monetary items at historical cost → rate on the transaction date; at fair value → rate when value was determined
Exchange differences	Recognised as **income or expense in the period** in which they arise (on settlement or restatement)

- **Para 46/46A option** (long-term foreign currency monetary items – LTFCMI, term ≥ 12 months at inception): exchange differences relating to the **acquisition of a depreciable capital asset** may be **added to/deducted from the cost** of the asset and depreciated over its balance life; others may be accumulated in the **Foreign Currency Monetary Item Translation Difference Account (FCMITDA)** and amortised over the balance period of the item. The option, once exercised, is irrevocable.
- **Foreign operations: integral** (activities are an extension of the reporting enterprise) – translate as if the transactions were the enterprise's own (monetary closing rate, non-monetary historical). **Non-integral** – assets and liabilities (monetary and non-monetary) at the **closing rate**; income and expenses at transaction-date (or average) rates; all differences to a **foreign currency translation reserve** until disposal of the net investment.
- **Forward exchange contracts** (not for trading/speculation): premium or discount (difference between forward rate and spot rate at inception) is **amortised as expense/income over the life of the contract**; exchange differences on the contract are recognised in P&L in the period of change. Contracts for **trading/speculation**:

no premium amortisation; gain/loss computed as contract rate vs forward rate for the remaining maturity at each balance sheet date, recognised in P&L.

WORKED EXAMPLE Foreign currency loan for a depreciable asset

1 April 2025: borrowed USD 10,000 at 6% (rate ₹85) and bought a machine. 31 March 2026: rate ₹90; interest USD 600 paid at ₹90 = **₹54,000** (expense). Exchange loss on the loan = 10,000 × (90 − 85) = **₹50,000**.

Without para 46A: ₹50,000 to P&L. With para 46A: add ₹50,000 to the cost of the machine (8,50,000 → 9,00,000 before depreciation) and depreciate over its remaining life.

17.5 AS 22 – Accounting for Taxes on Income

Tax expense = current tax + deferred tax. **Taxable income** is computed under tax laws; **accounting income** is net profit before tax.

- **Timing differences** originate in one period and reverse in later periods (e.g., depreciation differences, expenses disallowed u/s 43B and allowed on payment, provisions allowed later) → **deferred tax**. **Permanent differences** (e.g., penalties, exempt income) never reverse → no deferred tax.
- **Deferred tax liability (DTL):** recognised for all timing differences. **Deferred tax asset (DTA):** recognised only if there is **reasonable certainty** of sufficient future taxable income; where there is **unabsorbed depreciation or carry-forward losses**, only if there is **virtual certainty supported by convincing evidence**.
- Measured at tax rates **enacted or substantively enacted** at the balance-sheet date; **not discounted**. Reviewed at each balance-sheet date (write-down / reversal).
- Tax holiday periods (e.g., sections 80-IA/80-IB): deferred tax only on timing differences that reverse **after** the holiday period. DTA and DTL are offset only if there is a legally enforceable right and they relate to the same tax law.

WORKED EXAMPLE Current and deferred tax

PBT ₹10,00,000; book depreciation ₹1,00,000; tax depreciation ₹1,60,000; penalty ₹20,000 (disallowed); rate 25%.

Taxable income = 10,00,000 + 1,00,000 − 1,60,000 + 20,000 = 9,60,000 → **current tax ₹2,40,000**. Timing difference 60,000 → **DTL ₹15,000**. Tax expense = ₹2,55,000 (penalty is a permanent difference – no deferred tax).

17.6 AS 12 – Accounting for Government Grants

Government grants are assistance by Government in cash or kind in return for past or future compliance with conditions. Excluded: assistance that cannot reasonably be valued, and transactions with Government that cannot be distinguished from normal trading. Grants are recognised only when there is **reasonable assurance** that (i) the conditions will be complied with and (ii) the grant will be received.

Type of grant	Treatment
Related to **specific depreciable asset**	Either **deduct from gross value** of the asset (depreciation on net), or treat as **deferred income** recognised in P&L on a systematic basis over the useful life (in proportion to depreciation)
Related to **non-depreciable asset** (e.g., land) without obligations	Credit to **capital reserve**
Non-depreciable asset requiring fulfilment of obligations	Credit to P&L over the period of the cost of meeting the obligations
Promoters' contribution (e.g., grant related to total investment or capital outlay, no repayment)	**Capital reserve** (shareholders' funds)
Revenue grants (related to costs)	P&L – as "other income" or deducted from the related expense, matching the costs

Type of grant	Treatment
Compensation for losses already incurred / immediate support	P&L of the period when receivable (may be extraordinary)
Non-monetary grants (land, other assets)	At **acquisition cost**; assets given free – at **nominal value**

- **Refund of grants:** revenue grant – first charged against any unamortised deferred credit, excess to P&L. **Asset-related** grant – increase the book value of the asset or reduce the deferred income balance; on increasing book value, **depreciation on the revised book value is provided prospectively** over the residual useful life. Refund of promoters' contribution – reduce capital reserve.

WORKED EXAMPLE Refund of a grant deducted from cost

Machine cost ₹200 lakh; grant ₹50 lakh deducted → net ₹150 lakh; life 5 years, nil residual, SLM (₹30 lakh per year). After 2 years the full grant becomes refundable. Book value before refund = 150 − 60 = ₹90 lakh; after refund = **₹140 lakh**; future depreciation = 140 ÷ 3 = **₹46.67 lakh per year**.

17.7 Comparative provisions – AS and Ind AS

Topic	AS	Ind AS
Accounting policies	**AS 1** – disclosure of significant accounting policies; fundamental assumptions: going concern, consistency, accrual	**Ind AS 1** (presentation) and **Ind AS 8** (policies, estimates, errors) – changes in policy applied **retrospectively**; prior period errors restated
PPE	**AS 10** – cost or revaluation model; component accounting; revaluation surplus to reserve	**Ind AS 16** – same models; **decommissioning costs** included in cost; residual value and useful life reviewed annually; investment property under Ind AS 40
Foreign exchange	**AS 11** – integral and non-integral foreign operations; option to capitalise or amortise exchange differences on long-term monetary items (para 46A)	**Ind AS 21** – **functional currency** and presentation currency concept; no integral/non-integral distinction; exchange differences on monetary items to P&L (net investment in foreign operation to OCI)
Government grants	**AS 12** – capital approach for promoters' contribution (capital reserve) or income approach; grant related to assets may be **deducted from cost** or shown as deferred income	**Ind AS 20** – only the **income approach**; grants related to assets shown as **deferred income** (deduction from cost permitted after 2018 amendment VERIFY); non-monetary grants at fair value
Borrowing costs	**AS 16** – qualifying asset normally takes **12 months** or more to get ready; exchange differences treated as borrowing cost to the extent of interest adjustment	**Ind AS 23** – no 12-month bright line ("substantial period"); similar exchange difference rule; interest computed on effective interest method
Taxes on income	**AS 22** – **income statement approach**; timing differences; deferred tax assets on unabsorbed depreciation/losses only with **virtual certainty**	**Ind AS 12** – **balance sheet approach**; temporary differences; DTA when **probable**; deferred tax on OCI items in OCI

Formula & rules sheet (last-week revision)

Topic	Rule / formula
PDD and discount	PDD on debtors after bad debts; discount on (debtors – bad debts – PDD)
BRS	Start with one balance; add/less items recorded in only one of the two books; overdraft = negative balance
Depreciation	SLM = (cost – residual) ÷ life; WDV = opening WDV × rate; change in method is a change in estimate (prospective)
Bills – due date	Date of drawing + term + 3 days of grace; if a public holiday, preceding day (emergency holiday – next day)
Consignment	Closing stock = cost + proportionate non-recurring expenses (to the point of arrival); normal loss spread over good units; abnormal loss at cost + proportionate expenses
Del credere commission	Commission on total sales (credit and cash unless stated); bad debts borne by the consignee
NPO	Subscription income = received – outstanding opening – advance closing + outstanding closing + advance opening (for the year only); legacies and specific donations → capital fund/specific fund
Incomplete records	Profit = closing capital + drawings – additional capital – opening capital
Goodwill	Super profit = average profit – normal return on capital employed; capitalisation: (avg profit ÷ NRR) – capital employed
Sacrificing ratio	Old share – new share; gaining ratio = new share – old share
s. 37	Outgoing partner: 6% p.a. interest **or** share of profit from use of his share of property, at his option
Garner v Murray	Solvent partners bear the deficiency of an insolvent partner in the ratio of **fixed (or last agreed) capitals** before dissolution
Piecemeal	Proportionate capital method or maximum loss method; outside liabilities first, then partners' loans, then capitals
Finance lease (lessee)	Asset/liability = lower of fair value and PV of MLP; finance charge at implicit rate on opening liability
Branch – debtors method	Branch A/c: debit opening assets + goods sent + expenses paid; credit remittances + closing assets
Foreign branch (AS 11)	Integral operation: monetary items at closing rate, non-monetary at historical rate, revenue at average rate; difference to P&L
Loss of stock	Stock at fire = opening + purchases – (sales – GP); claim = loss × policy ÷ stock value (average)
Loss of profit	Short sales × GP rate + allowable ICOW – savings; × sum insured ÷ GP on annual turnover
Hire purchase	Interest on outstanding cash price; last-instalment interest as balancing figure; repossession: loss = book value – agreed value
AS 16	Qualifying asset = ordinarily 12 months or more; capitalise borrowing costs from commencement to completion
AS 22	DTA/DTL on timing differences at enacted/substantively enacted rates; virtual certainty for losses

Common mistakes to avoid

- Calculating discount on debtors before deducting the PDD.
- Forgetting the 3 days of grace or the holiday rule for the due date of a bill.
- Valuing consignment stock at cost without adding proportionate non-recurring expenses.
- Treating legacies and specific donations as revenue receipts of an NPO.
- Mixing the old and new profit-sharing ratios when distributing revaluation profit, reserves and JLP proceeds (always the **old** ratio).
- Applying Garner v Murray in the profit-sharing ratio instead of the capital ratio.
- Ignoring the average clause in loss-of-stock and loss-of-profit claims.
- Recording a finance lease as an operating lease (rent to P&L) in the lessee's books.
- Charging hire-purchase interest on the hire purchase price instead of on the outstanding cash price.
- Writing generic theory for AS questions – quote the paragraph rule and give the treatment with figures.