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CENTRE FOR DISTANCE EDUCATION

B. Com. Part-III

Advanced Accountancy

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Semester-VI : Paper-III (DSE-A3)

(From Academic Year 2021-22 onwards)

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Preface

Accounting is a language of business to communicate financial performance of the organisation. This book intend to dissiminate knowledge and skills regarding specific topics of accounting, especially for those students who have an opportunity to learn on distance mode.

This book is divided into two sections Semester-wise such as four units in Semester-V and four units in Semester-VI of B. Com. Part-III. The first section consists off units on final accounts of banking companies, farm accounting (including crop account, fishery, poultry, dairy and livestock etc.), hire purchase system, accounting for insurance claims and GST accounting with practicals using Tally Part-I, whereas the second section includes the units such as element of cost, financial statement analysis through ratio analysis, cash flow analysis and Tally with GST (Practical) Part-II.

We hope this book will be useful to students on distance mode. Though, we appeal them to refer standard reference books for additional inputs desired. We expect suggestions from all corners of the society for improvement in it in further edition.

We are thankful to Prof. (Dr.) D. T. Shirke, Hon. Vice-Chancellor; Prof. (Dr.) P. S. Patil, Hon. Pro-Vice-Chancellor; Dr. V. N. Shinde, I/c. Registrar and Dr. D. K. More, Director, Centre for Distance Education for availing us an opportunity to edit this book.

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Advanced Accountancy
Paper I and III : B. Com. III

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B. Com Part-III

Semester V and VI

SIM IN ADVANCED ACCOUNTANCY PAPER I AND III

INDEX

Each Unit begins with the section 'Objectives' -

Objectives are directive and indicative of :

1. What has been presented in the Unit and
2. What is expected from you
3. What you are expected to know pertaining to the specific Unit once you have completed working on the Unit.

The self check exercises with possible answers will help you to understand the Unit in the right perspective. Go through the possible answer only after you write your answers. These exercises are not to be submitted to us for evaluation. These are provided to you as Study Tools to help keep you in the right track as you study the Unit.

Unit 1

Bank Final Accounts (Vertical Format only)

Structure of Unit :

1.0 Objectives :

After studying this unit you will be able to understand the :

- Meaning of Bank
- Scope of banking business
- Various statutory provisions of Banking Regulation Act 1949
- Method of presenting final accounts in prescribed forms

1.1 Introduction :

Bank business in India is governed by the banking Regulation Act 1949, which came into force from 16^{th} March 1949. As per section 2 of this Act, provisions of companies Act 1956, are also applicable to Banking companies. Bank is a commercial institution, licensed to accept deposits and acts as a safe custodian of the funds of its customers, banks are mainly concerned with receiving, collection, transferring, buying, lending, investing, exchanging, servicing money and claims to money both domestically and internationally. The principal activities of a bank are operating current accounts, receiving deposits, and advancing loans.

1.2 Presentation of Subject Matter

1.2.1 Meaning and Definition of Bank :

As per section 5(b) of the Banking Regulation Act 1949, 'Banking' means the accepting, for the purpose of lending or investment, of deposits of money from the public repayable on demand or otherwise, and withdrawable by cheque, drafts, order or otherwise.

Section 5(c) of banking Regulation Act defines 'banking companies' as "any company which transacts the business of banking in India" However the definition given by the Act is too narrow. In modern world banking is not restricted merely to acceptance of deposits and lending Advances. Section 6 of the Act also recognises this fact and has accordingly laid down that in addition to the usual banking business, a banking company may carry on any additional business as specified by section 6

1.2.2 Scope of banking business :

As per the provisions of section 6 of the Banking Regulation Act, 1949 a banking company may engage in any one of the following forms of business. In addition to the banking business. These are

1) Borrowing, raising money, advancing money either upon or without security, dealing in bills of exchange, granting and issue of letter of credit, travellors cheques and circular notes, selling and dealing in bullion and specie, buying and selling of foreign exchange including foreign bank notes, dealing in stock, shares, debenture, purchasing and selling of bonds providing of safe deposit vaults, the collecting and transmitting of money and securities.

2) Acting as an agent for any Government or local authority or any other person, acting as an attorney on behalf of customers.

3) Contracting for public and private loans and negotiating and issuing the same.

4) Insuring, guaranteeing, underwriting any issue of any company, corporation or association and lending of money for the purpose of such issue.

5) Carring on and transacting every kind of guarantee and indemnity business.

6) Selling any property which is acquired in satisfaction of claims.

7) Acquiring and holding any property or right in any property against any loans connected with such security.

8) Undertaking and executing trusts.

9) Establishing and supporting any institution, funds, trusts to benefit employees or ex-employees of company.

10) The acquisition, construction, maintenance and alteration of any building for the purpose of the company.

11) Selling, leasing, mortgaging, disposing all or any property and rights of the company.

12) Doing all such other things as are incidental or conductive to the promotion or advancement of the business of the company.

13) Any other form of business which the Central Government may, by notification in the Official Gazette, specify as a form of business.

Restriction on Bank Business -

As per section 8 of the Banking Regulation Act 1949, certain restrictions are laid down on the business of banking company These are-

a) No banking company shall directly or indirectly deal in the buying, selling or bartering of goods, except in connection with the realisation of security given to or held by it.

b) No banking company can engage in any trade or buy, sell or barter goods for others otherwise than in connection with bill of exchange, received for collection or negotiation or with such of its business.

1.2.3 Statutory provisions of Banking Regulations Act :

1) Minimum Capital and Reserves

As per the section of 11 (2) of the Banking Regulation Act 1949, the aggregate value of paid up capital and reserves of a banking company in corporate outside India, shall not be less than 15 lakhs rupees, and it has a place of business in city of Mumbai or Calcutta, then it shall not be less than 20 lakhs rupees. It should be noted that such sum and 20% of the net profit of each year shall be kept deposited with Reserve. Bank of India is cash or in the form of men cumbered approved securities, or partly in cash and partly in the form of such securities.

However in case of a banking company which is incorporated in India, the aggregate value of capital and reserves shall not be less than the stated amount according to place of business.

2) Restriction on commission, Brokerage etc. :

No banking company shall pay out directly or indirectly by way of commission, brokerage in any form in respect of shares issued by it, any amount exceeding 2.5% of paid up value of shares.

3) Statutory Reserve :

According to section 17 of the banking Regulation Act, 1949, every banking company incorporated in India shall create a reserve and transfer to it at least 20% of its annual profit before any dividend is declared.

4) Cash Reserve :

Every banking company not being a schedule bank, has to maintain a cash reserve of at least 3% of the total of its demand and time liabilities in India, as on last Friday of the Second proceeding fortnight.

5) Restrictions on loans and advances :-

No banking company shall,

i) grant any loans or advances on the security of its own shares.

ii) grant any loan or advances to any of its directors, or any of the firm in which any of its director is interested as partner, employee or manager.

6) Restriction on Payment of Dividend :

No banking company shall pay any dividend on its shares until all its capitalized expenses have been completely written off.

7) Books of Accounts :

Bank has to adopt a specialized system of book-keeping which will ensure dimidiated entry of numerous transactions and keep an internal check on the books of accounts. For this, bank generally maintain a large number of subsidiary and memorandum books in addition to principal books of accounts.

Principal books of accounts :

Cash book and general ledger are the principal books of accounts of any bank. Cash book records all cash transactions and general ledger contains control accounts of all subsidiary ledgers and different assets and liabilities account.

8) Final Accounts :

According to section 29 of the Banking Regulation Act, 1949, every banking company is required to prepare with reference to that year a balance sheet and profit and loss account on the last working day of the year in the Form 'A' and Form 'B' respectively as given in schedule III

1.2.4 Form of Balance Sheet (Vertical)

Third Schedule

(Section - 29)

Form 'A'

Form of Balance Sheet

Balance Sheet of .... Bank

as on 31-3-.........

Particulars	Schedule No.	Current Year	Previous Year
Capital and Liabilities			
Capital	1		
Reserve and Surplus	2		
Deposits	3		

Borrowings	4		
Other liabilities and provisions	5		
Total			
Assets			
Cash in hand and Balance with R.B.I.	6		
Balance with other banks, money at call	7		
Investments	8		
Advances	9		
Fixed Assets	10		
Other Assets	11		
Total			
Contingent Liabilities	12		
Bills for collection			

1) **Capital :** It is a first item of Liabilities. It's details are given in schedule-1. Which contain authorized capital, issued, subscribed, called up and paid up capital.

2) **Reserves and Surplus** : It includes statutory reserves, capital reserves, share premium, profit and loss account balance. The details of this are given in schedule No. 2

3) **Deposits** : It contains demand deposits, saving bank deposits / accounts, term deposits. The details are given in schedule No. 3

4) **Borrowings** : It includes borrowings from Reserve Bank of India, borrowing from other banks and institutions and agencies. The details about it are given in schedule No. 4

5) **Other liabilities and provisions** : It includes Bills payables, Branch Office / interoffice adjustment credit balance, interest outstanding / accrued on deposits, provision for taxations, Rebate on bills discounted etc. and shown in schedule No. 5

6) **Cash in hand and balance with R.B.I.** - It includes cash in hand including foreign currency notes, and balance with Reserve Bank of India. Details are given in Schedule No. 6

7) **Balance with other banks, Money at call and short notice -** It contains balance with other banks, money at call and short notice. These are shown in schedule No. 7

8) **Investments** - Investment in Government securities, other approved securities, investment in shares / debentures and bonds, gold are shown under this heading. The details are given in schedule No. 8

9) **Advances** - It gives details about loans and advances granted by bank. It includes loans cash credit and overdraft, Term loans, bills purchased and discounted. The details are given in schedule No. 9

10) **Fixed Assets** - Premises, Furniture and Fixtures and other fixed assets are shown under this head. The details are given in schedule No. 10.

11) **Other Assets** - It includes advance taxes, stationery and stamps on hand, Branch adjustment (Dr. bal.), Interest accrued on advances, non banking assets etc. Details are given in schedule No. 11

12) **Contingent Liabilities** - It indicate the liabilities which are not provided in Balance Sheet. It includes liabilities on partly paid shares, claims against bank not acknowledged as debts; acceptances endorsement and other obligations etc. Details are given in schedule No. 12

13) **Bills for collection** - It includes bills receivables received on behalf of customers for collection. These are shown outside the Balance Sheet.

1.2.5 Form of Profit and Loss Account (Vertical)

Form 'B'

Form of Profit and Loss Account

For the year ended on 31-3-…………….

Particulars	**Schedule No.**	**Current Year**	**Previous Year**
I. Income			
Interest earned	13		
Other Income	14		
Total			

II. Expenditure			
Interest expended	15		
Operating expenses			
Provisions and Contingencies			
Total			
III. Profit/Loss			
Profit/Loss brought forward (op. bal)			
Net profit/loss for current year			
Total			
IV. Appropriations			
20% transfer to Statutory Reserve			
Transfer to other reserves			
Proposed Dividend/Interim Dividend			
Balance carried over to Balance Sheet			
Total			

I) **Income** : It includes interest earned or discount received by bank on advances or bills discounted, income on Investments, Interest on balance with R.B.I, etc. It is shown under schedule-13

Other Income : Includes commission exchange and brokerage, profit on sale of investments, profit on revelation of assets, Dividend from subsidiaries. These are shown in schedule No. 14.

II) **Expenditure** : These are shown under three different heads viz. interest expended, operating expenses and provisions. Interest expended includes interest paid by bank on deposits and borrowings. It is shown under schedule No. 15. Operating Expenses of bank such as salaries and allowances to staff and officers, Rent taxes rates, printing & stationery, Advertisement, depreciations on bank property etc. are shown under schedule -16, Provisions include provision made for dorebuttul debts, tax provisions and other contingencies.

III) **Profit / Loss** : It shows the profit or loss balance of last year and current year Net Profit (i.e. difference between Income and expenditures)

IV) Appropriations : Amount transferred to statutory reserve and other reserves, proposed dividends are shown under this heading.

1.2.6 Various Schedules :

Schedule No. 1 – **Capital**

Particulars	**Current Year**	**Previous Year**
Authorised Capital		
.... shares of Rs. .... each	....	
Issued Capital		
.... shares of Rs. .... each	....	
Subscribed Capital		
.... shares of Rs. .... each	....	
Called up capital		
.... shares of Rs. .... each		
Less : Calls in arrears		
Add : fortified shares	....	
Total		

Schedule No. 2 - **Reserves & Surplus**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
I. Statutory Reserves		
Opening Balance		
Additions during the year		
Deductions during the year		
II. Capital Reserves		
Opening Balance		
Additions during the year		
Deductions during the year		
III. Shares Premium		
Opening Balance		

Additions during the year		
Deductions during the year		
IV. Revenue and other Reserves		
Opening Balance		
Additions during the year		
Deductions during the year		
V. Balance in Profit and Loss Accounts		
Total (I + II + III + IV + V)		

Schedule No. 3 – **Deposits**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
A. I. Demand Deposits		
(i) From banks		
(ii) From others		
II. Savings Bank Deposits		
III. Term Deposits		
(i) From banks		
(ii) From others Total		
(I + II + III)		
B. (i) Deposits of branches in India		
(ii) Deposits of branches outside India		
Total		

Schedule No. 4 – **Borrowings**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
I. Borrowings in India		
(i) Reserve Bank of India		
(ii) Other banks		
(iii) Other institutions and agencies		

II. Borrowing outsides India		
Total (I + II)		
Secured borrowings included in I & II above Rs.		

Schedule No. 5 - **Other Liabilities and Provisions**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
I. Bills payable II. Inter-office adjustments (net). (cr.) III. Interest accrued IV. Others (including provisions)		
Total		

Schedule No. 6 - **Cash & Balances with Reserve Bank of India**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
Cash in hand (including foreign currency notes) **Balances with RBI** (i) in Current Account (ii) in Other Accounts		
Total (I + II)		

Schedule No. 7 **- Balances with Banks & Money at call & short Notice**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
India I. Balances with banks (a) In Current Accounts (b) In other Deposit Acocunts II. Money at Call and Short Notice		

(a) With banks		
(b) With other institutions		
Total		
Outside India		
(i) In Current Accounts		
(ii) In other Deposit Accounts		
(iii) Money at Call and Short Notice		
Total		
Grand Total (I + II)		

Schedule No. 8 – **Investments**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
I. Investments in India in		
(i) Government securities		
(ii) Other approved securities		
(iii) Shares		
(iv) Debentures and Bonds		
(v) Subsidiaries and/or joint ventures		
(vi) Others (to be specified)		
Total		
II. Investments outside India in		
(i) Government securities (including local authorities)		
(ii) Subsidiaries and/or joint ventures abroad		
(iii) Other investments (to be specified)		
Total Grand Total (I + II)		

Schedule No. 9 – **Advances**

Particulars	As on 31-3-.... (Current Year)	Previous Year
i) Bills purchased and discounted ii) Cash credits, overdrafts and loans repayable on demand iii) Term loans		
Total		
i) Secured by tangible assets ii) Covered by Bank/Government guarantees iii) Unsecured		
Total		
C. I. Advances in India (i) Priority Sectors (ii) Public Sector (iii) Banks (iv) Others **II. Advances Outside India** (i) Due from banks (ii) Due from others (a) Bills purchased and discounted (b) Syndicated loans (c) Others		
Total		
Grand Total (C. I. + C. II)		

Schedule No. 10 - **Fixed Assets**

Particulars	As on 31-3-.... (Current Year)	Previous Year
I. Premises At cost an on 31st March of the preceding		

year Additions during the year Deductions during the year Depreciation to date **II. Other Fixed Assets** (Including furniture & fixtures) At cost as on 31st March of the preceding year Additions during the year Deductions during the year Depreciation to date		
Total (I + II)		

Schedule No. 11 - **Other Assets**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
I. Inter-office adjustment (net) II. Interest accrued III. Tax paid in advance/tax deducted at source IV. Stationery and stamps V. Non-banking assets acquired in satisfaction of claims VI. Others.		
Total		

Schedule No. 12 - **Contingent Liabilities**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
I. Claims against the bank not acknowledged as debts II. Liability for partly paid investments III. Liability on account of outstanding forward		

exchange contracts. IV. Guarantees given on behalf of constituents (a) In India (b) Outside India V. Acceptances, endorsements and other obligations VI. Other items for which the bank is contingently liable		
Total		

Schedule No. 13 – **Interest Earned**

Particulars	As on 31-3-.... (Current Year)	Previous Year
Interest/discount on advances/bills Income on investments Interest on balances with Reserve Bank of India and Other inter-bank funds Others		
Total		

Schedule No. 14 – **Other Income**

Particulars	As on 31-3-.... (Current Year)	Previous Year
Commission, exchange and brokerage Profit on sale investments Less : **Loss on sale of investments** Profit on revaluation of investments Less : **Loss on revaluation of investments** Profit on sale of Land, Building and other assets Less : **Loss on sale of land, Building and other assets**		

Profit on exchange transactions Less : **Loss on exchange transactions** Income earned by way of dividends etc. From subsidiaries/companies and/or Joint ventures abroad/in India Miscellaneous Income		

Schedule No. 15 **- Interest Expended**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
Interest on deposits Interest on Reserve Bank of India/ Inter – bank borrowings others		
Total		

Schedule No. 16 **- Operating Expenses**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
I. Payment to and provisions for employees II. Rent, taxes and lighting III. Printing & Stationery IV. Advertisement & Publicity V. Depreciation on bank's property VI. Directors fees, allowances and expenses VII. Auditors fees and expenses (including branch auditors fees and expenses) VIII. Law charges IX. Postages, telegrams, telephones etc. X. Repairs and maintenance XI. Insurance XII. Other expenditure		
Total		

1.2.7 R.B.I. Guidelines for Compilation of Financial Statement

Item	Schedule	Coverage	Notes and Instructions for compilation
(1)	(2)	(3)	(4)
Capital	1.	**Nationalized Banks** Capital (fully owned by Central Government)	The capital owned by Central Government as on the date of the Balance Sheet, including contribution from Government if any, for participating in World Bank Projects, should be shown,
		Banking Companies incorporated outside India.	(i) The amount brought in by banks way of start-up capital as prescribed by RBI, should be shown under this head. (ii) The amount or deposits kept with RBI under subsection 2 of Section 11 of the Banking Regulation Act, 1949 should also be shown.
		Other Banks (Indian) Authorised capital (... Shares of Rs.... each) Issued Capital (... Shares of Rs. ... each) Subscribed Capital (........... Shares of Rs. .... each) Called-up Capital (............ Shares of Rs............ each) *Less :* **Calls unpaid** *Add :* **Forfeited** *Shares* **: Paid-up Capital**	Authorised, Issued, Subscribed. Called-up Capitals should be given separately. Calls-in-arrears will be deducted from Called-up Capital while the paid-up value of forfeited shares should be added, thus arriving at the paid-up capital, the necessary items which can be combined should be shown under one head, for instance, "Issued and Subscribed capital". **Notes**: General The changes in the above items, if any, during the years, say fresh contribution made by the Government, fresh issue of capital, capitalisation of reserves, etc. may be explained in the notes.

Reserve and Surplus	2	**(I) Statutory Reserves**	Reserves created in terms of Section 17 or another section of Banking regulation Act, must be separately disclosed.
		(II) Capital Reserves	The expression 'capital reserve' shall not include any amount regarded as free for distribution through the Profit and Loss Account. Surplus on revaluation should be treated as Capital Reserve. Surplus on translation of the financial statements of foreign branches (which includes fixed assets also) is of a revaluation reserve.
		(III) Share Premium	Premium on issue of share capital may be shown separately under this head.
		(IV) Revenue and other Reserves	The expression 'Revenue Reserve' shall mean any reserve other than capital reserve. This item will include all reserves, other than those separately classified. This expression 'reserve' shall not include any amount, written-off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability.
		(V) Balance of Profit	Includes balance of profit after appropriation. In case of loss the balance may be shown as a deduction. **Notes**: General Movement in various categories of reserves should be shown as indicated in the schedule.
Reserve and Surplus	3	**A. (I) Demand Deposits** (i) from banks (ii) from others	Includes all bank deposits repayable on demand. Includes all demand deposits of the non-banking sectors. Credit balance in overdrafts, cash

		(II) Saving Bank Deposits	credit accounts, deposits payable at call, overdue deposits, inoperative current accounts, matured time deposits and cash certificates, certificate of deposits, etc. are to be included under this category. Includes all savings bank deposits (including inoperative savings bank accounts) Includes all types of bank deposits repayable after specified term.
		(III) Term Deposits (i) from banks (ii) from others	Includes all types of deposits of the non-banking sector, repayable after a specified term. Fixed deposits, cumulative and recurring deposits, annuity deposits, deposits mobilised under various schemes, ordinary staff deposits, foreign currency non-resident deposit accounts, etc., are to be included under this category.
		B. (i) Deposits of branches in India **(ii) Deposits of branches outside India**	The total of these two items will agree with the total deposits. **Notes :** General (a) Interest payable on deposits which is accrued but not due should but be included but shown under other liabilities. (b) Matured time deposits and cash certificates, etc., should be treated as demand deposits. (c) Deposits under special schemes should be included under the term deposits, if they are not payable on demand. When such deposits have matured for payment they should be shown under demand deposits. (d) Deposits from banks will include deposits from the banking system in

			India, co-operative banks, foreign banks, which may or may not have presence in India.
Borrowings	4	**(I) Borrowings in India** (i) Reserve Bank of India (ii) Other Banks (iii) Outside Institutions and agencies **(II) Borrowings outside India** Secured borrowings included above	Includes borrowing / refinance obtained from Reserve Bank of India. Includes borrowings / refinance obtained from -commercial banks (including co-operative banks). Includes borrowings / refinance obtained from Industrial Development Bank of India, Export-Import of Bank of India, National Bank for Agriculture and Rural Development and other institutions, agencies (including liability against participation certificates, if any). Includes borrowings of Indian branches abroad as well as borrowing of foreign branches. This item will be shown separately. Includes secured borrowings/refinance in India and outside India. Notes: General (i) The total of I and II will agree with the total borrowings shown in the Balance Sheet. (ii) Inter-office transactions should not be shown as borrowings. (iii) Funds raised by foreign branches by way of certificates of deposits, notes, bonds, etc., should be classified depending upon documentation, as ‘deposits’, ‘borrowings’, etc. (iv) Refinance obtained by banks from Reserve Bank of India and

			various institutions arc being brought under the head 'Borrowings'. Hence, advances will be shown at the gross amount on the assets side.
Borrowings	5	I. Bills Payable	Includes drafts telegraphic transfers, traveler cheques, mail transfers payable, pay slips, bankers cheques and other miscellaneous items.
		II. Inter-office Adjustments	The inter-office adjustments balance, if the credit, should be shown under this head. Only net position of inter-office accounts, inland as well as foreign, should be shown here.
		III. Interest Accrued	Includes interest accrued but not due on deposits and borrowings.
		IV. Others (including provisions)	Includes net provision for income tax and other taxes like interest tax (less advance payment, tax deducted at source etc.,) surplus in aggregate in provisions for Bad Debts Provision Account, surplus in aggregate in provisions for depreciation in securities, contingency funds which are not disclosed as reserves but arc actually in the nature of reserves but are actually in the nature of reserves, proposed dividend/transfer to Government, other liabilities which arc not disclosed under any of the major heads such as unclaimed dividend, provisions and funds kept for specific purpose, unexpired discount, outstanding charges like rent, conveyance, etc. Certain types of deposits like staff security deposits margin deposits etc., where the repayment is not free, should also

			be included under this head. **Notes :** General (i) For arriving at the net balance of inter-office adjustments all connected inter-office accounts should be aggregated and the net balance should only be shown, representing mostly items in transit and unadjusted items. (ii) the interest accruing on all deposits, whether the payment is due or not, should be treated as a liability. (iii) it is proposed to show only pure deposits under the head deposits; and hence, all surplus provisions for bad and doubtful debts, contingency funds, secret reserves, etc. which are not netted off against the relative assets, should be brought under the head 'others' (including provisions).
Cash and Balance with the Reserve Bank of India	6.	**I. Cash in hand** (including foreign currency notes) II. Balance with RBI (i) in Current Account (ii) in Other Accounts	Includes cash in hand, including foreign currency notes and also of foreign branches in the case of banks having such branches.
Balance with banks and money at call and short notice	7.	**I. In India** (i) Balance with Banks (a) in current accounts (b) in other deposit accounts	Includes all balance with banks in India (including co-operative banks). Balance in current accounts and deposit accounts should be shown separately.
		(ii) Money at call and short notice (a) with banks (b) with other	Includes deposits repayable within 15 days notice, lent in the inter-bank call money market.

		institutions	
		II. Outside India (i) Current accounts (ii) Deposits (iii) Money at call and short notice	Includes balances held by foreign branches and balances held by Indian branches of the banks outside India. Balance held with foreign branches by other branches of the bank, should not he shown under this head but should be included in the inter-branch accounts. The amounts held in current accounts' and 'deposit accounts should be shown separately. Includes deposits usually classified in foreign currencies as money at call and short notice.
Investment	8.	**I. Investment in India** (i) Government Securities	Includes Central and State Government securities and Government treasury bills. These securities should be at the book value. However, the difference between the book value and market value should be given in the notes to the Balance Sheet.
		(ii) Other approved securities	Securities other than Government securities, which according to the Banking regulation Act 1949, are treated as approved securities, should be included here.
		(iii) Shares	Investment in shares of companies and corporation not included in item (ii) should be included here.
		(iv) Debentures and Bonds	Investments in debentures and bonds of Companies, Corporations not included in item (ii) should be included here.
		(v) Investments in subsidiaries/Joint ventures	Investment in subsidiary/joint ventures (including R.R.Bs) should be in included here.
		(vi) Others	Includes general investments, if any,

			kike gold, commercial paper and other instruments in the nature of shares / debentures / bonds.
		II. Investment Outside India (i) Government securities (including loal authorities) (ii) Subsidiaries and/or joint ventures abroad (iii) Others	All foreign Government securities issued by local authorities may be classified under this head. All investments made in the share capital of subsidiaries, floated outside India and/or joint ventures abroad, should be classified under this head. All other investments outside India by shown under this head.
Advances	9	**A.** (i) Bills purchased and Discounted (ii) Cash credits, overdrafts and loans repayable on demand (iii) Term loans	In classification under Section 'A', all outstanding in India as well as outside-less provisions made, will be classified under three heads as indicated, and both secured and unsecured advances will be included under these heads, including overdue installments.
		B. (i) Secured by tangible assets	All advances or part of advances which are secured by tangible asseta may be shown here. The item will include advances in India and outside India.
		(ii) Covered by Bank/Government Guarantee	Advances in India and outside India to the extent they are covered by guarantees of Indian and foreign governments and Indian and foreign banks and DICGS & ECGC are to be included.
		(iii) Unsecured	All advances not classified under (i) and (ii) will be included here, total of

			‘A’ should tally with the total of ‘B’.
		C. I. Advances in India (i) Priority sectors (ii) Public sectors (iii) Banks (iv) Others	Advances should be broadly classified into ‘Advances in India’ and ‘Advances outside India’. Advances in India will be further classified on the sectorial basis as indicated.
		II. Advances Outside India (i) Due form banks (ii) Due from others (a) Bills purchased and discounted (b) Syndicated loans (c) Others	Advances to sectors which for the time being are classified as priority sectors according to the instructions of the Reserve Bank are to be classified under the head ‘Priority sectors’. Such advances should be excluded from the item (ii) i.e., advance to public sector. Advances to Central and State Governments and other Government undertakings including Government companies and corporations, which are, according to the statutes, to be treated as Public sectors companies are to be included in the category ‘Public sectors companies are to be included in the category ‘Public sector’. All advances to the banking sector including co-operative banks, will come under the dead ‘Banks’. All the remaining advances will be included under the head. ‘Others’ and typically this category will include non-priority advances to the private, joint and co-operative sectors. Notes: general (i) The gross amount of advances including refinance and rediscounts but excluding provisions made to the satisfaction of auditors, should be

			shown as advances. (ii) Term loans will be loans not repayable on demand. (iii) Consortium advances would be shown net of share from other participating banks/institutions.
Fixed Assets	10	**I. Premises** (i) At cost as on 31st March of the preceding year (ii) Addition during the year (iii) Deductions during the year (iv) Depreciation to due	Premises wholly or partly owned by the banking company for the purpose of business, including residential premises should be shown against 'premises'. In the case of premises and other fixed assets, the previous balance, additions thereto, deductions there from, during the year, and also the total depreciation written-off should be shown. Where sums have been written-off on reduction of capital and revaluation of assets. every Balance Sheet after the first Balance Sheet, subsequent to the reduction or revaluation should show the revised figures for a period of five years, with the date and amount of revision made.
		II. Other Fixed Assets (including furniture and fixtures) (i) At cost on 31st March of the preceding year (ii) Additions during the year (iii) Deductions during the year (iv) Depreciation to date	Motor vehicles and all other fixed assets other than premises but including furniture and fixtures should be shown under this head.
Other Assets	11	I. Inter-office Adjustment (net)	The inter-office adjustment balance, if in debit, should be shown under this head. Only net position of inter-

			office accounts inland as well as foreign, should be shown here. For arriving at the net balance of inter-office adjustment accounts all connected inter-office accounts should be aggregated and the net balance, if in debit, only should be shown, representing mostly items in transit and unadjusted items.
		II. Interest Accured	Interest accrued but not due on investments and, advance and interest due but not collected on investment, will be the main components of this item. As banks normally debit, the borrowers' accounts with interest due on the balance sheet date, usually there may not be any account of interest due on advances. Only such interest as can be realised in the ordinary course should be shown under this head.
		III. Tax paid in advance/tax deducted at source	The amount of tax deducted at source on securities, advance tax paid etc. to the extent that these items are not set off against relative tax provision should be shown against this item.
		IV. Stationery and Stamps	Only exceptional items of expenditure on stationery like bulk purchase of security paper, loose leaf or other ledgers, etc. which are shown as quasi-asset to be written-off over a period of time, should be shown here. The value should be on a realistic basis and cost escalation should not be taken into account, as these items are for internal use.
		V. Non-banking assets acquired in	Immovable properties/tangible assets acquired in satisfaction of claims are

		satisfaction of claims	to be shown under this head.
		VI. Others	This will include items like claims which have not been met for instance, clearing items, debit items representing addition to assets or reduction in liabilities, which have not been adjustment for technical reasons, want of particulars, etc. advances given to staff by a bank as an employer and not as a banker, etc. Items which are in the nature of expenses, which are pending adjustments, should be provided for and the provision netted against this item, so that only realisable value is shown under this head. Accrued income other than interest may also be included here.
Contingent Liabilities	12	I. Claims against the bank not acknowledged as debts	
		II. Liabilities for partly paid Investments	Liabilities on partly paid shares, debentures, etc. will be included in this head.
		III. Liabilities on account of outstanding forward exchange contracts	Outstanding forward exchange contracts may be included here.
		IV. Guarantees given on behalf of constituents (i) in India (ii) outside India	Guarantees given for constituents in India and outside India may be shown separately.
		V. Acceptances, endorsement and other obligations	This item will include letters of credit and bills accepted by the bank on behalf of customers.
Bill for		**VI. Other items for which the Bank is**	Arrears of cumulative dividends,

Collection		**contingently liable**	bills rediscounted under under-writing contracts, estimated amounts of contracts remaining to be executed on Capital Account and riot provided for, etc., are to be included here. Bills and other items in the course of collection and not adjusted will be shown against this item in summary version only, a separate schedule is proposed.
		Profit and Loss Account	
Interest earned	13	I. Interest/discount on advances bills	Includes interest and discount on all types of loans and advances, cash credit, demand loans, overdrafts, export loans, term loans, domestic and foreign bills purchased and discounted (including those rediscounted), over interest and also interest subsidy, if any, relating to advances/bills.
		II. Income on investments	Includes all income derived from the investment portion folio by way of interest and dividend.
		III. Interest on balances with the Reserve Bank of India and other inter-bank fund	Includes interest on balances with Reserve Bank and other banks, call loans, money market placements, etc.
		IV. Others	Includes any other interest / discount income not included in the above heads.
Other Income	14	I. Commission, exchange and Brokerage	Includes all remuneration on services such as commission on collections, commission/exchanges on remittances and transfers, commission on letters of credit, letting out of lockers and guarantees,

			commission on Government business, commission on other permitted agency business including consultancy and other services, brokerage, etc., on securities. It does not include foreign exchange income.
		II. Profit on sale of investments, *Less* : Loss on sale of investments III. Profit on revaluation of investments. *Less* : Loss on revaluation of investments. IV. Profit on sale of land, buildings and other assets. *Less* : Loss on sale of land, buildings and other assets	Includes profit/loss on sale of securities, furniture, land and buildings, motor vehicle, gold, silver, etc. Only the net position should be shown. If the net position is a loss, the amount should be shown as a deduction. The net profit/loss on revaluation of assets may also be shown under this item.
		V. Profit on exchange Transactions. *Less* : Loss on sale of land, buildings and other assets.	Includes profit/loss on dealing in foreign exchange, all income earned by way of foreign exchange, commission and charges on foreign exchange transactions excluding interest which will be shown under interest. Only the net position should be shown. If the net position is a loss, it is to be shown as a deduction.
		VI. Income earned by way of dividends etc., from subsidiaries, companies, joint ventures abroad/in India.	

		VII. Miscellaneous income	Includes recoveries from constituents for godown rents, income from bank's properties, security charges, insurance, etc., and any other miscellaneous income. In case, any item under this head exceeds one percentage of the total income, particulars may be given in the notes.
Interest Expended	15	I. Interest on deposits	Includes interest paid on all types of deposits including deposits from banks and other institutions.
		II. Interest on Reserve Bank of India / Inter-bank borrowings	Includes discount/interest on all borrowings and refinance from the Reserve Bank of India and other banks.
		III. Others	Includes discount / interest on all borrowings / refinance from financial institutions. All other payments like interest on participation certificates, penal interest paid, etc. may also be included here.
Operating Expenses	16	I. Payments to and provisions for employees	Includes staff salaries/wages, allowances, bonus, and other staff benefits, like provident fund, pension, gratuity, live ness to staff, leave fare concessions, staff welfare, medical allowance to staff, etc.
		II. Rent, taxes and lighting	Includes rent paid by the banks on buildings and other municipal and other taxes paid (excluding income-tax and interest tax) electricity and other similar charges and levies, House rent allowance and other similar payments to staff should appear under the head 'Payments to and Provisions for Employees'

		III. Printing and Stationery	Includes books and forms, and stationery used by the bank and other printing charges, which are not incurred by way of publicity expenditure.
		IV. Advertisement and Publicity	Includes expenditure incurred by the bank for advertisement and publicity purposes including printing charges or publicity matter.
		V. Depreciation on Bank's property	Includes depreciation on bank's own property, motor cars and other vehicles, furniture, electric fittings, vaults, lifts, lease hold properties, non-banking assets, etc.
		VI. Director's fees, allowances and expenses	Includes sitting fees and all other items of expenditure incurred on behalf of the directors. The daily allowance, hotel charges, conveyance charges, etc. which though in the nature of reimbursement of expenses incurred, may be included under this head. Similar expenses of Local Committee members may also be included under this head.
		VII. Auditor's fees and expenses (including branch auditor's fees and expenses)	Includes the fees paid to the statutory auditors and branch auditors for the professional services rendered and also all expenses for performing their duties, even though they may be in the nature of reimbursement of expenses. If external auditors have been appointed by the banks themselves for internal inspections and audits and other services. the expenses incurred in that context including fees may not be included

			under this head but should be shown under 'other expenditure'
		VIII. Law charges	All legal expenses and reimbursement of expenses incurred in connection with legal services arc to be included here.
		X. Postage, telegraphs, telephones, etc.	Includes all postal charges like stamps, telegrams, telephones, etc.
		XI. Repairs and maintenance	Includes repairs to bank's property, their maintenance charges, etc.
		XII. Insurance	Includes insurance charges on bank's property, insurance premier paid to Deposit Insurance and Credit Guarantee Corporation, etc. to the extent they are not recovered from the concerned parties.
		XIII. Other expenditure	All expenses other than those not included in any of the other heads, like, licence fees, donations, dubscriptions to papers, periodicals, entertainment expenses, travel expenses, etc. may be included under this head. In case, any particular item under this head exceeds one percentage of the total income, the particulars may be given in the notes.
Provisions and contin- gencies			Includes all provisions made for bad and doubtful debts, provisions for taxation, provisions for diminution in the value of investments, transfers to contingencies and other similar items.

Disclosure of Accounting Policies

In order that the financial position of banks represent a true and fair view, the Reserve Bank of has directed the banks to disclose accounting policies regarding the key areas of operations along with the notes of account in their financial statements for the accounting year ending 31-3-1991 and onwards, on a regular basis. The accounting policies disclosed may contain the following aspects subject to reflection by individual banks:

1. **General :**

The accompanying financial statements have been prepared on the historical cost and conform to the statutory provisions and practices prevailing in the country.

2. **Transactions involving Foreign Exchange :**

   a) Monetary assets and liabilities have been translated at the exchange rates, prevailing at the close of the year. Non-monetary assets have been carried in the books at the historical cost.

   b) Income and expenditure items in respect of Indian branches have been translated at the exchange rates, ruling on the date of the transaction and in respect of overseas branches at the exchange rates prevailing at the close of the year.

   c) Profit or loss on pending forward contracts have been accounted for.

3. **Investments :**

   a) Investment in governments and other approved securities in India are valued at the lower of cost or market value.

   b) Investments in subsidiary companies and associate (i.e. companies in which the bank holds at least 25 percent of the share capital) have been accounted for on the historical cost basis.

   c) All other investments are valued at the lower of cost or market value.

4. **Advances :**

   a) Provisions for doubtful advances have been made to the satisfaction of the auditors:

i) In respect of identified advances, based on a periodic review of advances and after taking into account the portion of advance guaranteed by the Deposit Insurance and Credit Guarantee Corporation, the Export Credit and Guarantee Corporation and similar statutory bodies;

ii) In respect of general advances, as a percentage of total advances taking into account the guidelines issued by the Government of India and the Reserve Bank of India.

b) Provisions in respect of doubtful advances have been deducted from the advances to the extent necessary and the excess have been included under "Other Liabilities and Provisions".

c) Provision have been made on a gross basis. Tax relief, which will be available when the advance is written-off, will be accounted for in the year of write-off.

5. Fixed Assets :

a) Premises and other fixed assets have been accounted for at their historical cost. Premises which have been revalued are accounted for at the value determined on the basis of such revaluation made by the professional values, profit arising on revaluation has been credited to Capital Reserve.

b) Depreciation has been provided for on the straight line/diminishing balance method.

c) In respect of revalued assets, depreciation is provided for on the revalued figures and an amount equal to the additional depreciation consequent of revaluation is transferred annually from the Capital Reserve to the General Reserve / Profit and Loss Account.

6. Staff Benefits :

Provision for gratuity pension benefits to staff have been made on an accrual casual basis. Separate funds for gratuity / pension have been created.

7. Net Profit :

a) the net profit disclosed in the Profit and Loss Account in after:

i) provisions for taxes on income, in accordance with the statutory requirements,

ii) provisions for doubtful advances.

iii) adjustments to the value of “current investments” in government and other approved securities in India, valued at lower of cost of market value,

iv) transfers to contingency funds.

v) other usual or necessary provisions.

b) Contingency funds have teen grouped in the Balance Sheet under the head “Other Liabilities and Provisions”.

Some Special Transactions

Interest on Doubtful Debts

When a debt is found to be doubtful at the end of the accounting year, a question may arise whether the interest on that should be credited to interest Account or not. There is no doubt that interest has accrued; but It is equally clear that the realization of this interest is doubtful. Therefore, as prudent accounting policy, such interest should be transferred to Interest Suspense Account.

1.2.8 Important Adjustments/items and their effects in Bank Final Accounts:

1) Depreciation on bank property :

If it is asked to charge on original cost but written down value of asset is given then add amount of depreciation to the W.D.V. for getting original cost of asset.

a) Show the asset at its original cost in schedule No. 10 and deduct the total amount of depreciation from original cost.

b) Show the amount of depreciation of current year in operating expenses schedule No. 16

2) Rebate on bills discounted / Unexpired discount :

If it is given in trial balance - show in Schedule No. 5 if it is given for adjustment:-

a) Deduct the amount of rebate from Interest and discount in Schedule No. 13

b) Show the amount of rebate in other liabilities and provisions in Schedule No. 5

If it is overvalued then deduct from rebate amount and add in interest and discount in Schedule No. 13

If it is under - valued then add the amount in rebate and deduct from the interest and discount in Schedule-13

3) Provision for bad and doubtful debts :

Deduct the amount of provision from loans, cash credit and overdrafts in Schedule No. 9 and put the amount of provision in P & LA/c under the head provision

4) Provision for Taxation :

Show the amount of provision for tax in profit & loss account (Form 'B') under provision or other provisions and show the same amount of Provision in Schedule No. 5 (other Liab. and Provisions)

5) Statutory Reserve :

To transfer to statutory reserve is a statutory provision and hence not clearly stated in adjustments: Therefore every year transfer 20% of current years profit to statutory reserve.

Firstly add in statutory reserve in Schedule No. 2 and then show in appropriations (P & L A/c)

6) Acceptances, Endorsements on behalf of Customers :

It is a contingent liability and not actual liability hence it is shown only in Schedule No. 12 as it has no effect on tally of Balance Sheet.

7) Bills for Collection :

These are bill send by customers to bank for collection. These are not asset or liabilities of bank. Bank is just acting as an agent in this regard. It is shown outside the Balance Sheet just below the contingent liability.

8) Gold/Silver :

Gold is shown in Schedule NO. 8 (Investment) while silver is shown in Schedule No. 11 (Other Assets)

9) Accrued Interest on investment-

If it is given in trial balance, show it in Schedule No. 11 (Other Assets)

If it is given for adjustment then show in Schedule No. 13 and Schedule No. 11

1.2.9 Illustrative Examples on Bank Final Accounts

Illustration - I

1. From the following balances extracted from the books of Tushar Bank Ltd., Akola, prepare the Profit and Loss Account for the year ended 31st March 2021 and the Balance Sheet as on that date.

Particulars	Rs.
Current accounts	1,60,00,000
Savings Accounts	60,00,000
Fixed and time deposits	19,00,000
Acceptances	4,00,000
Unclaimed dividend	60,000
Dividend 2013-2020	1,00,000
Profit and Loss A/c (Credit) on 1-4-2021	4,20,000
Reserve fund	7,00,000
Share Capital : 20,000 shares of Rs. 50 each	10,00,000
Interest and discount received	15,00,000
Interest paid	4,00,000
Borrowings from other banks	14,00,000
Money at call	6,00,000
Investments (Market value Rs. 62,00,000)	60,00,000
Premises	24,00,000
(After depreciation upto 31-3-2020 Rs. 2,00,000)	
Sundry creditors	60,000
Bills payable	16,00,000
Bills for collection	2,80,000
Salaries	1,60,000
Rent and taxes	40,000
Audit fee	4,000

Printing	10,000
General expenses	6,000
Cash in hand	1,20,000
Cash with R.B.I.	30,00,000
Cash with other banks	26,00,000
Bills discounted and purchased	12,00,000
Loans, overdrafts and cash credits	1,40,00,000

Adjustments :

1) Authorised share capital is Rs. 20,00,000 divided into 40,000 shares of Rs. 50 each.
2) Rebate on bills discounted amounted to Rs. 10,000.
3) Create a provision for taxation Rs. 2,00,000.
4) Provision for bad and doubtful debts is required to be made at Rs. 60,000.
5) Provide 5% depreciation on the original amount of premises.

Tushar bank Ltd.
Profit and Loss Account
For the year ended 31st March 2021

Particulars	Schedule No.	Current Year	Previous Year
I. Income			
Interest earned	13	14,90,000	
Other Income	14	Nill	
Total		**14,90,000**	
II. Expenditure			
Interest expended	15	4,00,000	
Operating expenses	16	3,50,000	
Provision (tax)		2,00,000	
Other provisions		60,000	
Total		**10,10,000**	
III. Profit/Loss			
Profit brought forward		4,20,000	
Net profit for the year		4,80,000	

Total		**9,00,000**	
IV. Appropriations			
Transfer to Reserve fund		96,000	
Dividend for last year		1,00,000	
Balance c/d.		7,04,000	
Total		**9,00,000**	

Form 'A'

Balance Sheet of Tushar Bank Ltd.

As on 31-3-2021

Particulars	**Schedule No.**	**Current Year**	**Previous Year**
Capital and Liabilities			
Capital	1	10,00,000	
Reserve and surplus	2	15,00,000	
Deposits	3	2,39,00,000	
Borrowings	4	14,00,000	
Other liabilities and provisions	5	19,30,000	
Total		**2,97,30,000**	
Assets			
Cash in hand and with R.B.I.	6	31,20,000	
Balance with other banks, money at call and short notice	7	32,00,000	
Investments	8	60,00,000	
Advances	9	1,51,40,000	
Fixed Assets	10	22,70,000	
Other Assets	11	Nill	
Total		**2,97,30,000**	
Contingent Liabilities	12	4,00,000	
Bills for collection	--	2,80,000	

Working Details :

Schedule No. 1 : **Capital**

Particulars		Current Year	Previous Year
Authorised Capital			
40,000 shares of Rs. 50 each		20,00,000	
Issued Capital			
20,000 shares of Rs. 50 each fully paid		10,00,000	
	Total	**10,00,000**	

Schedule No. 2 : **Reserve and Surplus**

Particulars		Current Year	Previous Year
Reserve Fund	7,00,000		
Add 20% addition	96,000	7,96,000	
Balance of P & L Appropriation Ac.		7,04,000	
	Total	**15,00,000**	

Schedule No. 3 : **Deposits**

Particulars		As on 31-3-... (Current Year)	Previous Year
Current Accounts		1,60,00,000	
Saving Account		60,00,000	
Fixed and time deposits		19,00,000	
	Total	**2,39,00,000**	

Schedule No. 4 : **Borrowings**

Particulars		As on 31-3-... (Current Year)	Previous Year
Borrowing from other Banks		14,00,000	
	Total	**14,00,000**	

Schedule No. 5 : **Other Liabilities and Provisions**

Particulars	Current Year	Previous Year
Unclaimed dividend	60,000	
Sundry Creditors	60,000	
Bills payables	16,00,000	
Rebate on bills discounted	10,000	
Provision for taxation	2,00,000	
Total	**19,30,000**	

Schedule No. 6 : **Cash in hand and with R.B.I.**

Particulars	Current Year	Previous Year
Cash in hand	1,20,000	
Cash with R.B.I.	30,00,000	
Total	**31,20,000**	

Schedule No. 7 : **Balance with other Banks, Money at call & Short Notice.**

Particulars	Current Year	Previous Year
Money at call	6,00,000	
Cash with other Banks	26,00,000	
Total	**32,00,000**	

Schedule No. 8 : **Investments**

Particulars	Current Year	Previous Year
Investments (Market Value Rs. 6,20,000)	60,00,000	
Total	**60,00,000**	

Schedule No. 9 : **Advances**

Particulars		**Current Year**	**Previous Year**
Loans overdrafts & cash credits	1,40,00,000		
Less : provision	60,000	1,39,40,000	
Bills discounted and purchased		12,00,000	
	Total	**1,51,00,000**	

Schedule No. 10 : **Fixed Assets**

Particulars		**Current Year**	**Previous Year**
Premises	24,00,000		
Less : Depreciation	1,30,000	22,70,000	
(5% on original cost)			
	Total	**22,70,000**	

Schedule No. 11 : **Other Assets**

Particulars	**Current Year**	**Previous Year**
	Nil	
Total	**Nil**	

Schedule No. 12 : **Contingent Liabilities**

Particulars	**Current Year**	**Previous Year**
Acceptances on behalf of customer	4,00,000	
Total	**4,00,000**	

Schedule No. 13 : **Interest earned**

Particulars		**Current Year**	**Previous Year**
Interest and Discount	15,00,000		
Less Rebate on bill discount	10,000	14,90,000	
	Total	**14,90,000**	

Schedule No. 14 : **Other Incomes**

Particulars	Current Year	Previous Year
	Nil	
Total	**Nil**	

Schedule No. 15 : **Interest Expended**

Particulars	Current Year	Previous Year
Interest Paid	4,00,000	
Total	**4,00,000**	

Schedule No. 16 : **Operating Expenses**

Particulars	Current Year	Previous Year
Salaries	1,60,000	
Rentals Taxes	40,000	
Audit Fees	4,000	
Printing	10,000	
General Expenses	6,000	
Depreciation on Premises	1,30,000	
Total	**3,50,000**	

Illustration-II

1. From the following balances of Mahindra Bank Ltd., as on 31st March 2021, prepare Profit and Loss A/c for the year ended 31st march 2021 and Balance sheet as on that date.

Particulars	**Rs.**
Equity share capital of Rs. 100 each	
Rs. 50 paid up (Authorised and Issued 40,000 shares)	20,00,000
Profit and Loss A/c (Cr. on 1-4-2020)	8,00,000
Current Deposit A/c	68,20,000
Fixed Deposit A/c	78,00,000

Saving Bank A/c	51,30,000
Director's fees	90,000
Audit fees	20,000
Furniture (Cost Rs. 20,00,000)	17,40,000
Interest and discount received	42,00,000
Commission and exchange	20,00,000
Reserve fund	7,00,000
Printing and Stationery	80,000
Salary (including Manager's Rs. 4,00,000)	14,00,000
Building (Cost Rs. 60,00,000)	45,00,000
Cash in hand	3,20,000
Cash with RBI	70,00,000
Cash with Other bank	65,00,000
Law charges	30,000
Investment at cost	24,00,000
Loans, cash credit and overdraft	60,00,000
Bills discounted and purchased	28,00,000
Interest paid	30,00,000
Borrowing from Laxmi Bank Ltd.	40,00,000
Branch Adjustment A/c (Cr.)	26,00,000
Rent and Taxes	

Following additional information is available:

1) The Bank has accepted on behalf of the customers bills worth Rs. 30,00,000 against the securities or Rs. 38,00,000 lodged with the Bank.

2) Rebate on bills discounted to Rs. 1,10,000

3) Provide depreciation on building by 10% and on furniture by 5% on cost.

4) Provide Rs. 30,000 for bad and doubtful debts.

Mahindra Bank Ltd.
Profit and Loss Account
For the year ended 31st March 2021

Particulars	Schedule No.	Current Year	Previous Year
Income			
Interest earned	13	40,90,000	
Other Income	14	20,00,000	
Total		**60,90,000**	
Expenditure			
Interest expended	15	30,00,000	
Operating expenses	16	24,90,000	
Provisions		30,000	
Other provisions			
Total		**55,20,000**	
Profit/Loss			
Profit brought forward		8,00,000	
Net profit for the year		5,70,000	
Total		**13,70,000**	
Appropriations			
Transfer to Reserve fund		1,14,000	
Balance C/d.		12,56,000	
Total		**13,70,000**	

Form 'A'
Balance Sheet of Mahindra Bank Ltd.
as on 31-3-2021

Particulars	Schedule No.	Current Year	Previous Year
Capital and Liabilities			
Capital	1	20,00,000	
Reserve and surplus	2	20,70,000	
Deposits	3	1,97,50,000	

Borrowings	4	40,00,000	
Other liabilities and provisions	5	27,10,000	
Total		**3,05,30,000**	
Assets			
Cash in hand and with R.B.I.	6	73,20,000	
Balance with other banks, money at call and short notice	7	65,00,000	
Investments	8	24,00,000	
Advances	9	87,70,000	
Fixed Assets	10	55,40,000	
Other Assets	11	Nill	
Total		**3,05,30,000**	
Contingent Liabilities	12	30,00,000	
Bills for collection	--	--	

Working Details :

Schedule No. 1 : **Capital**

Particulars	Current Year	Previous Year
Authorised Capital		
40,000 shares of Rs. 1 00 each	40,00,000	
Issued and Paid up Capital		
40,000 shares of Rs. 1 00 each Rs. 50 paid	20,00,000	
Total	**20,00,000**	

Schedule No. 2 : **Reserve and Surplus**

Particulars		Current Year	Previous Year
Reserve Fund	7,00,000		
Add 20% addition	1,14,000	8,14,000	
Balance of P & L Appropriation A/c.		12,56,000	
Total		**20,70,000**	

Schedule No. 3 : **Deposits**

Particulars	Current Year	Previous Year
Current Deposits A/c	68,20,000	
Fixed Deposit A/c	78,00,000	
Saving Bank A/c	51,30,000	
Total	**1,97,50,000**	

Schedule No. 4 : **Borrowings**

Particulars	Current Year	Previous Year
Borrowing from other Banks	40,00,000	
Total	**40,00,000**	

Schedule No. 5 : **Other Liabilities and Provisions**

Particulars	Current Year	Previous Year
Branch Adjustment	26,00,000	
Rebate on bills discounted	1,10,000	
Total	**27,10,000**	

Schedule No. 6 : **Cash in hand and with R.B.I.**

Particulars	Current Year	Previous Year
Cash in hand	3,20,000	
Cash with R.B.I.	70,00,000	
Total	**73,20,000**	

Schedule No. 7 : **Balance with other Banks, Money at call & Short Notice.**

Particulars	Current Year	Previous Year
Cash with other Banks	65,00,000	
Total	**65,00,000**	

Schedule No. 8 : **Investments**

Particulars	Current Year	Previous Year
Investments at Cost	24,00,000	
Total	**24,00,000**	

Schedule No. 9 : **Advances**

Particulars		Current Year	Previous Year
Loans Cash Credits and overdrafts	60,00,000		
Less : provision	30,000	59,70,000	
Bills discounted and purchased		28,00,000	
	Total	**87,70,000**	

Schedule No. 10 : **Fixed Assets**

Particulars		Current Year	Previous Year
Furniture at cost	20,00,000		
Less : Depreciation upto date	3,60,000	16,40,000	
Building at cost	60,00,000		
Less De. upto date	21,00,000	39,00,000	
	Total	**55,40,000**	

Schedule No. 11 : **Other Assets**

Particulars	Current Year	Previous Year
	Nil	
Total	**Nil**	

Schedule No. 12 : **Contingent Liabilities**

Particulars	Current Year	Previous Year
Acceptances on behalf of customers	30,00,000	
Total	**30,00,000**	

Schedule No. 13 : **Interest earned**

Particulars		Current Year	Previous Year
Interest and Discount Received	42,00,000		
Less Rebate on bill discount	1,10,000	40,90,000	
Total		**40,90,000**	

Schedule No. 14 : **Other Incomes**

Particulars	Current Year	Previous Year
Commission and Exchange	20,00,000	
Total	**20,00,000**	

Schedule No. 15 : **Interest Expended**

Particulars	Current Year	Previous Year
Interest Paid	30,00,000	
Total	**30,00,000**	

Schedule No. 16 : **Operating Expenses**

Particulars	Current Year	Previous Year
Directors fees	90,000	
Audit fees	20,000	
Printing and Stationery	80,000	
Managers Salary	4,00,000	
Staff Salary	10,00,000	
Law Charges	30,000	
Rent and Taxes	1,70,000	
Depreciation on Furniture	1,00,000	
Depreciation on Building	6,00,000	
Total	**24,90,000**	

Illustration - III

The following is the Trial Balance of Lalu Bank Ltd.,

as on March 31st 2021

Particulars	Rs.	Particulars	Rs.
Loans, cash credits and		Share Capital :	
overdrafts	28,50,000	50,000 equity shares of	
Premises	5,00,000	Rs. 100 each fully paid	
Indian Government	41,70,000	Reserve Fund	50,00,000
Securities		Current Deposit	25,00,000
Salaries	2,80,000	Fixed Deposit	10,00,000
General Expenses	2,74,000	Savings Bank Deposit	12,50,000
Rent, Rates and Taxes	23,000	Profit & Loss A/c	5,00,000
Director's Fees	18,000	(1-4-2020)	1,60,000
Stock of Stationery	85,000	Interest and Discount	
Bill Purchased and		Recurring Deposits	12,80,000
Discounted	4,60,000		2,00,000
Shares	5,00,000		
Cash in hand and with			
Reserve Bank	19,30,000		
Money at call and short			
notice	8,00,000		
	1,10,90,000		**1,18,90,000**

The following information should be considered :

a) Provision for bad and doubtful debts is required, amounting to Rs. 50,000

b) Interest accrued on investments was Rs. 80,000

c) Unexpired discount amounts of Rs. 3,800

d) Endorsement made on behalf of customers totalled Rs. 11,50,000

e) Authorised capital was 80,000 equity shares of Rs. 100 each,

f) Rs. 1,00,000 were added to the premises during the year.

Depreciation at 5% on the opening balance is required,

g) Market Value of Indian Government Securities was Rs. 39,00,000

Prepare Profit and Loss Account for the year ended 31st March 2021 and Balance Sheet as on that date in the prescribed form.

Lalu Bank Ltd.
Profit and Loss Account
For the year ended 31st March 2021

Particulars	Schedule No.	Current Year	Previous Year
Income			
Interest earned	13	13,56,200	
Other Income	14	Nil	
Total		**13,56,200**	
Expenditure			
Interest expended	15	Nil	
Operating expenses	16	6,15,000	
Provisions		50,000	
Other provisions		--	
Total		**6,65,000**	
Profit/Loss			
Profit brought forward		1,60,000	
Net profit for the year		6,91,200	
Total		**8,91,200**	
Appropriations			
Transfer to Reserve fund		1,38,240	
Balance C/d.		7,12,960	
Total		**8,51,200**	

Form 'A'
Balance Sheet of Lalu Bank Ltd.
For the year ended on 31st March, 2021

Particulars	Schedule No.	Current Year	Previous Year
Capital and Liabilities			
Capital	1	50,00,000	
Reserve and surplus	2	33,51,200	
Deposits	3	29,50,000	

Borrowings	4	Nil	
Other liabilities and provisions	5	3,800	
Total		**1,13,05,000**	
Assets			
Cash in hand and with R.B.I.	6	19,30,000	
Balance with other banks, money at call and short notice	7	8,00,000	
Investments	8	46,70,000	
Advances	9	32,60,000	
Fixed Assets	10	4,80,000	
Other Assets	11	1,65,000	
Total		**1,13,05,000**	
Contingent Liabilities	12	11,50,000	
Bills for collection	--	--	

Working Details :

Schedule No. 1 : **Capital**

Particulars	Current Year	Previous Year
Authorised Capital		
80,000 shares of Rs. 100 each	80,00,000	
Issued and Paid up Capital		
50,000 shares of Rs. 100 each Fully paid	50,00,000	
Total	**50,00,000**	

Schedule No. 2 : **Reserve and Surplus**

Particulars		Current Year	Previous Year
Reserve Fund	25,00,000		
Add 20% addition	1,38,200	26,38,240	
Balance of P & L Appropriation A/c.		7,12,960	
Total		**33,51,200**	

Schedule No. 3 : **Deposits**

Particulars	Current Year	Previous Year
Current Deposits A/c	10,00,000	
Fixed Deposit A/c	12,50,000	
Saving Bank A/c	5,00,000	
Recurring Deposits	2,00,000	
Total	**29,50,000**	

Schedule No. 4 : **Borrowings**

Particulars	Current Year	Previous Year
	Nil	
Total	**Nil**	

Schedule No. 5 : **Other Liabilities and Provisions**

Particulars	Current Year	Previous Year
Unexpired Discount	3,800	
Total	**3,800**	

Schedule No. 6 : **Cash in hand and with R.B.I.**

Particulars	Current Year	Previous Year
Cash in hand and with R.B.I.	19,30,000	
Total	**19,30,000**	

Schedule No. 7 : **Balance with other Banks, Money at call & Short Notice.**

Particulars	Current Year	Previous Year
Money at call and short notice	8,00,000	
Total	**8,00,000**	

Schedule No. 8 : **Investments**

Particulars	Current Year	Previous Year
Indian Government securities		
(Market value 39,00,000	41,70,000	
Shares	5,00,000	
Total	**46,70,000**	

Schedule No. 9 : **Advances**

Particulars		Current Year	Previous Year
Loans Cash Credits and overdrafts	28,50,000		
Less : Provision	50,000	28,00,000	
Bills discounted and purchased		4,60,000	
	Total	**32,60,000**	

Schedule No. 10 : **Fixed Assets**

Particulars		Current Year	Previous Year
Premises Opening Bal.	4,00,000		
Add : Addition during year	1,00,000		
	5,00,000		
Less Dep. on Op. Bal. 5%	20,000	4,80,000	
	Total	**4,80,000**	

Schedule No. 11 : **Other Assets**

Particulars	Current Year	Previous Year
Stock of Stationery	85,000	
Interest accrued on Investment	80,000	
Total	**1,65,000**	

Schedule No. 12 : **Contingent Liabilities**

Particulars	**Current Year**	**Previous Year**
Endorsement on behalf of customers	11,50,00	
Total	**11,50,000**	

Schedule No. 13 : **Interest earned**

Particulars		**Current Year**	**Previous Year**
Interest and Discount	12,80,000		
Less : Unexpired Discount	3,800	12,76,200	
Interest on Investment		80,000	
Total		**13,56,200**	

Schedule No. 14 : **Other Incomes**

Particulars	Current Year	**Previous Year**
	Nil	
Total	Nil	

Schedule No. 15 : **Interest Expended**

Particulars	**Current Year**	**Previous Year**
	Nil	
Total	**Nil**	

Schedule No. 16 : **Operating Expenses**

Particulars	**Current Year**	**Previous Year**
Depreciation on Premises	20,000	
Salaries	2,80,000	
General Expenses	2,74,000	
Rent. Rate and Taxes	23,000	
Director Fees	18,000	
Total	**6,15,000**	

Illustration - IV

From the following balances extracted from the books of Karodpati Bank Ltd, Solapur prepare the Profit & Loss Account for the year ended 31st March, 2021 and the Balance Sheet as on that date.

Particulars	Rs.
Salaries and allowances (including remuneration to General Manager Rs. 9,00,000 and Director's Fees Rs. 1,00,000	25,00,000
Sundry expenses	1,50,000
Interest paid on deposits	21,25,000
Commission, exchange (credit)	17,00,000
Interest and discount received	48,00,000
Statutory Reserved fund	20,00,000
Deposits : a) Fixed	87,50,000
b) Savings	60,00,000
c) Current	90,00,000
Loans, cash-credits and over drafts	2,30,00,000
Bills discounted and purchased	15,00,000
Investment fluctuation fund	5,00,000
Cash in hand	17,50,000
Cash with RBI	25,00,000
Cash with Vijay Bank Ltd.	2,50,000
4% Government securities	60,00,000
Silver	5,00,000
Gold	21,00,000
Bills for collection	10,00,000
Interest accrued on investments	3,00,000
Acceptances, endorsements and other obligations	20,00,000
Profit and Loss account (credit banlance on 1-4-2020)	30,00,000
Shares in Telco Co. Ltd.	10,00,000
Interim divided paid	3,00,000
Drafts payable	8,00,000

Share capital (authorised and issued)	10,00,000
2,00,000 shares or Rs. 100 each Rs. 50 paid	
Rent and taxes paid	2,00,000
Premises	25,00,000
Furniture and fixtures	7,50,000
Provident fund	8,00,000
Rebate on bills discounted	75,000
Unclaimed dividend	1,00,000

Adjustments :

1. Provide Rs. 4,00,000 for taxation and Rs. 2,50,000 for bad and doubtful debts.
2. Rebate on bills discounted is over calculated by Rs. 25,000
3. An interim dividend declared was at 4% actual.
4. The market value of 4% Govt. securities on 31-3-2021 was Rs. 58,25,000 and was to be shown at this figure in the B/S.
5. Current Accounts include Rs. 4,00,000 debits balance being overdraft.

Solution :

Karodpati Bank Ltd.
Profit and Loss Account
For the year ended 31st March 2021

Particulars	Schedule No.	Current Year	Previous Year
Income			
Interest earned	13	48,25,000	
Other Income	14	17,00,000	
Total		**65,25,000**	
Expenditure			
Interest expended	15	21,25,000	
Operating expenses	16	28,50,000	
Provisions		2,50,000	
Other provisions		4,00,000	

Total		**56,25,000**	
Profit/Loss			
Profit brought forward		30,00,000	
Net profit for the year		9,00,000	
Total		**39,00,000**	
Appropriations			
Transfer to Reserve fund		1,80,000	
Balance C/d.		33,20,000	
Total		**39,00,000**	

Form 'A'

Balance Sheet of Karodpati Bank Ltd.

as on 31-3-2021

Particulars	Schedule No.	Current Year	Previous Year
Capital and Liabilities			
Capital	1	1,00,00,000	
Reserve and surplus	2	58,25,000	
Deposits	3	2,41,50,000	
Borrowings	4	Nil	
Other liabilities and provisions	5	21,50,000	
Total		**4,21,25,000**	
Assets			
Cash in hand and with R.B.I.	6	42,50,000	
Balance with other banks, money at call and short notice	7	2,50,000	
Investments	8	89,25,000	
Advances	9	2,46,50,000	
Fixed Assets	10	32,50,000	
Other Assets	11	8,00,000	
Total		**4,21,25,000**	
Contingent Liabilities	12	20,00,000	
Bills for collection	--	10,00,000	

Working Details :

Schedule No. 1 : **Capital**

Particulars		**Current Year**	**Previous Year**
Authorised Capital			
2,00,000 shares of Rs. 100 each		2,00,00,000	
Issued and Paid up Capital			
2,00,000 shares of Rs. 100 each Rs. 50 paid		1,00,00,000	
	Total	**1,00,00,000**	

Schedule No. 2 : **Reserve and Surplus**

Particulars		**Current Year**	**Previous Year**
Statutory Reserve Fund	20,00,000		
Add 20% transfer	1,80,000	21,80,000	
Investment flaction fund	5,00,000		
Less : loss on revaluation of Investment	1,75,000	3,25,000	
Balance of P & L Appropriation A/c.		33,20,000	
	Total	**58,25,000**	

Schedule No. 3 : **Deposits**

Particulars		**Current Year**	**Previous Year**
Fixed Deposits		87,50,000	
Saving Deposits		60,00,000	
Current Deposits	90,00,000		
Add overdrawn	4,00,000	94,00,000	
	Total	**2,41,50,000**	

Schedule No. 4 : **Borrowings**

Particulars		**Current Year**	**Previous Year**
		Nil	
Total		**Nil**	

Schedule No. 5 : **Other Liabilities and Provisions**

Particulars		**Current Year**	**Previous Year**
Drafts Payabla		8,00,000	
Provident Fund		8,00,000	
Rebate on bills discounted	75,000		
Less over calculated	25,000	50,000	
Provision for tax		4,00,000	
Unclaimed Dividend		1,00,000	
Total		**21,50,000**	

Schedule No. 6 : **Cash in hand and with R.B.I.**

Particulars	**Current Year**	**Previous Year**
Cash in hand	17,50,000	
Cash with R.B.I.	25,00,000	
Total	**42,50,000**	

Schedule No. 7 : **Balance with other Banks, Money at call & Short Notice.**

Particulars	**Current Year**	**Previous Year**
Cash with Millions Banks	2,50,000	
Total	**2,50,000**	

Schedule No. 8 : **Investments**

Particulars		**Current Year**	**Previous Year**
4% Govt. securities	60,00,000		
Less loss on revaluation	1,75,000	58,25,000	

Gold		21,00,000	
Shares in Ltd. Co.		10,00,000	
	Total	**89,25,000**	

Schedule No. 9 : **Advances**

Particulars		**Current Year**	**Previous Year**
Loan Cash Credits and overdrafts	2,30,00,000		
Less : Provision	2,50,000		
	2,27,50,000		
Add : Overdrawn Current A/c	4,00,000	2,31,50,000	
Bills purchased and discounted		15,00,000	
	Total	**2,46,50,000**	

Schedule No. 10 : **Fixed Assets**

Particulars	**Current Year**	**Previous Year**
Premises	25,00,000	
Furniture and fixtures	7,50,000	
Total	**32,50,000**	

Schedule No. 11 : **Other Assets**

Particulars	**Current Year**	**Previous Year**
Silver	5,00,000	
Interest accrued on Investment	3,00,000	
Total	**8,00,000**	

Schedule No. 12 : **Contingent Liabilities**

Particulars	**Current Year**	**Previous Year**
Acceptances, endorsement and other obligations	20,00,000	
Total	**20,00,000**	

Schedule No. 13 : **Interest earned**

Particulars		Current Year	Previous Year
Interest and Discount Received	48,00,000		
Add over calculated rebate	25,000	48,25,000	
	Total	**48,25,000**	

Schedule No. 14 : **Other Incomes**

Particulars	Current Year	Previous Year
Commission and Exchange	17,00,000	
Total	**17,00,000**	

Schedule No. 15 : **Interest Expended**

Particulars	Current Year	Previous Year
Interest paid on deposits	21,25,000	
Total	**21,25,000**	

Schedule No. 16 : **Operating Expenses**

Particulars	Current Year	Previous Year
General managers remuneration	9,00,000	
Directors fees	1,00,000	
Staff salaries and allowances	15,00,000	
Sundry Expenses	1,50,000	
Rent and taxes paid	2,00,000	
Total	**28,50,000**	

Illustration – 5

The following are the figure extracted from the books of Ichalkaranji Bank Limited, as on 31-3-2021 :

Particulars	Rs.
Interest and Discount Received	37,05,738
Interest paid on Deposits	20,37,452
Issued and Subscribed Capital	10,00,000
Salaries and Allowances	2,00,000
Director's fee and allowances	30,000
Rent and taxed paid	90,000
Postage and telegrams	60,286
Statutory reserve fund	8,00,000
Commission, exchange & brokerage	1,90,000
Rent received	65,000
Profit on sale of investments	2,00,000
Depreciation on Bank's properties	30,000
Stationery expenses	40,000
Other expenses	25,000
Auditor's Fee	5,000

Other Information:

a) A customer to whom a sum of Rs. 10 lakhs had been advanced has become insolvent and it is expected that only 50% can be recovered from his estate.

b) Also there were other debts, for which a provision of Rs. 1,50,000 was found necessary by the auditors.

c) Rebate on bills discounted on 31-3-2020 was Rs. 12,000 and or 31-3-2021 was Rs. 16,000.

d) Provide Rs. 6,50,000 for Income tax.

e) The directors desire to declare 10% dividends.

Prepare the Profit and Loss Account of Ichalkaranji Bank Ltd. for the year ended on 31-3-2021.

Solution - 5

Ichalkaranji Bank Ltd.
Profit and Loss Account
For the year ended 31st March 2021

Particulars	Schedule No.	Current Year	Previous Year
Income			
Interest earned	13	37,01,738	
Other Income	14	4,55,000	
Total		**41,56,738**	
Expenditure			
Interest expended	15	20,37,452	
Operating expenses	16	4,80,286	
Provisions (Bad & doubtful)		6,50,000	
Other provisions (Tax)		6,50,000	
Total		**38,17,738**	
Profit/Loss			
Profit brought forward		--	
Net profit for the year		3,39,000	
Total		**3,39,000**	
Appropriations			
Transfer to Reserve fund		67,800	
Proposed Dividend (10%)		1,00,000	
Balance C/d.		1,71,200	
Total		**3,39,000**	

Schedule No. 13 : **Interest earned**

Particulars		Current Year	Previous Year
Interest and Discount Received	37,05,738		
Add Opening balance of rebate on bills discounted	12,000		

	37,17,738		
Less : Closing balance of rebate on bills discounted	16,000	37,01,738	
	Total	**37,01,738**	

Schedule No. 14 : **Other Incomes**

Particulars	Current Year	Previous Year
Commission Exchange and brokerage	1,90,000	
Rent received	65,000	
Profit on sale of investment	2,00,000	
Total	**4,55,000**	

Schedule No. 15 : **Interest Expended**

Particulars	Current Year	Previous Year
Interest on deposits	20,37,452	
Total	**20,37,452**	

Schedule No. 16 : **Operating Expenses**

Particulars	Current Year	Previous Year
Salaries and allowances	2,00,000	
Directors fees and allowances	30,000	
Rent and taxes paid	90,000	
Postage and telegrams	60,286	
Depreciation on bank property	30,000	
Stationery expenses	40,000	
Auditors fees	5,000	
Other expenses	25,000	
Total	**4,80,286**	

Illustration – 6

Friends Bank Ltd. gives you the following particulars from their books for the year ended 31-3-2021. You are required to prepare Balance Sheet as on 31-3-2021 in the prescribed form.

Particulars	Debit Rs.	Credit Rs.
Cash in hand	1,50,000	
Share Capital		25,00,00
Investments in Equity Shares (Fully paid Rs. 3 lakhs Partly paid Rs. 2 lakhs)	5,00,000	
General Reserve		3,00,000
Statutory Reserve		6,00,000
Investments in Government securities (Central and State Government)	5,75,000	
Interest accrued on Investments	15,000	
Balances with Reserve Bank of India	2,00,000	
Balance with Other Banks – (Current Accounts)	1,50,000	
Borrowings from Central Bank of India (unsecured)		4,00,000
Bills Payable		2,00,000
Fixed Deposits		25,00,000
Current Accounts		40,00,000
Contingency Accounts		4,00,000
Loans	50,00,000	
Cash Credits	80,00,000	
Overdrafts	7,70,000	
Savings Accounts		65,00,000
Unclaimed Dividends		25,000
Bills Discounted & Purchased	15,00,000	
Branch Adjustments		74,000
Profit & Loss A/c (1-4-2020)		1,00,000
Advances	7,50,000	
Premises (less depreciation)	6,00,000	
Furniture (less depreciation)	2,00,000	
Provision for taxation		3,91,000
Profit for 31-3-2021		4,20,000
	1,84,10,000	**1,84,10,000**

Following further information is given.

a) Authorised Capital is Rs. 1,00,00,000 (2,00,000 Shares of Rs. 50 each.)

b) Issued Capital is half of the Authorised Capital. All Shares are fully subscribed on which Rs. 25 per share are paid up.

c) Constituents 'Liabilities for Acceptances and Endorsements Rs. 22,00,000.

d) Bills for collection Rs. 15,00,000.

e) Contingent liability for partly paid shares Rs. 2,00,000.

f) Provide for doubtful loans Rs. 20,000.

g) Market value of Investment on 31-3-2021 were

   i) Shares in companies Rs. 5,25,000

   ii) Government securities Rs. 6,00,000

Solution - 6

Form 'A'

Balance Sheet of Friends Bank Ltd.

as on 31-3-2021

Particulars	Schedule No.	Current Year	Previous Year
Capital and Liabilities			
Capital	1	25,00,000	
Reserve and surplus	2	14,00,000	
Deposits	3	1,34,00,000	
Borrowings	4	4,00,000	
Other Liabilities and Provisions	5	6,90,000	
Total		**1,83,90,000**	
Assets			
Cash in hand and with R.B.I.	6	3,50,000	
Balance with other banks, money at call and short notice	7	1,50,000	
Investments	8	10,75,000	
Advances	9	1,60,00,000	

Fixed Assets	10	8,00,000	
Other Assets	11	15,000	
Total		**1,83,90,000**	
Contingent Liabilities	12	24,00,000	
Bills for collection	--	15,00,000	

Working Details :

Schedule No. 1 : **Capital**

Particulars	Current Year	Previous Year
Authorised Capital		
2,00,000 shares of Rs. 50 each	1,00,00,000	
Issued and Paid up Capital		
1,00,000 shares of Rs. 500 each Rs. 25 per share paid up	25,00,000	
Total	**25,00,000**	

Schedule No. 2 : **Reserve and Surplus**

Particulars		Current Year	Previous Year
General Reserve		3,00,000	
Statutory Reserve	6,00,000		
Add 20% of current profit	84,000	6,84,000	
Balance of Profit & Loss Appropriation A/c.		4,16,000	
Total		**14,00,000**	

Schedule No. 3 : **Deposits**

Particulars	Current Year	Previous Year
Fixed Deposits	25,00,000	
Current Accounts	40,00,000	
Contingency Accounts	4,00,000	

Saving Accounts	65,00,000	
Total	**1,34,00,000**	

Schedule No. 4 : **Borrowings**

Particulars	**Current Year**	**Previous Year**
Borrowing from Central Bank of India	4,00,000	
Total	**4,00,000**	

Schedule No. 5 : **Other Liabilities and Provisions**

Particulars	**Current Year**	**Previous Year**
Bills Payables	2,00,000	
Unclaimed dividend	25,000	
Branch adjustments	74,000	
Provision for taxation	3,91,000	
Total	**6,90,000**	

Schedule No. 6 : **Cash in hand and with R.B.I.**

Particulars	**Current Year**	**Previous Year**
Cash in hand	1,50,000	
Balance with Reserve Bank of India	2,00,000	
Total	**3,50,000**	

Schedule No. 7 : **Balance with other Banks, Money at call & Short Notice.**

Particulars	**Current Year**	**Previous Year**
Balance with other Bank	1,50,000	
Total	**1,50,000**	

Schedule No. 8 : **Investments**

Particulars	**Current Year**	**Previous Year**
Investment in shares (M.V. Rs. 5,25,000)	5,00,000	

Investment in Government securities (Market value Rs. 6,00,000)	5,75,000	
Total	**10,75,000**	

Schedule No. 9 : **Advances**

Particulars		**Current Year**	**Previous Year**
Loans	50,00,000		
Less : Provision	20,000	49,80,000	
Cash Credits		80,00,000	
Overdrafts		7,70,000	
Bills discounted and purchased		15,00,000	
Advances		7,50,000	
	Total	**1,60,00,000**	

Schedule No. 10 : **Fixed Assets**

Particulars	**Current Year**	**Previous Year**
Premises less depreciation	6,00,000	
Furniture less depreciation	2,00,000	
Total	**8,00,000**	

Schedule No. 11 : **Other Assets**

Particulars	**Current Year**	**Previous Year**
Interest accrued on Investment	15,000	
Total	**15,000**	

Schedule No. 12 : **Contingent Liabilities**

Particulars	**Current Year**	**Previous Year**
Contingent liabilities for Acceptances	22,00,000	
Liability for partly paid shares	2,00,000	
Total	**24,00,000**	

P & L Opening Balance		:	1,00,000
Add :	Current year profit	:	4,20,000
			5,20,000
Less :	Bad debt provisions	:	20,000
			5,00,000
Less :	Transfer to statutory reserve	:	84,000
			4,16,000

1.3 Summary

A Bank is a financial institution which deals with money and credit. It accept deposits and leads money to those who are in need of it. If helps to transfer money from one place to another. Banker is a person or company carring on the business of receiving money and collecting drafts for customers subject to the obligation of honouring the cheques drawn upon him from time to time by customers up to the amount available on their customers.

A Banking company closes its accounts on 31st March every year. So one financial year is 1st April to 31st March. A Banking companies work as per guidelines of RBI. So control is given to RBI i.e. Reserve Bank of India. According to section 29 of the Banking Regulation Act. 1949, every banking company is required to prepare with reference to that year a balance sheet and profit and loss account on the last working day of the year in the form 'A' and Form 'B' respectively as given in Schedule III.

1.4 Check your Progress

1. Banking Regulation Act ………………

   a) 1956 b) 2013 c) 1949 d) 1972

2. ………….. is accounting year for all banking Companies.

   a) 1st Jan to 31st December b) 1st March to 28th February

   c) 1st April to 31st March d) None of the above

3. According to the ……………… Banking Companies Act 20% of the profit must be transferred to the statutory reserve.

   a) Section 17 b) Section 18 c) Section 19 d) Section 20

4. Schedule No. 1 to 5 related to …………………

a) Assets b) Profit

c) Capital & Liabilities d) None of the above

5. NPA means ………………

a) Net profit on Assets b) Net profit Actual

c) Not Performing Assets d) Non Performing Assets

6. All fixed Assets shown in schedule No …………………..

a) Schedule No. 10 b) Schedule No. 5

c) Schedule No. 11 d) Non of these

1.5 Key Terms:

1) Non banking assets :

The assets which are not required for banking operation are called as non banking assets. These are acquired by bank against security of loans advanced.

2) Money at call and short notice :

Such loans are advanced by banks from surplus cash to the needy banks loans repayable within 24 hours are termed as 'Money at Call'. Loans repayable by a notice of seven days are termed as 'Money at Short Notice'.

3) Bad debts :

Such part of advances, which is irrecoverable from clients.

4) Rebate on bills discounted :

This is a amount of discount received in advance. Bank discounts the bill, gets discount on it, but some amount received on discounting of bill may relate to next year. Such amount of discount related to next year but received in current year is treated as rebate on bills discounted.

5) Contingent Liabilities :

This is a liability, which is not actual liability but may occur in future.

6) Letter of Credit :

It is a letter addressed by a banker certifying that a person named therein is entitled to draw on him a credit up to certain limit. Unpaid balance of this letter on the Balance Sheet date form s liability of the issuing bank.

7) Unclaimed Dividends :

It is a amount of dividend which is declared by bank but not collected by share holders it forms part of liability of a bank.

1.6 Answer to check your progress

1) c 2) c 3) a 4) c 5) d 6) a

1.7 Exercise

a) Theory Questions

1. What is mean by Banking Companies? Explain its schedules.
2. Define Bank and Explain Scope of Banking business.

b) Short Notes

1. Schedule & Investments
2. Income
3. Rebate on Bills Discounted

Exercise – 1

The following Trial Balance has been extracted from the books of Commercial Bank Ltd. as on 31st March, 2021.

Particulars	Debit Rs.	Credit Rs.
Cash with RBI	5,00,000	
Cash in hand	3,70,000	
Current and Contingency A/c		26,00,000
(Before setting off overdraft of Rs. 1,00,000)		
Savings Bank Account		40,00,000
Fixed Deposit Account		15,00,000
Bills Purchased and Discounted	20,00,000	
Loans, Cash Credits including overdrafts	91,00,000	
Rebate on Bills Discounted		1,50,000
Bills Payable		2,50,000

Investments in Securities	16,00,000	
Reserve Fund		12,00,000
Non-Banking Assets acquired	1,00,000	
Gold	2,00,000	
Furniture	1,25,000	
Premises	3,75,000	
Profit and Loss A/c.		1,40,000
Interest Accrued	40,000	
Outstanding Liabilities		60,000
Borrowings from Banks		2,00,000
Margin Money held against letter of credit issued		70,000
Issued and fully paid up Equity Share Capital		42,40,000
	1,44,10,000	**1,44,10,000**

With the help of the above trial balance, prepare the Balance Sheet as on 31st March 2021, Provide Rs. 5,50,000 for Doubtful Debts.

Bills for Collection outstanding on 31-3-2021 Rs. 2,25,000

Authorised Capital consists of 8,48,000 Equity Shares of Rs. 10 each. Acceptances, Endorsements and other obligations Rs. 3,00,000. Contingent liability for public issue of shares underwritten Rs. 4,00,000.

Exercise – 2

From the following balances which are extracted from the books of Hindustan Bank, prepare the Profit and Loss Account for the year ending 31 March 2015 and a Balance Sheet as on that date.

Particulars	**Rs.**
Share Capital : 2,000 Shares of Rs. 500 each Rs. 200 per Share paid up	4,00,000
Bad debts written off	25,742
Reserve fund investments	2,00,000
General expenses	36,484

Current Accounts	40,48,844
Interest paid on Deposits	32,104
Deposit Accounts	13,84,046
Profit and Loss A/c (Cr.)	45,868
Acceptance for customers	3,08,565
Discount	48,752
Endorsements and Guarantee	14,804
Commission, Exchange and Brokerage	8,848
Cash	45,308
Interest received	1,06,452
Cash with Reserve Bank	4,02,420
Endorsements and Guarantee as per Contra	14,804
Owing by Foreign correspondent	40,088
Customers Liabilities for Acceptances	3,08,564
Borrowings from other Banks	12,96,412
Loans and Advances to customers	30,91,340
Investments	19,76,508
Bills discounted	12,45,648
Premises	4,43,580
Statutory Reserve	2,00,000

The following information is relevant:

a) Reserve Rs. 6,438 as Rebate on bills discounted.

b) Provide Rs. 15,000 for taxation reserve.

Exercise - 3

Following balances were extracted from the books of Sadhana Bank Ltd. as on 31st March 2021.

Particulars	Rs.
Share Capital	6,00,000
Share Premium	1,80,000
Buildings	1,30,000
Deposits with RBI	1,50,000
Cash in Hand	22,700
Cash with other Banks	50,000
Investment in Government Securities	3,88,000
Other Investments	3,12,000
Gold Bullion	30,260
Bills for collection	87,000
Interest accrued on Investment	49,240
Loss on sale of Investment	60,000
Employees Security Deposits	30,000
Savings Deposits	14,840
Current Deposits	1,94,000
Fixed Deposits	46,100
Profit on Bullion	2,400
Acceptance and Endorsements	1,13,000
Miscellaneous Income	5,400
Non-Banking Assets	4,000
Statutory Reserve	2,80,000
Furniture	10,000
Postage and Telegram	100

Managing Director's Remuneration	24,000
Borrowings from other Banks	1,54,460
Money at Call and Short Notice	52,000
Director's Fees	2,400
Interest (Dr)	15,900
Advances	4,00,000
Loss on Sale of Furniture	2,000
Bills discounted and Purchased	25,000
Interest (Credit)	1,44,000
Discount (Credit)	84,000
Audit Fees	10,000
Salaries	42,400
Commission and Brokerage	50,600
Rent (Cr.)	1,200
Profit and Loss A/c (Cr.)	13,000

Prepare Profit and Loss Account and Balance Sheet after considering the following :

1. Provide for Taxation Rs. 20,000.
2. Claim by employees for Bonus Rs. 30,000 is to be provided.
3. As security of current deposits reveals that there are three accounts overdrawn to the extent of Rs. 50,000 and total of credit balance is Rs. 2,44,000
4. Allow 5% depreciation on buildings.
5. Provision for bad and doubtful debts is required amounting to Rs. 20,000.

Exercise – 4

From the following you are required to prepare the Profit and Loss Account and the Balance Sheet of the Shivaji Bank Limited as on 31 st March 2021 in prescribed form :

Particulars	Debit Rs.	Credit Rs.
Issued Capital 20,000 shares of Rs. 100 each		20,00,000
Money at call and short notice	8,00,000	
Reserve Fund		7,00,000
Cash in hand and with RBI	6,50,000	
Deposits		
a) Saving		10,00,000
b) Current		5,00,000
c) Fixed		10,00,000
Cash with other Banks	9,50,000	
Borrowing from SBI		5,00,000
Investment in Government Securities	9,00,000	
Secured Loans	15,00,000	
Cash Credits	5,00,000	
Premises less depreciation	5,80,000	
Furniture less depreciation	1,20,000	
Rent	5,000	60,000
Interest and discount		8,00,000
Interest paid on deposits	3,00,000	
Commission and brokerage		70,000
Salaries to the staff	1,50,000	
Interest paid on borrowings	50,000	
Audit Fees	10,000	
Directors Fees	8,000	
Bill discounted	80,000	
Depreciation on Bank's property	13,000	

Printing and Stationery	8,000	
Postage	6,000	
	66,30,000	**66,30,000**

Adjustments:

a) Provide Rs. 20,000 for doubtful debts.

b) Acceptances and endorsements on behalf of customers amounting to Rs. 4,00,000.

c) Provide Rs. 60,000 for taxation reserve.

d) Provide Rs. 10,000 on bill discounted but not matured on 31 March 2021

Exercise - 5

From the following balances extracted from the books of Laxmi Vishnu Bank Ltd., Solapur prepare the Profit and Loss Account for the year ended 31 st March 2021 and the Balance Sheet as on that date.

Particulars	Rs.
Share Capital (Authorised and Issued)	3,00,000
10,000 shares of Rs. 50 each, Rs. 30 paid	
Reserve Fund	1,00,000
Money at call and Short Notice	1,25,000
Investment at cost	10,000
Interest paid on Deposits and Borrowings	70,000
Law Charges	3,000
Postage and telegrams	2,000
Salaries (including remuneration to Managing Director	45,000
Rs. 10,000 and Directors Fees Rs. 6,000)	
Rent, Taxes and Insurance	4,000
General Expenses (Including Stationery Rs. 3,000, Auditor's fees Rs. 5,000 and other expenditure Rs. 2,000)	10,000
Deposits : a) Fixed	5,00,000
b) Saving	2,00,000

c) Current	23,00,000
Premises (after Depreciation upto 31-3-2020 Rs. 25,000)	1,75,000
Furniture (after Depreciation upto 31-3-2020 Rs. 5,000)	15,000
Cash in Hand	35,000
Cash with RBI	2,00,000
Cash with other Banks	3,00,000
Borrowings from other Banks	3,50,000
Interest and Discount	2,23,250
Profit and Loss Account (Credit balance on 1-4-2020)	50,000
Dividend for the year 2013-2020	30,000
Loans, Cash Credit and Overdrafts	16,14,250
Bills Payable	25,000
Bills discounted and Purchased	3,50,000
Unclaimed Dividend	5,000
Branch Adjustment (Cr.)	12,500
Commission and Exchanve	22,500
Library Books	6,000
Repairs to Bank Property	4,000
Non-Banking Assets	25,000
Gold Bullion	75,000

Adjustments :

1. Provide depreciation at 5% on Premises and at 10% on Furniture. (On original cost of the assets in question)
2. Provide Rs. 20,000 for Bad and Doubtful Debts.
3. Provide Rs. 25,000 for Taxation.
4. Rebate on Bills Discounted for unexpired period amounted to Rs. 750
5. The Bank has accepted on behalf of customers bills worth Rs, 1,00,000 and has Bills for collection being bills receivables, worth Rs. 50,000.

Exercise – 6

From the following balances extracted from the books of Dhanlaxmi Bank Ltd., Solapur prepare the Profit and Loss Account for the year ended 31 st March 2021 and the Balance Sheet as on that date.

Particulars	Rs.
Share Capital (Authorised and Issued)	6,00,000
20,000 shares of Rs. 50 each, Rs. 30 paid	
Reserve Fund	2,00,000
Money at call and Short Notice	3,00,000
Investment at cost	20,00,000
Interest paid on Deposits and Borrowings	1,40,000
Law Charges	6,000
Postage and telegrams	4,000
Salaries (including remuneration to Managing Director	90,000
Rs. 20,000 and Directors Fees Rs. 12,000)	
Rent, Taxes and Insurance	8,000
General Expenses (Including Stationery Rs. 6,000, Auditor's fees Rs. 10,000 and other expenditure Rs. 4,000)	20,000
Deposits : a) Fixed	10,00,000
b) Saving	4,00,000
c) Current	46,00,000
Premises (after Depreciation upto 31-3-2020 Rs. 50,000)	3,50,000
Furniture (after Depreciation upto 31-3-2020 Rs. 10,000)	30,000
Cash in Hand	70,000
Cash with RBI	4,00,000
Cash with SBI	6,00,000
Borrowings from other Banks	7,50,000
Interest and Discount	2,23,250
Profit and Loss Account (Credit Balance on 1-4-2020)	1,00,000

Dividend for the year 2019-20	60,000
Loans, Cash Credit and Overdrafts	32,28,250
Bills Payable	50,000
Bills discounted and Purchased	7,50,000
Rebate on Bills Discounted (on 31-3-2021)	10,000
Branch Adjustment (Cr.)	25,000
Commission, Exchange received	45,000
Library- Books	12,000
Repairs to Bank Property	8,000
Gold Bullion	1,50,000

Adjustments :

1. Provide depreciation at 5% on Premises and at 10% on Furniture. (On original cost of the assets)
2. Provide Rs. 58,000 for Bad and Doubtful Debts.
3. Rebate on Bills Discounted as on 31-3-2021 amounted to Rs. 16,500 for unexpired period.
4. Loans advanced by bank included a sum of Rs. 1,00,000 due from a customer against the mortgage of his machinery. As the client is unable to pay the amount, the bank takes over the machinery at the market value of Rs. 70,000 in full satisfaction of its claim on the date of Trial Balance.

❑❑❑

Unit-2

a) Farm Accounting

Structure of the Unit

2.0 Objective

After studying this unit you will be able to understand –

- The objectives of farm accounting.
- The book keeping and preparation of financial statements for farm transactions.
- The special features of depreciation on fixed assets.

2.1 Introduction

Agriculture activity is a predominant activity in India. In the recent years, Commercial farming has been assuming great importance, particularly in States like Punjab, Tamil Nadu, Andhra Pradesh and Haryana. Farming activities now comprises not only of growing crops but also include animal husbandry (rearing of livestock), poultry farming, sericulture (silkworm breeding), pisciculture (rearing of fish), floriculture (growing flowers) etc. As a result of this development, 'farm accounting' has attracted great attention.

2.2 Presentation of Subject Matter

2.2.1 Meaning of farm accounting

In the recent years, commercial farming has been assuming great importance. Agriculture activity is a predominant activity in India. Farming activity includes animal husbandry, poultry farming, sericulture, pisciculture etc. Corporate entities are entering in the farming business in a big way. Therefore, the Institute of Cost and Works Accountant of India issued a booklet, explaining how the farm books should be kept and how the profit or loss arising from the farming operations should be ascertained.

2.2.2 Features of farm Accounting :

While preparing the farm accounts, one should be guarded about the peculiar features of farm accounting. Some of the features of farm transactions are given below:

1. The farm business is family type. It is confined to the family. The farmer keeps a single bank account for business and for his private purposes.
2. Part of the produce and products of the farm are consumed by the family.
3. The farmer and his family members may work on the farm without receiving any specified wages.
4. Farming activities are not confined to raising crops alone. Besides raising crops, the farmers, engage themselves in other farming activities like poultry, dairying, pig production, rearing fish, growing flowers etc.

5. Inventory valuation of standing crops, cattle, poultry, etc., is the most difficult one.
6. Agriculture operations on a farm are subject to natural calamities such as pests, diseases, floods, weather conditions etc. and variations in Governments policies, market prices of inputs, like, fertilizers, seeds, chemicals.
7. Most of the small farmers are illiterate and they cannot afford the expense of employing someone to maintain the accounts.
8. Even big farmers are not aware of accounting techniques which can prove useful for managerial decisions.
9. The collection of statistical data is done in a conventional manner.
10. Agriculture sector in India is unorganized and dominated by small farmers. The average size of holding land is very small etc.

2.2.3 Objectives of Farm Accounting

Following are the objectives of maintaining farm accounts;

1. To ascertain the financial position of the farming operations at any time.
2. To provide acceptable accounting records which can form the basis for securing finance from financial institutions.
3. To understand the Crop-wise performance so that the profitable and unprofitable activities can be segregated.
4. To provide reliable and useful information for assessment of agriculture income tax.
5. To have better control over farming activities.
6. To provide useful information for claiming compensation from government or insurance companies in case of loss suffered due to natural calamities etc.

2.2.4 Accounting for farms :

There are four types of transactions relating to farm activities i.e. Cash, Credit, exchange and national. The cash and credit transactions are recorded as usual. The exchange transactions, in the nature of barter, are normally recorded at opportunity cost that is the price in the open market. Notional transactions means the transactions which take place between the members of owner's family and the farm.

The performance of each crop shall be found out separately to understand the profitability of crops. The direct cost clearly identifiable with a crop shall be charged accordingly. The common cost should be suitable allocated on some accepted basis.

Books of Accounts :

Following books of accounts are maintained under farm accounting :

1. Cash Book for recording cash transactions. Analytical column cash book is prepared.
2. Debtors and Creditors Register to record credit transactions.
3. Stock Register is prepared for recording opening, purchase, sale and stock remained at the end.
4. Fixed Assets Register which contains the details of cost of asset, depreciation on it and closing balance.
5. Loan Register is prepared for recording loan amount and interest on it.
6. Register for National Transactions is prepared to record the transactions between farm and farm household.
7. Cost analysis Register for keeping record of each farming activity to know the profit of each activity etc.

Cost and Revenues:

Expenses and incomes associated with farming activities, other than agriculture activities are given below.

Farming Activities	Cost/Expenses	Revenues/Incomes
Poultry	Chicken feed, hay, packing, boxes, cost of shed, medicines, salaries and wages.	Sale of eggs, chickens, broilers, hens, sale of manures.
Dairy	Cattle feed, hay, cost of cultivation of feed crop, insecticides, salaries and wages,	Sale of milk, milk products, calves, dairy cattle and slaughtered

	cost of maintaining milk processing facilities	cattle
Fisheries	Cost of seed and water, fish feed, cost of tanks, catching expenses depreciation on assets, salaries and wages	Sale of fish

2.2.5 Preparation of Final Accounts :

Farm final accounts can be prepared according to any of the two methods i.e. Single entry method and Double entry method.

Single Entry Method : Under this method two statements are prepared one in the beginning of the year and another at the end of the accounting year. The excess of assets over liabilities is considered as a net worth of the business and the profit or loss made by business during a period can be ascertained by comparing the net worth of the business on two dates after making the adjusting entries of drawings, introduction of additional capital etc.

Double Entry method : Under this method farm account is prepared by following the principles of double entry system. This accounts is debited with opening stock and the relevant expenses incurred and credited with the sale proceeds and closing stock. The difference between debit and credit is show profit or loss. For every farm activity a separate columns are provided. The profit or loss of each activity is transferred to Balance Sheet.

2.2.6 Illustrative example of farm Accounting

Illustration 1 :

From the information given below prepare a 'Crop Account' to ascertain the gross profit made by this section of the farm :

Opening Stocks:	Rs.
Grains	8,000
Seeds	600
Fertilizers	3,000

Purchases :	
Seeds	8,200
Fertilizers	32,000
Sale of grain	
Grain distributed as wages	3,000
Wages paid in cash	3,700
Grains used by the proprietor	4,300
Grains consumed by the live stock section	2,700

Solution :

Dr. Crop Account Cr.

Particulars		Rs.	Particulars		Rs.
To Opening Stock			By Sales of Grain		32,000
Grains	8,000		Wages		3,300
Seeds	600		(Grains distributed)		
Fertilizers	3,000		Drawings		4,300
		11,600	Grains used by the Proprietor)		2,700
			Live stock section (grains consumed)		
To Purchases :			Closing Stock :		
Seeds	1,800		Grains	3,700	
Fertilizers	8,200		Seeds	300	
		10,000	Fertilizers	400	
					4,400
To Wages :					
Cash	3,700				
Grains	3,300				
		7,000			
To Repairs and Maintenance		1,900			
To Depreciation Farm Machinery		2,500			
To Crop Insurance		600			
To Profit from Crops		13,100			
		46,700			46,700

Illustration 2 :

From the following information, prepare "Crop Account" to find out the profit made by the crop section of the farm.

	Rs.	Rs.
Opening Stocks :		
Grain	2,600	
Seeds	600	
Fertilizers	400	
		3,600
Purchases :		
Seeds	400	
Fertilizers	600	
		1,000
Wages paid in cash		3,500
Wages paid in kind by given grain		2,500
Sale of grain		25,400
Grain consumed by the proprietor		600
Grain consumed by the live stock section		2,400
Depreciation on farm machinery		1,000
Repairs and maintenance of farm machinery		2,000
Closing Stock		
Grain	2,000	
Seeds	400	
Fertilizers	600	
		3,000

Solution :

Dr. Crop Account Cr.

Particulars		Rs.	Particulars		Rs.
To Opening Stock			By Sales of Grain		25,000
Grains	2,600		By Wages in kind (contra)		2,500
Seeds	600		By Grain consumed by		
Fertilizers	400		live stock section		2,400
		3,600	By Grain consumed by the		
To Purchases :			proprietor (Drawings)		600
Seeds	400		By Closing Stocks:		
Fertilizers	600		Grain	2,000	
		1,000	Seeds	400	
			Fertilizers	600	3,000
To Wages :					
In Cash	3,500				
In Kind	2,500				
		6,000			
To Depreciation		1,000			
To Repairs and Maintenance		2,000			
To Crop profit transferred					
to Profit and Loss A/c		20,300			
		33,900			33,900

Illustration 3 :

From the following information prepare Cattle Account to ascertain the profit made by the cattle division.

	No.	Value Rs.
Opening Stock of live stock	100	2,00,000
Closing stock of live stock	118	2,42,000

Opening stock of cattle food		4,000
Closing stock of cattle food		5,000
Purchases of cattle during the year	180	3,70,000
Sales of cattle during the year	175	4,38,000
Sales of carcasses	5	1,000
Purchases of cattle food		40,000
Wages of rearing cattle		10,000

Crop worth Rs. 11,000 grown in the farm was used for feeding the cattle. Out of the calves born 4 died and their carcasses realised Rs. 100.

Solution :

Dr. Cattle Account Cr.

Particulars	**No**	**Amount Rs.**	**Particulars**	**No.**	**Amount Rs.**
To Opening Stock of live stock	100	2,00,000	By Sale of Cattle	175	4,38,000
To Purchase of cattle	180	3,70,000	By Sales of carcasses	5	1,000
To Calves born (Bal. fig.)	22	---	By Sales of carcasses of calves	4	100
To Cattle food : Opening Stock 4,000; Purchases 40,000; 44,000; Less Closing stock 5,000		39,000	By Closing stock of live stock	118	2,42,000
To Wages for rearing cattle		10,000			
To Crop Account-Crop grown in the farm used for feeding cattle		11,000			
To Net profit transferred to General profit and Loss Account		51,000			
	302	6,81,100		302	6,81,100

Illustration 4 :

From the information given below, prepare a "Crop Account" to ascertain the gross margin made by this division of the farm.

Opening Stock	Rs.
Grain	3,000
Seeds and fertilizers	2,000
Purchases :	
Seeds	500
Fertilizers	1,500
Sale of grain	15,000
Grain distributed as wages	2,000
Wages paid in cash	3,000
Grain consumed by the proprietor	2,000
Grain consumed by the live stock section	1,500
Repairs and maintenance of farm machinery	1,200
Depreciation on farm machinery	300
Crop insurance	500
Closing Stock :	
Grain	6,000
Seeds and fertilizers	3,000

Solution :

Dr. Crop Account Cr.

Particulars		Rs.	Particulars	Rs.
To Opening Stock			By Sale of grain	15,000
Grain	3,000		By Wages (contra)	2,000
Seeds and fertilizers	2,000		By Drawings – grain consumed	
		5,000	by proprietor	2,000
To Purchases :			By Live stock section-grain	
Seeds	500		consumed by animals	1,500
Fertilizers	1,500			

		2,000	By Closing Stock		
To Wages			Grain	6,000	
Cash	3,000		Seeds and fertilizers	3,000	
Grain	2,000				9,000
		5,000			
To Crop insurance		500			
To Repairs and maintenance		1,200			
To Depreciation		300			
To Profit transferred to general profit and loss account		15,500			
		29,500			29,500

Illustration 5 :

From the following Trial Balance extracted from the books of Suraj Farms draw up the final accounts for the year ended 31st March, 2021 and the Balance Sheet as on the date :

Debit Balances		Rs.	Credit Balances		Rs.
Stock on 1-4-2020			Sales		
Live stock	1,50,000		Live Stock	48,000	
Paddy	60,000		Paddy	2,12,000	
Cattle feed	11,000		Milk	1,57,000	4,17,000
Fertilizers	5,000		Sundry Creditors		26,000
Seeds	3,000	2,29,000	Outstanding expenses		4,000
Purchases :			Capital Account		4,41,800
Live Stock	30,000				
Cattle feed	60,000				
Fertilizers	16,000				
Seeds	5,800	1,11,800			
Sundry Debtors		21,000			
Repairs and Maintenance of Farm equipments		12,000			

Farm equipments	1,50,000		
Crop expenses	50,400		
Live stock expenses	12,500		
General expenses	11,700		
Cash in hand	7,300		
Cash at Bank	8,500		
Land	2,75,000		
	8,89,200		8,89,200

Additional Information :

1. Closing stock as on 31-03-2021

   Live stock Rs. 1,32,000; Paddy Rs. 30,000; Cattle feed Rs. 6,000; Fertilizers Rs. 3,500; Seeds Rs. 2,700.

2. The consumption of the farm output by the proprietor:

   Milk etc., Rs. 6,000

   Paddy Rs. 9,500

3. Provide 10% depreciation on Farm Equipments and 2% on Land and Buildings.

Solution :

Trading and Profit and Loss Account

Dr. for the year ended 31-03-2021 Cr.

Particulars	**Rs.**	**Rs.**	**Particulars**	**Rs.**	**Rs.**
To Opening Stock			By Sale of Cattle		
Live stock	1,50,000		Live stock	48,000	
Paddy	60,000		Paddy	2,12,000	
Cattle feed	11,000		Milk	1,57,000	4,17,000
Fertilizers	5,000				
Seeds	3,000	2,29,000	By Produce consumed		
			by proprietary		
To Purchase			Milk	6,000	

Live stock	30,000		Paddy	9,500	15,500
Cattle feed	60,000				
Fertilizers	16,000		By Closing Stock :		
Seeds	5,800	1,11,800	Live stock	1,32,000	
			Paddy	30,000	
To Crop expenses		50,400	Cattle feed	6,000	
To Live stock expenses		12,500	Fertilizers	3,500	
To Gross Profit		2,03,000	Seeds	2,700	1,74,200
		6,06,700			6,06,700
To General expenses		11,700	By Gross Profit		2,03,000
Repairs and Main.		12,000			
Depreciation					
From Equipments	15,000				
Land & Buildings	5,500	20,500			
To Net Profit		1,58,800			
		2,03,000			2,03,000

Balance Sheet
as on 31-03-2021

Particulars	**Rs.**	**Amt.**	**Particulars**	**Rs.**	**Amt.**
Sundry Creditors		26,000	Cash in hand		7,300
Outstanding exp.		4,400	Cash in Bank		8,500
Capital A/c	4,41,800		Sundry Debtors		21,000
Less : Produce consumed	15,500		Closing Stocks :		
	4,26,300		Live Stock	1,32,000	
Add : Net Profit	1,58,800	5,85,100	Paddy	30,000	
			Cattle feed	6,000	
			Fertilizers	3,500	
			Seeds	2,700	1,74,200
			Farm equipments	1,50,000	
			Less : Depreciation	15,000	1,35,000
			Land & Buildings	2,75,000	

			Less : Depreciation	5,500	2,69,500
		6,15,500			6,15,500

Illustration 6 :

Mr. Gopal has a five acres farm land. He grows rice on four acres. The balance area has mango trees. Other particulars about his activities, during 2020-21 are :

	Amount Rs.
Opening stock of fertilizers	30,000
Rice saplings purchases	50,000
Water Charges	12,000
Sprinkler system	60,000
Pump	30,000
Fertilizer purchases	90,000
Insecticide spraying charges`	9,000
Wooden boxes purchased during the year	6,000
Jute bags purchased during the year	48,000
Agriculture labour wages	60,000
Orchard labour wages	24,000
Threshing Machine	10,000
Dead trees sold	5,000
Salary to Manager	6,000

During the year, he obtained 90,000 mangoes from his trees, which he disposed off at Rs. 10 per dozen. All the boxes were used for packing.

He also obtained 100 quintals rice per acre, half of which fetched him Rs. 7 per kilo and the rest Rs. 5 per kilo. One-tenth quantity of the bags purchased, remained unutilized. Fertilizers, worth Rs. 20,000 remained in stock at the end of the year. Depreciation is to be provided at 10 per cent. Rural development authority of his region monitors his performance and he needs to provide product wise Profit and Loss Account to them. He apportions common expenses in proportion of the area under each product. Insecticide is required to be sprayed once in every three years on mango trees to keep them free from harmful insects.

Prepare product wise Profit and Loss Accounts.

Solution :

In the Books of Mr. Gopal

Profit and Loss Account

Dr. for the year ended 31-03-2021 Cr

Particulars	Rice	Mango	Particulars	Rice	Mango
To Purchases			By Sales	2,40,000	75,000
Rice Saplings	50,000	--	By Scrap sale		
To Fertilizers consumed	80,000	20,000	Sale of dead trees	---	5,000
To Jute Bags consumed	43,200	---			
To Wooden Boxes	---	6,000			
To Labour Wages	60,000	24,000			
To Salary to Manager	4,800	1,200			
To Water Charges	9,600	2,400			
To Depreciation on					
Sprinkler					
system @ 10%	4,800	1,200			
To Water Charges	9,600	2,400			
To Depreciation on					
Sprinkler					
system @ 10%	4,800	1,200			
Pump @ 10%	2,400	600			
Thresher @ 10%	1,000	---			
To Insecticide					
Spraying		3,000			
To Profit c/d		21,600	By Loss c/d	15,800	
	2,55,800	80,000		2,55,800	80,000

2.3 Summary :

Farming is similar to any other business, occupation etc. However, it has some special peculiar features. These features deserve special attention while designing farm accounting or accounting practices. Agriculture sector in India is most unorganized. Even big farmers are not fully aware of accounting techniques of farm accounting. However, efforts should be made to make farm accounting more popular so that advantages of farm accounting may be obtained by Indian farmers.

2.4 Check your Progress

A) Fill in the gaps.

1. .... Activity is a predominant activity in India.
2. .... is the application of accounting practices in agriculture operations.
3. Land development expenses is included in the cost of ....
4. .... is usually not depreciated because its monetary value tends to increase with the passage of time.
5. .... transactions are those that take place between the members of the owner's family and the farm.

B) State the following statements are true or false.

1. Farming sector in India is by and large, unorganized.
2. Only big farmers in India are aware of accounting techniques related to farm accounting.
3. When farm products are consumed by farm workers it is debited to wages accounting.
4. Farm accounting is still in its infant stage of development in India.
5. The collection of data of farm accounting is done in a conventional manner.

2.5 Key Terms

- **Land development expenses :** A business may purchase land for cultivation. When virgin land is to be cultivated, a big sum has to be spent for clearing the land, leveling, bunding and providing irrigation and drainage facilities. All these expenses are termed as 'land development expenses' and should preferable be added to the cost of land.

- **Depreciation on assets :** Depreciation must be provided on farm assets but not depreciation is provided on land because its monetary value tends to increase with the passage of time.
- **Drawings :** The treatment of drawings in kind (i.e. dairy products and crop products consumed by the family) is done by making the following entry;

  Drawing A/c Dr.

  To Milk/Crops A/c

The wages paid in kind of labours :

Wages A/c

To Milk/Crops A/c

2.6 Answer to check your progress

A) 1. Farm 2. Farm accounting 3. Land 4. Land 5. National

B) 1. True 2. False 3. True 4. True 5. True

2.7 Exercise :

(Theory and Practical Problems)

a) Broad Questions

1. What is mean by Farm Accounting? Explain its features.
2. Define 'Farm Accounting' explain its objectives.

b) Write short notes

a) Features of farm Accounting

b) Objectives of farm Accounting

c) Crop Accounts

d) Accounting for farms

Exercise-1

From the following Trial Balance, extracted from the books of Raj Farms, draw up the final accounts for the year ending 30th March, 2021.

Debit Balances		Rs.	Credit Balances		Rs.
Stock on 1-4-2020		26,000	Sundry Creditors		2,600
Live Stock	15,000		Outstanding expenses		400
Paddy	6,000		Sales :		
Cattle feed	1,000		Live stock	4,800	
Fertilizers	500		Paddy	42,500	
Seeds	500	23,000	Milk	25,700	73,000
Purchases :			Capital Account		50,300
Live stock	3,000				
Cattle feed	10,800				
Fertilizers	1,600				
Seeds	500	15,900			
Sundry Debtors		2,100			
Repairs and maintenance of farm machinery		2,200			
Farm Machinery		15,000			
Crop expenses		5,400			
Live stock expenses		3,800			
General expenses		3,900			
Cash in hand		1,500			
Cash at bank		8,500			
Land		45,000			
		1,26,300			1,26,300

Additional Information :

1. Closing stocks : Live stock, Rs. 10,000; Paddy Rs. 5,000; Cattle feed Rs. 600; Fertilizers Rs. 400.
2. Mr. Raj has consumed the following items out of his farm output :

Milk	Rs. 3,000
Paddy	Rs. 500

Provide 10% depreciation on farm machinery.

Exercise-2

From the following Trial Balance of Viraj, prepare trading and profit and loss account for the year ending 31st March, 2021 and a balance sheet as on that date.

Debit Balances		Rs.	Credit Balances	Rs.
Opening Stock			Sales :	
Paddy	500		Paddy	3,000
Potatoes	800		Potatoes	2,000
Cattle	1,000		Sugar cane	3,000
Sheep	700	3,000	Cattle	10,000
			Milk etc.	2,000
Purchases :			Sheep	3,000
Cattle	8,000		Loan from Land	
Sheep	1,000		Development Bank	8,700
Seeds	500		Capital Balance	20,000
Manures	1,000		Creditors for supplies	2,000
Cattle feed	1,000	11,500		
Crop expenses :				
Labour	400			
Other expenses	300	700		
Live stock expenses :				
Veterinary and medicines	500			
Labour	200			
Dairy expenses	300	1,000		
Expenses of machinery				
Repairs	300			
Diesel and oil	500			
Electricity	200	1,000		
General overheads :				
Rent and rates	1,000			
Insurance	200			
Wages for permanent	800			

labour				
Bank interest	500	2,500		
Farm Machinery		10,000		
Cash in hand		1,000		
Cash at Bank		3,000		
Land		20,000		
		53,700		53,700

Additional Information :

1. Closing stock : Rs.

Paddy	1,000
Potatoes	600
Cattle	1,500
Sheep	1,000

2. 50% of rent and rates may be taken as the share of Mr. Viraj for his residence.

3. Mr. Viraj has consumed the following from out of farm output:

Milk etc.	200
Potatoes	100
Paddy	700

4. Provide 10% depreciation on machinery.

Exercise-3 :

From the following trial balance of Sandhya Farm, prepare Corp Account, Live-stock Account, Profit & Loss Account for the year ended 31st March, 2021, and Balance Sheet as on that date.

Trial Balance

Debit Balance	**Rs.**	**Credit Balance**	**Rs.**
Opening Stock :		Sundry Creditors	7,500
Growing Crops	5,000	Bank Overdraft	1,500
Wheat	2,500	Managers Personal Account	1,000

Fertilizer	2,500	**Sales :**	
Live-stock	12,500	Wheat	17,500
Feeding Materials	3,000	Live-stock	37,500
Crop Expenses	5,000	Loan	30,000
Live-stock Expenses	14,150	Provision for Depreciation	15,000
Farm House Expenses	600	Profit & Loss A/c	5,000
Interest on Loan (Crop)	2,000	Capital	1,35,000
Salaries & Wages :			
Manager's Salary	3,000		
Farm Labour	2,500		
Staff Meals	250		
Loan & Building	1,05,000		
Farm Machinery	54,000		
Sundry Debtors	15,000		
Cash in Hand	13,000		
Repairs to Machinery	500		
Tools & Implements	1,250		
Office Expenses	2,000		
Live-stock Purchases	6,250		
	2,50,000		2,50,000

Additional Information :

(a) Stock on 31st March, 2021 Growing crops Rs. 2,000; Wheat Rs. 2,000; Fertilizer Rs. 1,000; Live-stock Rs. 20,000; Feeding materials Rs. 500; Tools and Implements Rs. 1,000.

(b) Depreciation on Tools & Implements is to be allocated between Crop and Live-stock equally.

(c) Manager's salary and staff meals are charged 30% to the Live-stock Account and 80% to the Crop Account.

(d) Farm product worth Rs. 500 is consumed by cattles.

(e) Farm house expenses and Farm Labour distributed between Crop and Live-stock in the ratio of 3 : 2.

Exercise-4 :

From the following prepare : (i) Crop A/c, (ii) Live-stock A/c, (iii) Profit & Loss A/c for the year ended 31-3-2021 and (iv) Balance Sheet as on that date.

Particulars	Debit Rs.	Credit Rs.
Stocks (1-4-2020)		
Live-stock	6,000	--
Crops	4,000	--
Feed	200	--
Farm House Expenses	240	--
Crop Expenses	2,000	--
Live-stock Expenses	5,500	--
Live-stock Purchases	2,500	--
Salaries & Wages		
Farm Labour (Crop)	1,000	--
Manager's Salary	1,200	--
Legal Fees	600	--
Office Expenses	200	--
Staff Meals	100	--
Sundry expenses (Live-stock)	160	--
Repairs to Machinery	400	--
Repairs & Maintenance (Live-stock)	100	--
Interest on Loan (Crop)	600	--
Cash in Hand	2,800	--
Sundry Debtors	8,000	--
Tools & Implements	300	--
Sheds (Live-stock)	100	--
Farm Machinery	22,000	--
Land & Building	40,000	--
Sales :		
Live-stock	--	15,000
Corn & Strand	--	7,000
Provision for Depreciation	--	8,000

Manager's Personal Account	--	100
Sundry Creditors	--	1,000
Bank Overdraft	--	900
Loan	--	10,000
Capital	--	56,000
	98,000	98,000

Adjustments :

1. Depreciate machinery by Rs. 100 and charge it to Crop A/c only.
2. Crop worth Rs. 400 was used for feeding Live-stock.
3. Office expenses and legal fees are purely of Administrative nature.
4. Charge 10% of salaries and staff meals to Live-stock A/c.
5. Depreciation on tools and implements is to be apportioned between Crop and Live-stock in the ratio of 3 : 1.
6. The manager of the farm resides in the Farm House as Free Residence but chargeable only 1/3 of the Farm House Expenses and is also entitled to a commission of 5% on profit made by Live-stock A/c before his commission.
7. Closing Stocks on 31-3-2021 were :

Growing Crops	Rs.	2,000
Tools & Implements	Rs.	100
Live-stock	Rs.	8,000
Feed	Rs.	400

2.8 Further Readings

1) Advanced Accountancy – Shukla & Grewal
ii) Advanced Accountancy – Chakrab horthy
iii) Advanced Accountancy – R. R. Gupta
iv) Advanced Accountancy – R. L. Gupta
v) Advanced Accountancy – Tulsian
vi) Steps in Advanced Accounting – Maheshwari

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Unit - 2

b) Hire Purchase System

Excluding Hire Purchase Trading Account

Structure of Unit :

2.0 Objectives

2.1 Introduction and Legal Position

2.2 Presentation of Subject Matter

2.2.1 Meaning of Purchase Agreement

2.2.2 Distinction between Hire Purchase and Installment

2.2.3 Terms used in Hire purchase

2.2.4 Accounting Entries in the books of Hire Purchaser and Vendor

2.2.5 Methods of calculation of interest.

2.2.6 Default and Repossession

2.3 Summary

2.4 Check your progress

2.5 Key words

2.6 Answer to check your progress

2.7 Exercise

2.0 Objectives :

After studying this unit students should be able to understand :

- Meaning and nature of Hire Purchase System.
- Difference between Hire purchase and Installment.
- Different Methods of calculation of Interest.
- Accounting entries to record hire purchase transactions.
- Accounting treatment after default in payment of installments.

2.1 Introduction & Legal Position :

Hire purchase means a transaction where goods are purchased or sold with the stipulation that (a) payment will be made by installments; (b) each installment will be treated as hire so that if default is made in the payment of even the last installment, the seller will be entitled to take away the goods without compensating the hire purchaser in any way; and (c) in case all instalments are paid, the goods will be treated as sold and property will pass to the purchaser. The property in the goods does not pass to the purchaser or hirer till the final instalment is paid.

He is free to return the goods without having to pay the instalment falling due after the return. In case of the instalment system, the property in the goods passes to the purchaser immediately the contract is signed and, if default is made in the payment of any instalment, the remedy open to the seller is to sue the purchaser for payment of the instalments due and not to take possession of the goods. This is the legal position but the intention of both the parties is, in both cases, to buy and sell, the payment being made in instalments.

The total payment made in case of hire purchase or instalment is more than the case price-naturally because in addition to case price, interest is also payable. It is necessary to calculate the interest so that the amount paid for interest is charged to revenue and the asset is capitalized only at the case price.

2.2 Presentation of Subject Matter

2.2.1 Meaning of Hire Purchase Agreement :

Hire purchase agreement means an agreement under which goods are let on hire and under which the hirer has on option to purchase them in accordance with the terms of the agreement and includes the agreement under which :

i) Possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodical instalments.

ii) The property in the goods (i.e. ownership of goods) is to pass to such a person on the payment of the last instalment; and

iii) Such a person has a right to terminate the agreement at any time before the property so pass.

2.2.2 Distinction between Hire purchase system and Instalments system :

Basis of Distinction	Hire Purchase System	Instalment System
1) Act Governing	It is governed by Hire Purchase Act 1972	It is governed by the Sale of Goods Act 1930
2) Nature of contact	It is an agreement of hiring.	It is an agreement of sale.
3) Passing of Title (ownership)	The title of goods passes on last payment.	The title of goods passes immediately.
4) Right to reposses	The seller may take possession of the goods if hirer is in default.	The seller can sue for price if the buyer is in default. He cannot take possession of the goods.
5) Right to Dispose off	Hirer can not hire out, sell, pledge or assign entitling transferee the goods till the payment of last instalment.	The buyer may dispose off the goods and give good title to bonafied purchaser.
6) Accounting	Asset account is debited step by step as and when instalments are paid.	The asset account is debited with full cash value immediately upon the agreement.

2.2.3 Terms used in Higher purchase Agreement :

a) **Hirer / Hire Purchaser :** A 'Hirer' means a person obtains possession of the goods from an owner under a hire purchase agreement.

b) **Hire vendor :** Hire Vendor means a person who delivers the possession of goods to the hirer under a hire purchase agreement.

c) **Cash Price :** Cash price means the price at which the goods may be purchased by the hirer for cash.

d) **Down Payment :** Down payment means an initial payment payable by the hirer on signing the hire purchase agreement.

e) **Hire Purchase Price :** Hire purchase price means the total sum payable by the hirer to the hire vendor. The hire purchase price includes cash price of the goods plus interest on outstanding balances.

Hire purchase price = Cash price + Interest on outstanding Balances.

2.2.4 (I) Accounting Entries in the Books of Hire Purchaser :

Following are the two methods of recording the hire purchase transactions the books of hire purchase.

a) Part cash price method.

b) Full cash price method.

Part cash price method is generally used to record hire purchase transaction but if there is repossession of goods for non-payment of instalment by the hire vendor the full cash price method is suitable.

a) Part cash price method :

Performa Journal Entries :

Sr.No.	Nature of transaction	Journal Entry	
1.	For cash down (On signing the agreement) Payment becomes due	Asset A/c To vendor's Ac/ (with cash down payment)	Dr.
2.	For payment of cash down	Vendor's A/c To Cash / Bank A/c	Dr.
3.	When subsequent instalments Falls due	Asset A/c (with cash price) Interest A/c (with interest) To vendor's A/c (with amount of instalents)	Dr. Dr.
4.	When instalment is paid	Vendor's A/c To Cash / Bank A/c.	Dr.

(Conted. on next page)

5.	For charging depreciation At the end of the year	Depreciation A/c Dr. To asset A/c (At the given rate on full cash price)
6.	For closing of depreciation and interest A/c	Profit & Loss A/c Dr. To Depreciation A/c To Interest A/c

Notes :

i) The first entries are made only if cash down / advance payment is made at the time of singing the agreement.

ii) The entries 3 to 6 are to be repeated every year till the last year.

b) Full Cash price Method :

Under this method, the asset A/c is debited with full cash price on signing the agreement as if asset is purchased on credit Performa Journal Entries.

Sr.No.	Nature of transaction	Journal Entry
1.	On signing the agreement	Asset A/c Dr. To Vendor's A/c (with full cash price of asset)
2.	For payment of cash down amount	Vendor's A/c Dr. To cash / Bank A/c (with cash down amount)
3.	For instalments becomes Due	Interest A/c Dr. To vendor's A/c (with interest amount in instalment)
4.	For payment of instalments	Vendors A/c Dr. To Cash / Bank (with amount of instalments)

(Conted. on next page)

5.	For charging depreciation Of the end of the year	Depreciation A/c Dr. To Asset A/c. (with amount of depreciation)
6.	For transfer in interest and Depreciation to P & L A/c	Profit & Loss A/c Dr. To Interest A/c. To Depreciation A/c

Note : Entries 3 to 6 are to be repeated every year.

2.2.4 (II) Accounting Entries in the books of Vendor :

Sr.No.	Nature of transaction	Journal Entry
1.	On singing the agreement	Hire purchaser's A/c Dr. To sales A/c (with Full cash price)
2.	For receipt of cash down Payment	Cash / Bank A/c Dr. To Hire purchaser's A/c (with cash down amount)
3.	When instalments becomes due	Hire purchaser's A/c Dr. To Interest A/c (with interest included in instalments)
4.	For receipt of instalment	Cash / Bank A/c Dr. To Hire purchaser's A/c (with the amount of instalments)
5.	For transfer of interest to P & L. A/c.	Interest A/c Dr. To profit & Loss A/c.

2.2.5 Methods of Calculation of Interest :

I) When Cash price, Hire Purchase Price and Rate of Interest are given :

When cash price, hire purchase price and rate of interest are given in the problem it is simple method. Interest at a given rate is calculated on the outstanding balance of cash price at the being of each year. Following are the illustrations.

Illustration – 1

On 1st April 2015, Sandeep purchased a machine for Ashok on hire purchase basis. The particulars are as follows :

i) Cash price of machne Rs. 20,000/-

ii) Cash down payment Rs. 8,000/-

iii) Balance in three annual instalment of Rs. 4,000/- plus interest.

iv) Interest to be charged on outstanding balance at 5% p.a.

v) Depreciation at 10% on reducing balance method.

For the above particulars pass journal entries in the books of both the parties and given necessary ledger accounts.

Solution :

In this problem cash price is given Rs. 20,000/- and total instalments is given also Rs. 20,000/- The rate of interest is 5% p.a. therefore we have to calculate the interest amount at the end of each year.

Installments Analysis Table :

Date	Outstanding Balance Cash price	Date of Payment	Instalment Advance	Interest	Portion of cash price	Depreciation of 10% on WDV
1-4-2015	20,000	1-4-2004	8,000	—	8,000	—
1-4-2015	12,000	31-3-2005	4600	600	4000	2000
1-4-2016	8,000	31-3-2006	4400	400	4000	1800
1-4-2017	4000	31-3-2007	4200	200	4000	1620

In the books of Sandeep (Hire Purchaser)

Journal Entries (Part Cash Method)

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
1-4-2015	Machine A/c	Dr.		8,000	
	To Ashok A/c				8,000
	(Amount payable to Ashok on signing the agreement)				
1-4-2015	Ashok A/c.	Dr.		8,000	
	To Aash				8,000
	(Cash down payment made to Ashok)				
31-3-2016	Machine A/c	Dr.		4,000	
	Interest A/c	Dr.		600	
	To Ashok A/c				4,600
	(Instalment including interest payable to Ashok)				
31-3-2016	Ashok A/c	Dr		4,600	
	To Cash				4,600
	(Payment of instalment to Ashok)				
31-3-2016	Depreciation A/c	Dr.		2,000	
	To Machine A/c				2,000
	(Charging depreciation @ 10% on WDV basis)				
31-3-2016	P & L A/c	Dr.		2,600	
	To Depreciation A/c				2,000
	To Interest A/c				600
	(Balance on Depreciation & interest is Transferred to Profit & Loss A/c)				

31-3-2017	Machine A/c	Dr.		4,000	
	Interest A/c	Dr.		400	
	To Ashok A/c				4,400
	(Instalment including interest is payable)				
31-3-2017	Ashok A/c	Dr.		4,400	
	To Cash				4,400
	(Payment of instalment)				
31-3-2017	Depreciation A/c	Dr.		1,800	
	To Machine A/c				1,800
	(Charging depreciation at 10% on WDV basis)				
31-3-2017	Profit & Loss A/c	Dr.		2,200	
	To Depreciation				1,800
	To Interest				400
	(Balance of depreciation and interest transfer to P & L A/c.)				
31-3-2018	Machine A/c	Dr.		4,000	
	Interest A/c	Dr.		200	
	To Ashok A/c				4,200
	(Instalment including interest is payable)				
31-3-2018	Ashok A/c	Dr.		4,200	
	To cash				4,200
	(Payment of Instalment)				
31-3-2018	Depreciation A/c	Dr.		1,620	
	To machine A/c				1,620
	(charging depreciation at 10% on WDV basis)				
31-3-2018	Profit & Loss A/c	Dr.		1,820/-	
	To Depreciation A/c				1,620
	To Interest A/c				200
	(Balance of depreciation & interest is transfer)				

Ledger Account :

Dr. **Machine A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Ashok	8,000	31-3-2016	By Depreciation	2,000
1-4-2016	To Asho	4,000	31-3-2016	By Balance c/d	10,000
		12,000			**12,000**
1-4-2016	To balance b/d	10,000	31-3-2017	By Depreciation	1,800
31-3-2017	To Ashok	4,000	31-3-2017	By Balance c/d	12,200
		14,000			**14,000**
1-4-2017	To balance b/d	12,200	31-3-2018	By Depreciation	1,620
31-3-2018	To Ashok	4,000	31-3-2018	By Balance c/d	14,580
		16,200			**16,200**
1-4-2018	To balance b/d	14,580			

Dr. **Ashok A/c (Vendor)** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Cash	8,000	1-4-2016	By Machine A/c	8,000
31-3-2016	To Cash	4,600	31-3-2016	By Machine A/c	4,000
			31-3-2016	By Interest	600
		12,600			**12,600**
1-3-2017	To Cash	4,400	31-3-2017	By Machine	4,000
			31-3-2017	By Interest	400
		4,400			**4,400**
31-3-2018	To Cash	4,200	31-3-2018	By Machine	4,000
			31-3-2018	By Interest	200
		4,200			**4,200**

Dr. **Depreciation A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
31-3-2016	To Machine	2,000	31-3-2016	By Profit & Loss A/c	20,000
31-3-2017	To Machine	1,800	31-3-2017	By Profit & Loss A/c	1,800
31-3-2018	To Machine	1,620	31-3-2018	By Profit & Loss A/c	1,620

Dr. **Interest A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
31-3-2016	To Ashok	600	31-3-2016	By Profit & Loss A/c	600
31-3-2017	To Ashok	400	31-3-2017	By Profit & Loss A/c	400
31-3-2018	To Ashok	200	31-3-2018	By Profit & Loss A/c	200

Journal Entries in the books of Ashok (Vendor)

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
1-4-2015	Sandeep A/c Dr.		20,000	
	To Sales			20,000
	(Sale of machine to Sandeep HP basis)			
1-4-2015	Cash A/c Dr.		8,000	
	To Sandeep A/c			8,000
	(receipt of cash down payment from Sandeep)			
31-3-2016	Sandeep A/c Dr.		600	
	To Interest A/c			600
	(interest receivable from Sandeep)			
31-3-2016	Cash A/c Dr.		4,600	
	To Sandeep A/c			4,600
	(receipt of Instalment including interest)			

(Conted. on next page)

31-3-2016	Interest A/c Dr.		600	
	To Profit & Loss A/c			
	(transfer to balance interest to P & L A/c)			
31-3-2017	Sandeep A/c Dr.		400	
	To Interest A/c			400
	(interest receivable from Sandeep)			
31-3-2017	Cash A/c Dr.		4,400	
	To Sandeep A/c			4,400
	(transfer of balance to P & L A/c)			
31-3-2018	Sandeep A/c Dr.		200	
	To Interest A/c			200
	(interest receivable from Sandeep)			
31-3-2018	Cash A/c Dr.		2,200	
	To Sandeep A/c			2,200
	(receipt of instalment including interest)			
31-3-2018	Interest A/c Dr.		200	
	To Profit & Loss A/c			200
	(transfer of balance to P & L A/c)			

Ledger Accounts :

Dr. **Sandeep A/c (Hire Purchaser's)** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Sales	20,000	1-4-2015	By Cash	80,000
31-3-2016	To Interest	600	31-3-2016	By Cash	4,600
			31-3-2016	By Balance c/d	8,000
		20,600			**20,600**

(Conted. on next page)

1-4-2016	To balance b/d	8,000	31-3-2017	By Cash	4,400
31-3-2017	To Interest	400	31-3-2017	By Balance c/d	4,000
		8,400			**8,400**
1-4-2017	To Balance	4,000	31-3-2018	By Cash	4,200
31-3-2018	To Interest	200			
		4,200			**4,200**

Dr. **Interest A/c** Cr.

Date	**Paticulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
3-1-2016	To Profit & Loss A/c	600	31-3-2016	By Sandeep	600
31-3-2017	To Profit & Loss A/c	400	31-3-2017	By Sandeep	400
31-3-2018	To Profit & Loss A/c	200	31-3-2018	By Sandeep	200

Illustration – 2 :

On 1st Apri 2015, Asian Ltd., purchased a machine on hire purchase system from Sunshine Ltd., The Cash price of the machine was Rs. 74,500/- and the payment was to be made as follows :

Rs. 20,000/- was to be made on signing to agreement and the balance in three annual instalments of Rs. 20,000/- each at the end of each year. 5% interest is charged by Sunshine Ltd., per annum. Asian Ltd., was decided to write off 10% depreciation per annum on reducing value of the machine. Prepare necessary ledger accounts in the books of Asian Ltd.,

Solution :

Calculation of Interest Chart

Date	Advance Instalment	Interest @ 5% on outstanding Cash price	Cash price included in Instalment	Cash price unpaid	Depreciation @ on WDV
1-4-2015	—	—	—	74,500	74,500
1-4-2015	20,000	—	20,000	54,500	—
31-3-2016	20,000	5% on 54,500 = 2725	17,275	37,225	74,500 – 7,450 = 67,050
31-3-2017	20,000	5% on 37,225 = 1,861	18,139	19,086	67,050 – 6,705 = 60,345
31-3-2017	20,000	Bal figure = 914	19,086	—	60,345 – 6,035 = 54,310

Note :

In the above problem cash price of the machine is given Rs. 74,500/- and hire purchase price is also given Rs. 80,000/- (i.e. 20,000/- Adv. + instalments of Rs. 20,000 each). Therefore the difference of Rs. 5,500/- (80,000 – 74,500) is interest payable.

Ledger Accounts in the books of Asian Ltd.,

Dr. **Interest A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
31-3-2016	To Sunshine Ltd.	2,725	31-3-2016	By Profit & Loss A/c	2,725
31-3-2017	To Sunshine Ltd.	1,861	31-3-2017	By Profit & Loss A/c	1,861
31-3-2018	To Sunshine Ltd.,	914	31-3-2018	By Profit & Loss A/c	914

Dr. **Machine Account** Cr.

Date	**Paticulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
1-4-2015	To Sunshine Ltd.,	20,000	1-4-2015	By Depreciation	7,450
31-3-2016	To Sunshine Ltd.,	17,275	31-3-2016	By balance C/d	29,825
		37,275			**37,275**
1-4-2016	To balance b/d	29,825	31-3-2017	By Depreciation	6,705
31-3-2017	To Sunshine Ltd.	18,139	31-3-2017	By Balance A/c	41,259
		47,964			**47,964**
1-4-2017	To balance Ltd.	41,259	31-3-2018	By Depreciation	6,035
31-3-2018	To Sunshine	19,086	31-3-2018	By Balance c/d	54,310
		60,345			**60,345**

Dr. **Sunshine Ltd., (Vendor) A/c** Cr.

Date	**Paticulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
1-4-2015	To cash	20,000	1-4-2015	By Machine	20,000
31-3-2016	To Cash	20,000	31-3-2016	By Machine	17,275
			31-3-2016	By Interest	2,725
		40,000			**40,000**
31-3-2017	To Cash	20,000	31-3-2017	By Machine	18,139
			31-3-2017	By Interest	1,861
		20,000			**20,000**
31-3-2018	To Cash	20,000	31-3-2018	By Machine	19,086
			1-3-2018	By Interest	914
		20,000			**20,000**

II) When Hire purchase price and rate of interest are given but cash price is not given :

In this method though the rate of interest is given the total interest payable can not be calculated, as the cash price of asset is not given. Therefore at the start cash price of the asset should be ascertained. To do this calculation the analysis of instalment will start from the last instalment. Hence this method is called 'Reverse Method'

Illustration – 3 :

Aniket purchased a motor car on hire purchase system from Sahyadri Motors on 1-4-2014 on paying Rs. 12,000 down. The balance amount (including 10% p.a.) was paid at the end of each year as under. 31-3-2015 Rs. 25,600/- 31-3-2016 Rs. 19,600/- 31-3-2017 Rs. 14,000/-, 31-3-2018 Rs. 8,800/-.

Depreciation was charged by Aniket @ 10% under fixed instalment syste system. Show calculation of interest in each instalment and ledger accounts in the books of Aniket and Sahyadri Motors.

End of the year	Amount Due	Interest = 10 $\frac{10}{110}$ = 1/11	Cash at the beginning (100)	Beginning of the year
31-3-2018	8800	8800 x 1/11 = 800	8,000	1-4-2007
31-3-2017	8000 + 14000	22000 x 1/11 = 22000	20,000 = 2,000	1-4-2006
31-3-2016	20,000 + 19,600	39,600 x 1/11 = 39,600	36000 = 36,600	1-4-2005
31-3-2015	36,000 + 25,600	61,600 x 1/11 = 61,600	56,000 = 5,600	1-4-2004
1-4-2014	56,000 + 12,000 = 68,000	68,000 x Nil = --	68,000	1-4-2004
		12,000	68,000	

Thus the cash price of motor at the beginning is Rs. 67,000/- and total interest payable is Rs. 12,000/- Advance payment is made on the day of signing the agreement, hence it does not includes interest.

Dr. **Motor Car A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2014	To Sahyadri Motor	68,000	31-3-2015	By Depreciation	6,800
			31-3-2015	By balance c/d	61,200
		68,000			**69,000**
1-4-2015	To balance b/d	61,200	31-3-2016	By Depreciation	6,500
			31-3-2016	By balance c.d	54,400
		61,200			**61,200**
1-4-2016	To balance b/d	54,400	31-3-2017	By Depreciation	6,800
			31-3-2017	By Balance c/d	47,600
		54,400			**54,400**
1-4-2017	To balance b/d	47,600	31-3-2018	By Depreciation	6,800
			31-3-2018	By Balance c/d	40,800
		47,600			**47,600**

Dr. **Sahyadri Motors A/c.** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2014	To Cash	12,000	1-4-2014	By Motor Car	68,000
31-3-2015	To Cash	25,600	31-3-2015	By Interest	5,600
31-3-2015	To Balance c/d	36,000			
		73,600			**73,600**
31-3-2016	To Cash	19,600	1-4-2015	By Balance B/d	36,000
31-3-2016	To Balance c/d	20,000	31-3-2016	By Interest	3,600
		39,600			**39,600**

31-3-2016	To Cash	14,000	1-4-2016	By balance b/d	20,000
31-3-2017	To balance c/d	8,000	31-3-2017	By Interest	2,000
		22,000			**22,000**
31-3-2018	To Cash	8,800	1-4-2017	By Balance	8,000
			31-3-2018	By Interest	800
		8,800			**8,800**

In the Books of Sahyadri Motors

Dr. **Sunshine Ltd., (Vendor) A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2014	To Sales	68,000	1-4-2004	By Cash	12,000
31-3-2015	To Interest	5,600	31-3-2005	By Cash	25,600
			31-3-2005	By Balance c/d	36,000
		73,600			**73,600**
1-4-2015	To Balance b/d	36,000	31-3-2016	By Cash	19,600
31-3-2016	To Interest	3,600	31-3-2016	By Balance c/d	20,000
		39,600			**39,600**
1-4-2016	To Balance b/d	20,000	31-3-2017	By Cash	14,000
31-3-2017	To Interest	2,000	31-3-2017	By Balance b/d	8,000
		22,000			**22,000**
1-4-2017	To Balance b/d	8,000	31-3-2018	By Cash	8,800
31-3-2018	To Interest	800			
		8,800			**8,800**

Dr. **Interest A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
31-3-2015	To Profit & Loss A/c	5,600	31-3-2015		5,600
31-3-2016	To Profit & Loss A/c	3,600	31-3-2016		3,600
31-3-2017	To Profit & Loss A/c	2,000	31-3-2017		2,000
31-3-2018	To Profit & Loss A/c	800	31-3-2018		800

Illustration - 4

On 1st April, 2015 the Unique transports Ltd., purchased a Mini Truck from Hindusthan Motors Ltd., on hire purchase basis. The payment was made as under -

Rs. 50,000 on signinging the agreemal　　Rs. 65,000 on 31-3-2016

Rs. 60,000 on 31-3-2017　　Rs. 55,000 on 31-3-2018

Interest includes in cash price @10% p.a. Unique depreciates the truck at 20% on WDV. Given hedger Accounts in the books of Unique Ltd.,

Solution :

The hire purchase price is given Rs. 2,30,000 and rate of interest is 10% but cash price is not given. Suppose cash price is Rs. 100 the interest is 10, then the total amount due is Rs. 110 (100 + 10).

Therefore when the total amount due is Rs. 110, the interest is Rs. 1-. So, when the total amount due is Re. 1 interest is 10/110 = 1/11

End of the year	Amount Due	Interest = 10 $\frac{10}{110}$ = 1/11	Cash price at the beginning	Beginning of the year
31-3-2018	55000	55,000 x 1/11 = 5,000	50,000	1-4-2017
31-3-2017	50,000 + 60,000 = 1,10,000	1,10,000 x 1/11 10,000	1,00,000	1-4-2017
31-3-2016	1,00,000+1,65,000 = 1,65,000	1,65,000 x 1/11 = 15,000	1,50,000	1-4-2016
1-4-20015	1,50,000 + 50,000 = 2,00,000	2,00,000 x -- = 30,000	2,00,000 2,00,000	1-4-2015
		30,000	2,00,000	

Thus the total purchase price is Rs. 2,30,000 the total interest included in instalment is Rs. 2,00,000 and cash price is Rs. 2,00,000/-

In the books of Unique Transports Ltd.,

Dr. **Mini Truck A/c (Part Cash Method)** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Hindustan Motors	50,000	31-3-2016	By Depreciation	40,000
31-3-2016	To Hindustan Motors	50,000	31-3-2016	By Balance c/d	60,000
		1,00,000			**1,00,000**
1-4-2016	To Balance b/d	60,000	31-3-2017	By Depreciation	32,000
31-3-2017	To Hindustan Motors	50,000	31-3-2017	By Balance c/d	78,000
		1,10,000			**1,10,000**
1-4-2017	To Balance b/d	78,000	31-3-2018	By Depreciation	25,600
31-3-2018	To Hindustan Motors	50,000	31-3-2018	By Balance c/d	1,02,400
		1,28,000			**1,28,000**
1-4-2018	To Balance b/d	1,02,400			

Dr. **Hindustan Motors A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Cash	50,000	1-4-2015	By Mini Truck	50,000
31-3-2016	To Cash	65,000	31-3-2016	By Mini Truck	50,000
			31-3-2016	By Interest	15,000
		1,15,000			**1,15,000**
31-3-2017	To Cash	60,000	31-3-2017	By Mini Truck	50,000
			31-3-2017	By Interest	10,000
		60,000			**60,000**
31-3-2018	To Cash	55,000	31-3-2018	By Mini Truck	50,000
			31-3-2018	By Interest	5,000
		55,000			**55,000**

III) Ratio Method :

Sometimes Cash price of the asset and hire purchase price of the asset are given but rate of interest is not mentioned. In such cases the total interest (H. P. Price – Cash price) is apportioned in the ratio of outstanding balances of H.P. price at the beginning of each period.

Illustration – 5 :

Mr. Ravishankar purchased a machine on hire purchase basis from the Telco Machines Ltd. On 1st April 2015. The cash price of the machine was Rs. 1,00,000/-. Mr. Ravishnakar paid Rs. 20,000/- on signing the agreement and took the delivery of the machine. The balance amount was paid in four equal Installments of Rs.24,000/- each at the end of the each year.

Depreciation is charged @10% p.a. on the WDV basis.

Prepare Machine A/c and Telco Machine A/c in the books of Revishankar.

Solution :

In this hire purchase price of the machine is given Rs. 16,000/- (20,000 + 16,000)

Instalment Analysis Table

Date	Advance Installment paid	Instalment outstanding	Ratio of Instalment	Interest included Instalment instalment	Cash price included in WDV basis	Depreciation at 10% on
1-4-2015	20,000	--	--	--	20,000	Cash price 100000
31-3-2016	24,000	96,000	4	16000 x 4/10 = 64,000	176600	100000-100000 = 90000
31-3-2017	24,000	72,000	2	16000 x 3/10 = 4800	19200	90000 – 9000 = 81000
31-3-2018	24,000	48,000	3	16000 x 2/10 = 3200	20800	81000 - 8100 = 72900
31-3-2019	24000	24000	1	16000 x 1/10 = 16000	22400	72900 - 7290 =65,610
			10	16000	100000	

In the books of Ravishankar (Part Cash Method)

Dr. **Machine A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Telco Machnes	20,000	31-3-2016	By Depreciation	10,000
31-3-2016	To Telco Machine	17,600	31-3-2016	By Balance c/d	27,600
		37,600			**37,600**
1-4-2016	To Balance b/d	27,600	31-3-2017	By Depreciation	9,000
31-3-2017	To Telco Machines	19,200	31-3-2017	By Balnace c/d	37,800
		46,800			**36,800**
1-4-2017	To Balance b/d	37,800	31-3-2018	By Depreciation	8,100
31-3-2018	To Telco Machine	22,400	31-3-2019	By Balance b/d	65,610
		72,900			**72,900**

Dr. **Telco Machine A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Bank	20,000	1-4-2015	By Machine	20,000
31-3-2016	To Bank	24,000	31-3-2016	By Machine	17,600
			31-3-2016	Interest	6,400
		44,000			**44,000**
31-3-2017	To Bank	24,000	31-3-2017	By Machine	19,200
			31-3-2017	By Interest	4,800
		24,000			**24,000**
31-3-2018	To Bank	24,000	31-3-2018	By Machine	20,800
			31-3-2018	By Interest	3,200
		24,000			**24,000**
31-3-2018	To Bank	24,000	31-3-2019	By Machine	22,400
			31-3-2019	By Interest	1,600
		24,000			**24,000**

2.2.6 Default and Repossession :

If a hire purchaser fails to pay an installment on the stipulated date, the hire purchaser is said to be at default. In such case, the hire vendor may reposes the goods. Repossession means taking back the possession of goods by the hire vendor. Subject to agreement, the repossession may be complete or partial.

2.2.6.1 Complete Repossession :

In case of complete or full repossession the hire vendor take back the possession of all the goods and forfeit the installments already paid by the hire purchaser.

Accounting treatment :

In the books of hire purchaser

i) All entries till the date of default are passed in the usual manner.

ii) On the date of default for transfer of Vendor A/c balance.

a. Hire Vendor A/c Dr. (with entire balance in
To Asset A/c (vendor A/c)

b. For transfer of balance on asset A/c to Profit & Loss A/c
Profit & Loss A/c Or (with entire balance requiring
To Asset A/c in Asset A/c

In the books of Hire Vendor

i) All entries the date of default are passed in the usual manner.

ii) On the date of default

a. For repossession of goods :
Goods repossessed A/c Dr. (with balance in hire
To Hire Purchaser's A/c Purchaser's A/c)

b. For amount spent for repairs of goods repossessed.
Goods repossessed A/c Dr. (with amount spent on repairs
To Cash / Bank

c. For sale of goods reposed
Cash / Bank A/c Dr. (With sale proceeds of
To goods repossessed A/c goods repossessed)

d) For transfer to profit on sale of goods repossessed

Goods repossessed A/c Dr.

To Profit and Loss A/c

(In case of loss on sale, reverse entry will be passed)

Illustration : 6

On 1-4-2015 Shahu Traders acquired two Motor Cycle each costing Rs. 37,300/- for M/s. Hind Motors Ltd. On hire purchase. Payment to be made Rs. 20,000 down and the balance in three equal instalments of Rs. 20,000 each at the end of each year. The interest is charged at 5% p.a. Depreciation to be provided is at 10% p.a. on reducing balance method.

M/s. Shahu Traders after having paid the advance and the first instalment at the end of first year failed to pay the second instalment because of financial difficulties. Hind Motors took the possession of both the Motor cycle and sold them for Rs. 46,500/- after spending Rs. 2800/- for repairs

Write up necessary ledger accounts in the books of both the parties.

Solution :

In the method cash price of the motor cycle is given Rs. 74,600/- (37300 x 2) Hire purchase price is given Rs. 80,000 (20000 adv + 20000 x 3) and the rate of interest is given at 5%. Therefore we have to calculate the interest included in each instalment by simple method.

Instalment Analysis Table

Date	Advocate Instalment	Interest included In instalment	Cash price included in Instalment	Unpaid Cash price	Depreciation of 10% on WDV
1-4-2015	--	--	--	74,600	74,600
1-4-2015	20000	--	20,000	54,600	--
31-3-2016	20,000	5% on 54,600 =2,730	17,270	38,330	74,600-7,460 =67,140
31-3-2017	20,000	5% on 37,330 =1,867	18133	19,197	67,140-6,714 =60,426
31-3-2018	20,000	Bal. figure = 803	19,197	--	60,426-6,043 =54,383
	80,000	5,400	74,600		

Dr. **Motor Cycle Account (Full Cash price Method)** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Hind Motors	74,600	31-3-2016	By Depreciation	7,460
			31-3-2016	By Balance c/d	67,140
		74,600			**74,600**
1-4-2016	To Balance b/d	67,140	31-3-2017	By Depreciation	6,714
			31-3-2017	By Hind Motors (traveller)	39,197
			31-3-2017	By P. & L. A/c	21,229
		67,140			**67,140**

Dr. **Hind Motors Ltd., A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Bank	20,000	1-4-2015	By Motor cycle	74,600
31-3-2016	To Bank	20,000	31-3-2016	By Interest	2,730
31-3-2016	To Balance c/d	37,330			
		77,330			**77,330**
31-3-2017	To Motor cycle	39,197	1-4-2016	By Balance b/d	37,330
			31-3-2017	By Interest	1,867
		39,197			**39,197**

In the Books of Hind Motors

Dr. **Hind Motors Ltd., A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Sales	74,600	1-4-2015	By Bank	20,000
31-3-2016	To Interest	2,730	31-3-2016	By Bank	20,000
			31-3-2016	By Balance c/d	37,330
		77,330			**77,330**

1-4-2016	To Balance b/d	37,330	31-3-2017	By Goods	
31-3-2017	To Interest	1867		Respossed	39,197
		39197			**39197**

Dr. **Goods Repossessed A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
31-3-2017	To Shahu Traders	39,197	31-3-2017	By Bank (Sales)	46,500
31-3-2017	To Bank (Repairs	2,800			
31-3-2017	To P & L A/c	4,503			
		46,500			**46,500**

Alternative Method :

In the books of Shahu Traders (Part Cash Method)

Dr. **Motor Cycle A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Hind Motors	20,000	31-3-2016	By Depreciation	7,460
31-3-2016	To Hind Motors	17,270	31-3-2016	By Balance c/d	29,810
		37,270			**37,270**
1-4-2016	To Balance b/d	29,810	31-3-2017	By Depreciation	6,714
31-3-2017	To Hind Motors	18,133	31-3-2017	By Hind Motors	20,000
			31-3-2017	P & L A/c	21,229
		47,943			**47,943**

Dr. **Hind Motors A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Bank	20,000	1-4-2015	By Motor Cycle	20,000
31-3-2016	To Bank	20,000	31-3-2016	By Motor Cycles	17,270
			31-3-2016	Interest	2,730
		40,000			**40,000**
31-3-2017	To Motor Cyccle	20,000	31-3-2017	By Motor Cycle	18,133
	A/c (Transfer)		31-3-2017	By Interest	1,867
		20,000			**20,000**

Illustration - 7 :

Mr. Kankadas purchased a machine on hire purchase system on 1-4-2016 from Mr. Narayandas for Rs. 11,175 and payment was to be made as Rs. 3,000 on signing the agreement and the balance in three annual instalments to Rs. 3,000/- each at the end of each year. Interest charged of 5% p.a. Kankadas depreciation the machine at 10% p.a. on reducing balance method.

Mr. Kankdas after having paid down payment and first instalment of the end of first year could not pay second instalment due to financial difficulties and Mr. Narayandas took possession of the machine.

Mr. Narayandas sold the machine for Rs. 7,500 after spending Rs. 800 for repairs of machine. Shown necessary ledger accounts assuming accounts are closed on 31st March every year.

Solution :

The cash price of the machine is given Rs. 11,175 and hire purchase pria is given Rs. 12,000. Hence told interest included in instalment is Rs. 825/-. The rate of interest is given 5%.

Interest Calculation Table

Date	Advocate Instalment	Interest included In instalment	Cash price included in Instalment	Unpaid Cash price	Depreciation of 10% on WDV
1-4-2016	--	--	--	11,175	11,175
31-3-2016	3,000	--	3,000	8,175	--
31-3-2017	3,000	8,775 x 5% = 409	22,591	5,584	11,175 - 1,118 = 10,057
31-3-2018	3,000	5,584 x 5% = 280	2,720	2,864	1,005 - 1,006 = 9,051
31-3-2019	3,000	Bal figure = = 136	2,864	--	9,051 - 905 = 8,146
	1,200	825	11,175		

In the books of Mr. Kankadas

(Full cash price method)

Dr. **Machine A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2016	To Narayandas	11,175	31-3-2017	By Depreciation	1,118
			31-3-2017	By Balance c/d	10,057
		11,175			**11,175**
1-4-2017	To Balance b/d	10,057	31-3-2018	By Depreciation	1,006
			31-3-2018	By Narayandas (Transfer)	5,864
			31-3-2018	By Profit & Loss A/c	3,187
		10,057			**10,057**

Dr. **Mr. Narayandas A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2016	To Bank	3,000	1-4-2016	By Machine	11,175
31-3-2017	To Bank	3,000	31-3-2017	By Interest	409
31-3-2017	To Balance c/d	5,584			
		11,584			**11,584**
31-3-2018	To Machine A/c	5,864	1-4-2017	By Balance b/d	5,584
	(Transfer)		31,3,2018	By Interest	280
		5,864			**5,864**

In the Books of Mr. Narayandas

Dr. **Kankadas A/c.** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2016	To Sales	11,175	1-4-2016	By Bank	3,000
31-3-2017	To Interest	409	31-3-2017	By Bank	3,000
			31-3-2017	By Balance c/d	5,584
		11,584			**11,584**
1-4-2017	To Balance b/d	5,584	31-3-2018	By Goods	5,864
31-3-2018	To Interest	280		Repossessed A/c	
		5,864			**5,864**

Dr. **Goods Repossessed A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
31-3-2018	To Kankdas	5,864	31-3-2018	By CAsh (Sales)	7,500
31-3-2018	To Cash (Repairs)	800			
31-3-2018	To Profit & Loss A/c	1,964			
		7,500			**7,500**

2.2.6 Partial Repossession :

In case of partial repossession the hire vendor takes back the possession of a part of the goods.

Accounting treatment :

In the books of Hire Purchaser

i) All entries till the date of for future are passed in usual manner.

ii) On a date of default following entries are passed.

a. For transfer of agreed value of goods repossessed.

Hire vendor's A/c	Dr.	(with agreed value of
To Asset A/c		goods repossessed)

b. For transfer on default

Profit & Loss A/c	Dr.	(with difference in book value
To asset A/c		and agreed value)

(In case of profit on default reverse entry will be passed)

In the books of Hire Vendor

i) All entries till the date of default are passed in usual manner.

ii) On the date of default following entries are passed.

a. On repossession of goods at agreed values.

Goods Repossessed A/c	Dr.	(with agreed value of goods
To Hire purchaser's A/c		repossessed)

b. For amount spent on repairs of goods repossessed.

Goods Repossessed A/c	Dr.
To cash	

c. For sale of goods repossessed

Cash / Bank A/c	Dr.
To Goods Repossessed A/c	

d. For transfer of Profit on sale of goods reposed

Goods repossessed A/c Dr.

To Profit & Loss A/c

(In case of loss on sale, reverse entry will be passed)

Illustration – 8 :

X Transport Ltd., purchased from Delhi Motors 3 Tempos costing Rs. 50,000/- each on hire purchase system on 1-4-2016. Payment was to be made Rs. 30,000 down and the remainder in 3 equal instalments payable on 31-3-2017, 31-3-2018 and 31-3-2019 together with interest at 9% p.a. X Transport Ltd. Writes of depreciation at the rate of 20% p.a. on the diminishing balance. X Ltd. Paid the instalments due all the end of first year i.e. 31-3-2017 but could not pay the next on 31-3-2018. Delhi Motors agreed to leave tempo with purchaser on 1-4-2018 adjusting the value of the other 2 Tempos against the amount due on 1-4-2018. The Tempos are valued on the basis of 30% depreciation annually on WDV.

Delhi Motors after spending Rs. 2,000 on repairs sold all the 2 Tempos for Rs. 60,000.

Show ledger accounts in the books of X Transport Ltd. & Delhi Motors.

Interest Analysis Table

Date	Advocate Instalment	Interest of 9% on unpaid cash price	Cash Price included in Instalment	Unpaid Cash price	Depreciation of 20% on WDV
1-4-2016	–	–	–	1,50,000	1,50,000
1-3-2016	30,000	–	30,000	1,50,000-30,000 = 1,20,000	–
31-3-2017	50,800	9% on 1,20,000 = 10,800	40,000	1,20,000-40,000 = 80,000	1,50,000-30,000 1,20,000
31-3-2018	47,200	9% on 80,000 =7,200	40,000	80,000-40,000 =40,000	1,20,000-24,000 96,000
31-3-2019	43,600	9% on 40,0000 = 3,600	40,000	30,000-40,000 = Nil	96,000-19,200 = 76,800
	1,71,600	21,600	1,50,000		

In the Books of X Transports Ltd.,

Dr. **Tempos Account** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Delhi Motors	1,50,000	31-3-2017	By Depreciation	30,000
			31-3-2017	By Balance c/d	1,20,000
		1,50,000			**1,50,000**
1-4-2017	To Balance b/d	1,20,000	31-3-2018	By Depreciation	24,000
				By Balance c/d	96,000
		1,20,000			**1,20,000**
1-4-2018	To Balance b/d	96,000	1-4-2018	ByDelhi Motors (Vaue of 2 tempos takon away WN-1)	49,000
			31-3-2019	By P & L. A/c (Loss on Default WN-3)	15,000
			31-3-2019	By Depreciation A/c	6,400
			31-3-2019	By Balance c/d (Tempo retailed W.N.-2)	25,600
		96,000			**96,000**

Dr. **Sunshine Ltd., (Vendor) A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2016	To Bank	30,000	1-4-2016	By Tempos	1,50,000
31-3-2017	To Bank	50,800	31-3-2017	By Interest	10,800
31-3-2017	To Balance c/d	80,000			
		1,60,800			**1,60,000**

(Conted. on next page)

31-3-2018	To Balance c/d	87,200	1-4-2017	By Balance b/d	80,000
			31-3-2018	By Interest	7,200
		87,200			**87,200**
1-4-2018	To Tempos	49,000	1-4-2018	By Balance	87,200
1-4-2018	To Balance c/d	38,200			
		87,200			**87,200**

In the books of Delhi Motors

Dr. **X Transports Ltd., A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2016	To Sales	1,50,000	1-4-2016	By Bank	30,000
31-3-2017	To Interest	10,800	31-3-2017	By Bank	50,800
			31-3-2017	By Balance c/d	80,000
		1,60,000			**1,60,000**
1-4-2017	To Balance b/d	80,000	31-3-2018	By Balance c/d	87,200
31-3-2018	To Interest	7,200			
		87,200			**87,200**
1-4-2018	To Balance b/d	87,200	1-4-2018	By Goods repossessed	49,000
			1-4-2018	By Balance c/d	38,200
		87,200			**87,200**

Dr. **Goods repossessed A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2018	To X Transports	49,000	1-4-2018	By Bank (Sale)	60,000
1-4-2018	To Bank (Reports)	2,000			
1-4-2018	To P & L A/c	9,000			
		60,000			**60,000**

Working Note :

1) Agreed Value of 2 Tempos repossessed

Cash price of Tempos	1,00,000
Less : Dep. At agreed 30% for 1st year	30,000
	70,000
Less : Dep. Of agreed 30% for 2nd year	21,000
Value of reposed temp	49,000

2) Value of One tempo with Hire purchaser

Cash price of one tempo	50,000
Less : Deperciation at 20% for 1st year	10,000
	40,000
Less : Depreciation at 20% for 2nd year	8,000
	32,000
Less : Depreciation at 20% for 3rd year	6,400
Value of one Tempo	25,600

3) Loss of Default

Cost of 2 tempos	1,00,000
Less : Depreciation at 20% for 1st year on WDV	20,000
	80,000
Less : Depreciation at 20% for 2nd year on WDV	16,000
Book value of 2 tempos on date of default	64,000
Less : Agreed value as per WN 1	49,000
Loss on default	15,000

Illustration : 9

Prashant purchased 4 motor cycles of Rs. 56,000 each on hire purchase system on 1-4-2015. The hire purchase price for all 4 motor cycle was Rs. 2,40,000 to be paid Rs. 60,000 down and three instalments of Rs. 60,000 each at the end of each year.

Interest is charged at 5% p.a. Buyer depreciation motor cycle at 10% p.a. on straight line method. After having paid down payment and 1st Instalmant, buyer could not pay 2nd instalment and seller took possession of 3 motor cycles at an agreed value to be calculated after depreciating cars of 20% p.a. on written down value method. One motor cycle was left with the buyer.

Seller after spending Rs. 4,500 on repairs, sold away all the three motor-cycle to Mahesh for Rs. 1,40,000.

Give ledger accounts in the books of both the parties.

Solution :

The cash price of 4 motor cycle is given Rs. 2,24,00 and hire purchase price is given Rs. 2,40,000. Therefore the interest included in instalment is Rs. 16,000. The interest included in 1st instalment Rs. 82,000 (5% on Rs. 1,64,000) 2nd instalment Rs. 5,619 (5% on Rs. 1,12,200), 3rd instalment Rs. 2,190 (balancing figure).

In the books of Prashant

Dr. **Motor Cycle A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Vendor's A/c	2,24,000	31-3-2016	By Depreciation	22,400
			31-3-2016	By Balance c/d	2,01,600
		2,24,000			**2,24,000**
1-4-2016	To Balance b/d/	2,01,600	31-3-2017	By Depreciation	22,400
			31-3-2017	By Vendor A/c (Value of 3 motor cycles taken over)	1,07,520
			31-3-2017	By Profit & Loss A/c (Loss on default)	26,880
			31-3-2017	By Balance c/d Valued one motor cycle)	44,800
		2,01,600			**2,01,600**

Dr. **Vendor's A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Bank	60,000	1-4-2015	By Motor Cycle	2,24,000
31-3-2016	To Bank	60,000	31-3-2016	By Interest	8,200
31-3-2016	To Balance	1,12,200			
		2,32,200			**2,32,200**
31-3-2017	To Motor cycle A/c	1,07,520	1-4-2016	By Balance b/d	1,12,200
31-3-2017	To Balance c/d	10,290	31-3-2017	By Interest	5,610
		1,17,810			**1,17,810**

In the books of Vendor

Dr. **Prashant A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To sales	2,24,000	1-4-2015	By Bank	60,000
31-3-2016	To Interest	8,200	31-3-2016	By Bank	60,000
			31-3-2016	By Balance c/d	1,12,200
		2,32,200			**2,32,200**
1-4-2016	To Balance b/d	1,12,200	31-3-2017	By Goods repossessed	1,07,520
31-3-2017	To Interest	5,610			
			31-3-2017	By Balance b/d	5,610
		1,17,810			**1,17,810**

Dr. **Goods repossessed A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2017	To Prashant A/c	1,07,520	31-3-2017	By Bank (Sale)	1,40,000
31-3-2017	To each (repairs)	4,800			
31-3-2017	To Profit & Loss A/c	27,680			
		1,40,000			**1,40,000**

Working Notes :

1) Agreed Value of 3 motor cycle taken over

Cost of 3 motorcycle	1,68,000
Less : Depreciation at 20% on WDV for 1st Year	33,600
	1,34,400
Less : Depreciation of 20% on WDV for 2nd year	26,880
Value date of default	1,07,520

2) Value of one motor cycle with the buyer

Cost of 1 motorcycle	56,000
Less : Depreciation at 10% on straight line	
Method for 1st year	5,600
	50,400
Less : Depreciation of 10% on straight line method	
For 2nd year value of 1 motor cycle	5,600
	44,800

3) Less on date of default

Cost of 3 motor cycle	1,68,000
Less : Depreciation at 10% on straights line	
For 1st year	16,800
	1,51,200
Loss : Depreciation 10% on straight line	
For 2nd year	16,800
	1,34,400
Less : Agreed value as per WN-1	1,07,520
Less : on default	26,880

2.3 Summary :

Hire purchase system is a midway between cash sale system and credit sale system. Cash sale system is the most common method of selling delivering goods only against the prompt payment. In credit sale system goods are sold and delivered immediately but the price is collected on some future date without interest.

In Hire purchase system goods are delivered immediately and price is collected in easy instalments with regular intervals. The instalments so collected are inclusive of interest and unpaid balance of the cash value of goods delivered. Though the goods are delivered immediately to the buyer, the ownership in goods does not pass to the buyer unless all the instalments are paid. Even if only last instalment is not paid, the buyer loses the possession of the goods because seller is thereof owner having right to take away the goods.

2.4 Check your progress

✢ **Objective Type**

State True or False.

A) From the accounting point of view, there is no difference between sale and Hire purchase sale.

ii) In hire purchase transaction the property in the goods passes to the hire purchaser at the payment of the cash down.

iii) The difference between the hire purchase price and cash price is known as interest.

iv) Interest is calculated on the hire purchase price of the given rate.

v) Depreciation an asset is calculated on the cash price of the asset.

vi) In the books of hire purchaser, the asset account is always debited of full cash price of the asset.

vii) The payment of cash down does not offect the amount to be debited to the asset account.

B) Choose correct alternative :

i) Cash paid down at the time of hire of hire purchase transaction is debited by the hire purchaser to –

a) Asset Account, b) Purchase Account,
c) Hire Vendor Account.

ii) The amount of interest is credited by the buyer to –

a) Interest Account, b) Vendor Account,
c) Asset Account.

iii) When to goods are re-possessed by the vendor, the balance in asset account is transferred to –

a) Hire Vendor Account, b) Goods repossessed Account,
c) Profit and Loss Account.

iv) The depreciation in the books of buyer is charged on

a) The hire purchase price, b) The cash price,
c) whichever is higher out of H.P. Price and Cash price.

v) In hire purchase ownership of goods is transferred only on –

a) Signing the agreement b) Payment of last instalment
c) Payment of first instalment.

2.5 Key Words :

i) Hire purchaser : A person obtains possession of the goods from an owner under hire purchase agreement.

ii) Hire Vendor : A person who delivers the possession of goods to the hire purchaser under hire purchase agreement.

iii) Cash Price : Means the at which the goods may be purchased by the hire purchaser for cash.

iv) Hire Purchase price : The total sum payable by the Hire Purchaser to the Hire vendor.

H.P. Price = Cash Price + Interest.

v) Down Payment / Advance : An initial payment payable by the hire purchaser on signing the agreement.

2.6 Answer to Check Your Progress

A) [**Ans. :** i) False, ii) False, iii) True, iv) True, v) True, vi) False, vii) True]

B) [**Ans.:** i) a, i) b, iii) b, iv) b, v) b]

2.7 Exercise

Therotical Questions :

a) Broad Questions

1. Distinguish between Hire purchase and Instalment System.
2. What is mean by Hire Purchases System? Explain its features.

b) Short Notes

1. Hire Purchases agreement
2. Hire Purchases system Sales, Normal Sales
3. Repossission of Goods

Practical Problems :

A) Simple Method (when instalment amount is not given)

1) M/s. Asian Ltd., purchased a machne for Rs. 2,40,000 agreeing to pay Rs. 40,000/ down and four annual instalments of Rs. 50,000 each with 5% interest payable of the end of each year.

M/s Asia Ltd. Depreciates the machine at 5% p.a. on the diminishing method. Show necessary ledger accounts in the books of purchaser and vendor A/c.

b) Simple Method (When cash price, Hire purchase price and instalments are given)

2) Sandwik Ltd., purchased a Motor Truck on Hire purchase system Rs. 90,000 was payable on delivery on 1-4-2010 and the balance by four annual instalments of Rs. 90,000 each on 31 st March. The vendor charged 5% interest on the unpaid balance. The cash price of the truck is Rs. 4,09,500. Depreciation of 10% of straight line was writing off each year.

c) Reverse Method : (When cash price is not given)

3) India Ltd. Purchased a motor car on hire purchase system from Sahyadri Motor on 1-4-2014 and agreed to pay interest 20% p.a. on the unpaid balance of Cash price. India Ltd. Decided to depreciate the car by 20% on reducing balance method. India Ltd. Paid Rs. 55,000 on signing the agreement and the balance in four annual instalments as follows :-

31-3-2015	Rs. 99,000	31-3-2016	Rs. 88,000
313-2017	Rs. 77,000	31-3-2018	Rs. 66,000

Show Motor Car A/c and Vendor A/c in the books of India Ltd.,

4) Small Industries Ltd. Purchased a machinery on hire purchase system on 1-4-2012 from HMT Ltd. With an agreement to pay in five instalments and agreed to pay interest at 10% on the unpaid balance of cash price.

Small Industries decided to depreciate the machinery by 10% on straight line method.

The Instalments paid were as follows.

31-3-2013	Rs. 22,500	31-3-2016	Rs. 18,000
31-3-2014	Rs. 21,000	31-3-2017	Rs. 16,500
31-3-2015	Rs. 19,500		

Prepare machinery A/c and vendor A/c in the books of small Industries.

D) Ratio Method : (When Rate of interest is not given)

5)
i)	Purchase		Mr. Bhima
ii)	Assets Purchased		Tractor
iii)	Cash price		Rs. 2,50,000
iv)	Seller		M/s. Balwant Agency
v)	Date of Transaction		1-4-2013
vi)	Payment on the date of signing		Rs. 50,000
vii)	Instalments		
	On 31-3-2014	Rs.	60,000
	On 31-3-2015	Rs.	60,000
	On 31-3-2016	Rs.	60,000
	On 31-3-2017	Rs.	60,000
viii)	Depreciation at 20% on diminishing balance method.		

You are required to prepare Tractor A/c and Vendor A/c in the books of Mr. Bhima.

6) Sagar Hotel Ltd. Purchased a refrigerator from M/s Poonawala under Hire Purchase system. The Hotel cash price of the Refirigerator is Rs. 34,000. Cash paid to

the hire vendor is as under.

Date	Rs.	
1-4-2014	10,000	(Against Delivery)
31-3-2015	10,000	
31-3-2016	10,000	
31-4-2017	10,000	

The Sagar Hotel Ltd. Charged depreciation @ 20% under Diminishing Balance Method.

You are required to give Hire Vendor's Account and Refrigerator A/c in the books of Hire Purchaser.

(Oct. 2008)

Default & Repossession :

A) Complete Repossession :

7) On 1st April, 2015 Power Fabrication works purchased a lathe machine on hire purchase. The cash price of the machine was Rs. 5,00,000 and the same was to be paid, commencing from 1-4-2015 in five six monthly instalments together with interest at 10% p.a. The books of accounts are closed on 31st March every year. The rate of depreciation is at 10% p.a. of WDV method.

All the instalments were duly paid upon 1-4-2016 but due to financial difficulty Hire Purchaser could not pay the instalment on 30-9-2016. The vendor repossessed the machine. Show ledger account in the books of Hire purchaser.

8) Bombay Transports Ltd., purchased from Kolkatta Motors. Three Mini Trucks costing Rs. 2,00,000 each on hire purchase system. Payment was to be made in three equal instalments together with interest at 5%. Bombay Transports write of depreciation @ 20% p.a. on the diminishing balance. If paid the instalment due at the end of the first year but could not pay the next instalment.

Hire vendor took the possession of all the three trucks and sold them for Rs. 3,50,000 after spending Rs. 20,000/- for its repairs.

Give necessary ledger accounts in the books of both the parties.

B) Partial Repossession.

9) M/s Radhika Trading Co. purchased two motor cycle from Bajaj Auto Ltd. Costing Rs. 40,000/- each on 1st April 2016 on hire purchase system. The terms of agreement were.

Cash down payment Rs. 10,000/- for each motor cycle, Remaindor in 3 equal instalments together with interest at 10% p.a. to be paid at the end of each year.

Radhika Trading co writes off 25% depreciation each year on diminishing balance method. Radhika Trading Co. paid the installments due on 31st March 2018 but could not pay the final instalment.

Bajaj Auto Ltd. Repossessed one motor cycle adusting its value against the amount due. The repossession was done on the basis of 30% depreciation on diminishing balance method. The vendor spent Rs. 4,280/- for the repairs of the motor cycle and sold it for Rs. 20,000/-

Hire purchaser close its books on 31st March every year.

Write up necessary ledger accounts in the books of both the parties.

10) Adinath Engineering works purchased 5 lathe machine from Ruchi Machines Ltd., on hie purchase system. The cash price of each machine was Rs.1,00,000/-. It was agreed that Rs. 1,25,000 should be paid immediately and the balance in three equal instalments of Rs. 1,50,000 each of the end of each year. The Ruchi machines charges interest at 10% p.a. The buyer depreciates machines at 20% p.a. on the diminishing balance method.

Adinath Engineering works paid cash down and two instalments but failed to pay the last instalment. Ruchi Machines repossessed three machnes, leaving two machines with the buyer and adjusting the value of 3 machines against the amount due. The Repossessed machines were valued on the basis of 30% depreciation p.a. on the written down value. The machines repossessed were sold by the vendor for Rs. 1,50,000 after necessary repairs amounting to Rs. 25,000/-

Show necessary accounts in the books of both the parties.

- **Further Readings :**

  1) Advance Accountancy : R. R. Gupata
  2) Steps in Advanced Accountancy – S. N. Maheshwari
  3) Advance Accountincy – V. A. Patil Dr.P. M. Herekar.

❑❑❑

Unit-3

Insurance Claim

Loss of Stock and Loss of Profit Policy

Structure of the Unit

3.0 Objectives

3.1 Introduction

3.2 Presentation of Subject Matter

Compatation of Insurance Claim and Loss of Stock Policy

3.2.1 When proper records are available and the information of stock lying with the business on the date of fire is known.

3.2.2 When Proper records are not available.

3.2.3 Problems on loss of stock policy

3.3 Computation of Insurance claims under Loss of Profit Policy

3.3.1 Important Terms

3.3.1.1 Indemnity Period

3.3.1.2 Short Sales

3.3.1.3 Standard Sales

3.3.1.4 Gross Profit

3.3.1.5 Standing Charges

3.3.1.6 Increased Cost of Working

3.3.1.7 Saving of Expenses

3.3.1.8 Average Clause

3.2.2 Procedure for Calculating the five clam under Loss of Procit

3.3.2.1 Ascertain the amoutn of short sales

3.3.2.2 Calculation of Gross Profit Rate

3.3.2.3 Ascertain the increased cost of Working and add it.

3.0 Objectives :

The study of this unit will help students to –

- identity the major risks to which a business is exposed.
- compute the amount of loss recoverable from the insurance company against a policy for loss of stock, or consequential loss.
- compute the amount of loss recoverable from the insurance company against a policy for loss of profit.
- make necessary accounting entries.
- explain the meaning of certain key terms.

3.1 Introduction :

A fire in a business place destroys a number of assets such as building, furniture, machinery, stock etc. A businessman needs insurance cover to insure against possible loss of assets in the event of occurrence of fire. In the interest of business unit, it is necessary to take fire insurance policy to indemnify itself against such losses resulting from the fire. A fire insurance claim is lodged with insurance company in regard to the following.

1. To cover the loss of stock destroyed by fire.

2. To cover loss of profit during the period of dislocation of normal business operations.

However, the businessman will have to exercise due care and caution in insuring adequately for the loss and stock and loss of profit. In the absence of insurance cover, normal business operations cannot be restored. Insurance cover would enable him to carry on business without any risk.

In the present unit we are mainly concerned with estimating the amount of claim under loss of stock and loss of profit as a result of fire.

3.2 Presentation of Subject Matter

Computation of Insurance claim under Loss of Stock Policy :

A fire insurance policy can be taken for indemnification against loss of fixed assts and loss of stock on account of fire claims in relation with fixed assets are based on the value of these fixed assets if the same are insured against fire or any other hazards. But difficulty arises particularly in case of stock for which no account appears in the books. If proper stock book is maintained for the purpose, claims can be ascertained easily for loss of stock. On the other hand if the stock book is not maintained, the value of stock destroyed by fire will be estimated on the basis of quantity and price of the same as shown by different documents, papers and certain other information. These are two situations in which claims can be ascertained.

3.2.1 When proper records are available and the information of stock lying with the business on the date of fire is known :

Under this situation following would be the steps for lodging claim with insurance company.

i) Ascertain the value of stock lying with business unit on the date of fire.

ii) Ascertain the value of stock salvaged from fire.

iii) Find out stock destroyed by fire by deducting the stock salvaged from the stock value on the date of fire.

iv) The amount of claim would be equal to the stock destroyed by fire. (Provided there is no application of average clause).

3.2.2 When proper records are not available :

The following steps involved for lodging claim with insurance company.

Step – 1 :

Calculate the rate of gross profit on the basis of last accounting year, or on the basis of last few years after adjusting abnormal items if any. This is done by preparing trading account of previous year, which gives the figure of gross profit. The proforma of Trading A/c. is as under:

Dr. **Trading Account for the year ended ....** Cr.

Particular	Rs.	Rs.	Particular	Rs.	Rs.
To Opening stock		xxx	By Sales	xxx	
To Purchases ...	xxx		- Return Inward	xxx	
- Return outward	xxx				xxx
		xxx	By Closing stock		xxx
To wages		xxx			
To Carriage inward		xxx			
To Freight		xxx			
To Gross Profit c/d (Balancing figure)		xxx			
		xxx			xxx

Step - 2

Calculate the gross profit rate from the above.

$$\text{Gross profit rate} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100.$$

Step – 3

Prepare Memorandum Trading Account for the period from the opening date of the year to the date of fire.

In the memorandum Trading A/c. all the figures of opening stock, purchases, wages and sales during the above period are available and given in the problem. The figure of gross profit is ascertained by applying the gross profit percentage of last year as calculated in step no.2 to the sales for the current period. Having obtained the figure of gross profit, the memorandum Trading A/c. is balanced and balancing figure would represent the figure of stock lying with the business unit on the date of fire. The proforma of Memorandum Trading Account is as under :

Memorandum Trading Account.

(for the period from the first day of the year of accounting to the date of fire)

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening stock		xxx	By Sales	xxx	
To Purchases	xxx		+ Unrecorded sales	xxx	
+ Unrecorded purchases	xxx			xxx	
	xxx		- Return Inwards	xxx	
- Return outward	xxx	xxx	By closing stock		xxx
To wages		xxx	(i.e. stock destroyed		
To Carriage & freight		xxx	by fire)		
To Gross profit		xxx	(Balancing figure)		xxx
(…% on…sales)					
		xxx			xxx

Step – 4 : Prepare a statement of fire claim lodged with insurance company.

Company – For calculating the amount of claim for loss of stock, salvaged stock, if any should be deducted from the value of stock destroyed by fire.

Amount of claim for loss of stock	Rs.
Value of closing stock on the date of fire…… (as per memorandum Trading Account)	xxx
Less – value of stock salvaged	xxx
Amount of claim :	xxx

Step – 5 : Application of Average Clause :

Average clause applies if actual loss exceeds the amount of the insured value; the amount of claim is to be limited after applying the average clause. Average clause means the claim for the loss of stock is proportionately reduced having regard to the under-insurance of stock. Under-insurance means the business unit has not been adequately covered the stock values for the purpose of insurance, i.e. the policy amount taken by the business unit is less as compared to the normal stock holding. Therefore, the amount of claim is proportionately reduced by keeping in view the extent of under insurance. The following equation is used for calculating the claim by applying Average clause.

$$\text{Claim} = \frac{\text{Amount of Policy}}{\text{Value of stock on the date of fire}} \times \text{Loss of stock destroyed by fire.}$$

Notes :

1) It must be remembered that the amount of actual loss is less than the insured value of actual goods (i.e. policy amount), then the amount of claim would be equal to the stock, destroyed by fire.

2) If the gross profit rate remains constant from year to year provided it is not disturbed by abnormal happenings. Normally there is reasonably consistency in the gross profit rate, the gross profit percentage is taken as the basis for further calculation. If it is fluctuating, it is better to make an estimated rate of gross profit based on the available information.

3) Existence of Abnormal items of purchase and sales disturb the gross profit rate. Abnormal item means items, which do not carry normal price tag due to reasons that they are defective or poor quality or slow moving items etc. Such items therefore, required to be separated from other normal items so as to reflect the correct gross profit percentage. While preparing Trading A/c., the existence if such abnormal items are separated with two purposes. One to ascertain the profit or loss on such items and stock such items on the date of fire. Second is to render the normal gross profit rate undisturbed or undiluted.

3.2.3 Problems on Loss of Stock Policy :

Illustration – 1 : A fire occurred in the business premises of Calcutta Traders on 15 May 2015 destroying a great part of his stock. On 1st January 2014 it appeared in the books as Rs.30,000/-. The value of stock salvaged was Rs.18,000/- the Gross Profit on the sales was 30% and sales amounted to Rs.1,50,000/- from January 2014 to the date of fire, while for the same period the purchases amounted to Rs.1,47,000/-.

Prepare statement of claim for submission to Insurance Co.

Solution : Given rate of Gross profit – 30%.

I. Preparation of Memorandum Trading A/c. to find out closing stock on the date of fire.

Memorandum Trading A/c.

(for the period from 1st Jan 2015 to 15th May, 2015)

To Opening stock	30,000	By Sales	1,50,000
To Purchases	1,47,000	By Closing stock	
To Gross Profit c/d.	45,000	(on 15th May, 2015)	72,000
(30% on sales Rs.150000)		(Balancing figure)	
	2,22,000		2,22,000

II. Preparation of statement of fire insurance claim.

Statement of fire claim.	**Rs.**
Value of closing stock at the date of fire.............. (as per memorandum trading A/c.)	72,000
Less : Stock of goods salvaged	18,000
Value of goods destroyed by fire, i.e. fire claim	54,000

Illustration – 2 : A merchant's godown caught by fire on Nov. 3, 2012 at night causing serious damage to stock. The following information is obtained from the books and record salvaged :

	Rs.
Stock at cost on 31.12.2010	45,000
Stock at cost on 31.12.2011	50,000

Purchases during the year 2011 ……………….. 4,75,000

Sales during the year 2011 ……………………. 5,87,500

Purchases from 15th Jan. to Nov. 3, 2012 …….. 4,40,000

Sales from 1st Jan. to Nov. 3, 2012 ………….. 4,00,000

In June 2012, shop soiled goods of the cost price of Rs.2,000 were thrown away as valueless.

Assuming that the rate of Gross Profit has been the same in 2012 as in 2011, estimate the value of the stock in the godown at the time of fire and a statement of claim for submission to the Insurance Company.

Solution :

I. Preparation of Trading Account for the year ending 31st Dec. 2011 to find out Gross Profit and Rate of Gross Profit Rate.

Trading Account for the year ended 31.12.2011

To Opening stock	45,000	By Sales	5,87,500
To Purchases	4,75,000	By Closing stock	50,000
To Gross Profit c/d			
(Balancing figure)	1,17,500		
	6,37,500		6,37,500

II. Calculation of Rate of Gross Profit for 2011.

$$\text{Rate of Gross Profit} = \frac{\text{Gross profit}}{\text{Sales}} \times 100$$

$$= \frac{1,17,500}{5,87,500} \times \frac{100}{1}$$

$$= 20\%$$

III. Preparation of Memorandum Trading Account for the period January 2012 to Nov. 3, 2012.

Memorandum Trading Account

(for the period 1st Jan. 2012 to Nov. 3, 2012.)

To Opening stock	50,000	By Sales	4,00,000
To Purchases	4,40,000	By Closing stock	
To Gross Profit	80,000	burnt by fire	1,70,000
(20% on sales)		(Balancing figure)	
	5,70,000		**5,70,000**

IV. Calculation of Amount of Claim to be submitted.

Value of closing stock at the date of fire	1,70,000
Less- shop-solid goods thrown away	2,000
Amount of claim	1,68,000

Illustration – 3 : Fire occurred in the premises of Alpha & Beta Co. on 1st Sept. 2012 and stock of the value of Rs.1,01,000 was salvaged and business books and records were saved.

The following information was obtained.

Purchases for the year ended 3.3.2012	7,00,000
Sales for the year ended 3.3.2012	11,00,000
Purchases from 1.4.2012 to 1.09.2012	2,40,000
Sales from 1.4.2012 to 1.09.2012	3,60,000
Stock on 3.3.2011	3,00,000
Stock on 3.3.2012	3,40,000

It is also given that the stock on 31.3.2012 was overvalued by Rs.20,000.

Calculate the amount of the claim to be processed to the Insurance Company irrespective of losses. Rate of Gross profit is to be based on the year ended 31.3.2012.

Solution :

I. Calculation of Gross Profit for the year ended 31.3.2011.

Trading Account for the year ended 31.3.2011.

To Opening stock	3,00,000	By sales		11,00,000
To Purchases	7,00,000	By Closing stock	3,40,000	
To Gross Profit c/d	4,20,000	- Over valuation		
(Bal. Fig.)		of stock.	20,000	3,20,000
	14,20,000			14,20,000

II. Calculation of Rate of Gross Profit for the year 2012.

$$\text{Rate of Gross Profit} = \frac{\text{G.P.}}{\text{Sales}} \times 100$$

$$= \frac{4,20,000}{11,00,000} \times \frac{100}{1}$$

$$= 38.18\%$$

III. Preparation of Memorandum Trading A/c. to find out loss of stock on the date of fire.

Memorandum Trading Account
(for the period from 1.4.2012 to 1.9.2012)

To Opening stock	3,20,000	By	3,60,000
To Purchases	2,40,000	By Closing stock	
To Gross Profit c/d.		lost in fire	3,37,448
(38.18% of Sales Rs.3,60,000)	1,37,448		
	6,97,448		**6,97,448**

IV. Calculation of statement of claim.

Value of stock on the date of fire (i.e. 1.09.2012)	3,37,448
Less – Value of stock salvaged	1,01,000
Claim for Loss of Stock	2,36,448

Illustration – 4 : A fire occurred on 15th April 2020 and destroyed the business premises of Delhi Electronics Ltd. The books of accounts and stock amounting to Rs.18,000 were saved and the following information was available from the books.

Year	Sales Rs.	Gross Profit Rs.
Year ending Dec. 31, 2015	8,60,000	2,15,000
Year ending Dec. 31, 2016	7,10,000	2,13,000
Year ending Dec. 31, 2017	6,00,000	2,00,000
Year ending Dec. 31, 2018	5,50,000	1,87,000
Year ending Dec. 31, 2019	4,80,000	1,60,000

The stock on Dec. 31, 2019 was valued at Rs.97,000. The purchases, sales and production wages from Jan. 1, 2020 to 14th April 2020 were ascertained at Rs.75,000, 1,59,000/- and Rs.30,000 respectively.

You are to prepare a statement in support of claim against the Insurance Company.

Solution :

I. Calculation of rate of gross profit of past years.

$$\text{Rate of Gross Profit} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100.$$

Years	**Calculation**	**Rate of Gross Profit**
2015	215000 / 860000 x 100	25%
2016	213000 / 710000 x 100	30%
2017	200000 / 600000 x 100	33.33%
2018	187000 / 550000 x 100	34%
2019	160000 / 480000 x 100	33.33%

Note : The rte of gross profit has been constant over last 3 years hence we expect the rate of gross profit 33.33% during 2020.

II. Preparation of Memorandum Trading Account.

Memorandum Trading Account.

(for the period from 1 Jan. 2020 to 15th April 2020)

	Rs.		Rs.
To opening stock	97,000	By Sales	1,59,000
To purchases	75,000	By Closing stock	96,000
To production wages	30,000	(on 15.4.2020)	
To gross profit (33.33% on sales Rs.1,59,000)	53,000		
	2,55,000		2,55,000

III. Calculation of statement of fix claim.

Value of stock on the date of fire (i.e. 15.4.2020)	96,000
Less : Value of stock salvaged ………………..	18,000
Amount of claim ………..Rs.	78,000

Illustration – 5 : A fire broke out in the warehouse of Mercantile Traders Ltd. on 30th Sept. 2018. The company desires to file a claim with insurance company for loss of stock and give you the following information to enable you to prepare a statement showing the amount to be claimed.

		Rs.
1.	The lost accounts of the Company were prepared on 31st Dec. 2017	--
2.	Sundry Debtors on 31.12.2017	40,000
3.	Sundry Creditors on 30.09.2018	30,000

4. Cash received from Debtors 1,44,000

5. Stock on 31.12.2017 15,000

6. Purchases from 1-1-2018 to 30-9-2018 1,25,000

7. Rate of Gross Profit 25%

Solution :

In this problem figure of sales is missing. To find this missing item the total debtors A/c. is prepared.

I. Preparation of Memorandum Trading Account.

Memorandum Trading Account

(for the period from 1.1.2018 to 30.9.2018)

	Rs.		**Rs.**
To Opening stock	15,000	By Sales	1,34,000
To Purchases	1,25,000	By Closing stock	39,500
To Gross Profit	33,500	(on 30.9.2018)	
(25% on sales- 134,000)			
	1,73,500		**1,73,500**

II. Preparation of statement of fire claim. Rs.

	Rs.
Value of stock on the date of fire (i.e.30.9.2018)	39,500
Less : Value of stock salvaged ………………………	Nil
Amount of claim Rs. …………	39,500

Working Note : 1) Rate of Gross Profit of last year is given.

2) To find out credit sales, a total debtors A/c. is prepared.

Total Debtors Account.

To Opening balance	40,000	By Cash	1,44,000
To Sales (Bal. Figure)	1,34,000	(Cash collected from Drs)	
		By Closing Balance c/d.	30,000
	1,74,000		1,74,000

Illustration – 6 : A fire occurred in the business of Patil Traders on 20.10.2019. From the following particular ascertain the loss of stock and prepare a claim for Insurance applying average clause.

Stock on 1.1.2017	30,600
Purchases from 1.1.2018 to 31.12.2018	1,22,000
Sales from 1.1.2018 to 31.12.2018	1,80,000
Stock on 31.12.2018	27,000
Purchases from 1.1.2019 to 19.10.2019	1,47,000
Sales from 1.1.2019 to 19.10.2019	1,50,000

The stock were always valued at 90% of cost. The stock saved was worth Rs.18,000. The amount of policy was Rs.63,000.

Solution :

I. Preparation of Trading A/c. to find out Gross Profit.

Trading Account.

(for the year ended 31.12.2018.)

	Rs.		**Rs.**
To Opening stock $\left[\frac{30600}{90} \times 100\right]$	34,000	By Sales	1,80,000
To Purchases	1,22,000	By Closing stock $\left[\frac{27000}{90} \times 100\right]$	30,000
To Gross Profit c/d. (Balancing figure)	54,000		
	2,10,000		**2,10,000**

II. Calculation of Rate of Gross Profit.

$$\text{Rate of Gross Profit} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

$$= \frac{54,000}{180000} \times 100$$

$$= 30\%$$

III. Preparation of Memorandum Trading A/c. to find out closing stock on the date of fire.

Memorandum Trading Account

(for the period from 1.1.2019 to 19.10.2019)

To Opening stock	30,000	By Sales	1,50,000
To Purchases	1,47,000	By Closing stock	72,000
To Gross profit c/d	45,000	(i.e. on the date of fire)	
(30% of sales Rs.150000)			
	2,22,000		2,22,000

IV. Statement of fire claim.

Value of stock on the date of fire	72,000
Less : Value of stock salvaged	18,000
Value of stock destroyed by fire	54,000

V. Calculation of claim by applying Average Clause.

Application of Average Clause.

$$\text{Claim} = \frac{\text{Insurance Policy}}{\text{Stock on the date of fire}} \times \text{Actual loss by fire.}$$

$$= \frac{63,000}{72,000} \times 54,000$$

$$= 47,250$$

Note : If policy amount is given the average clause is applied for calculation of fire claim.

Illustration – 7 : Find out the amount of claim to be lodged with Insurance Company from the following information.

Particulars	2015 Rs.	2016 Rs.	2017 Rs.	2018 Rs. (up to date of fire i.e.20.6.2018)
Opening stock	30000	—	—	—
Purchases	150000	150000	180000	120000
Sales	120000	160000	260000	168000
Wages	6000	10000	12000	8000
Closing stock	40000	80000	100000	—

During the year 2017, the closing stock included goods purchased but not recorded Rs.10000. The salvaged stock was valued at Rs.18000. The amount of Policy was Rs.68000. There was an average clause in the policy. The firm closes its books on 31st Dec. every year.

Solution :

I. Preparation of Trading Account for 3 years to ascertain Gross profit for last three years.

Trading Account

(for the year ended 31st Dec. 2015, 2016, & 2017)

	2015 Rs.	**2016 Rs.**	**2017 Rs.**		**2015 Rs.**	**2016 Rs.**	**2017 Rs.**
To Opening stock	30000	40000	80000	By Sales	120000	160000	260000
To Purchases Add Unrecorded Purchases	100000	150000	190000	By closing Stock	40000	80000	100000
To Wages	6000	10000	12000				
To Gross Profit c/d (Bal.figure)	24000	40000	78000				
	160000	**240000**	**360000**		**160000**	**240000**	**360000**

Note : In the year 2017 there was unrecorded purchases amounted to Rs.10000, therefore the total purchases for 2017 were (180000 + 10000) Rs. 190000.

II. Calculation of Gross Profit Rate.

$$\text{Gross Profit Rate} = \frac{\text{Gross Profit}}{\text{Sales.}}$$

1. 2015 ………….. $\dfrac{24000}{120000} \times 100 = 20\%$

2. 2016 ………… $\dfrac{40000}{160000} \times 100 = 25\%$

3. 2017 ………… $\dfrac{78000}{260000} \times 100 = 30\%$

Hence, average percentage of Gross profit to sale will be :

$$= \frac{20 + 25 + 30}{3} = \frac{75}{3} = 25\%$$

III. Preparation of Memorandum Trading Account for ascertainment of value of closing stock on the date of fire.

Memorandum Trading Account

(for the period 1.1.2018 to 20.6.2018)

	Rs.		**Rs.**
To Opening stock	1,00,000	By Sales	1,68,000
To Purchases	1,20,000	By Closing stock	1,02,000
To Wages	8,000	(Balancing figure	
To Gross Profit c/d.	42,000	i.e. stock on the date of fire)	
	2,70,000		2,70,000

IV. Calculation of Loss of stock destroyed by fire.

Value of stock on the date of fire …………..	1,02,000
Less : Value of stock salvaged …………….	18,000
Loss of stock by fire …	84,000

V. Calculation of fire claim by applying Average Clause.

Claim by application of the Average Clause.

$$\text{Amount of Claim} = \frac{\text{Insurance Policy}}{\text{Value of stock on the date of fire}} \times \text{Loss of stock destroyed by fire.}$$

$$= \frac{68,000}{102000} \times 84,000$$

$$= 56,000/-$$

Illustration – 8

On 20^{th} Sept. 2018, the premises of Hindustan Lever Ltd. destroyed by fire and a stock of Rs.6000 was salvaged and retained by the insured. The business books and records were saved from which the following information is obtained.

	Rs.
Stock on 1.1.2017	50,000
Stock on 31.12.2017	70,000
Purchases for the year ended 31.12.2017	4,74,000
Sales for the year ended 31.12.2017	6,00,000
Purchases from 1.1.2018 to 20.9.2018	1,50,000
Sales from 1.1.2018 to 20.09.2018	2,05,000

In valuing the stock on 31.12.2017, Rs. 4,000 had been written off, certain stock having cost of Rs.9,000/-.

Half of these goods were sold in July 2018 for Rs.5,000. The balance is estimated to be worth the original cost. Subject to above exception the gross profit had remained at the uniform rate.

On 19th Sept. 2018, goods worth Rs.4,000 had been received by the godown keeper but had not been entered in the purchase A/c. Show the statement of claim for loss of stock.

Solution :

I. Preparation of Trading A/c. for 2017 to find out gross profit.

Trading Account for the year ended 31.12.2017.

	Rs.		Rs.
To Opening stock	50,000	By Sales	6,00,000
To Purchases	4,74,000	By Closing stock 70,000	
		Add:amount written off previously 4000	
To Gross Profit c/d. (Bal figure)	1,50,000		74,000
	6,74,000		6,74,000

II. Calculation of Gross profit rate for 2007.

$$\text{Gross profit rate} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

$$= \frac{1,50,000}{6,00,000} \times 100$$

$$= 25\%.$$

III. Preparation of memorandum Trading A/c. up-to-date of fire to find out stock burnt by fire.

Memorandum Trading Account.

(for the period from 1.1.2018 to 20.9.2018)

To Opening stock	74,000		By Sales		2,05,000
Less Abnormal item at original	9,000		Less- Sale proceeds abnormal items.	5,000	
		65,000			2,00,000
To Purchases		1,50,000	By closing stock		69,000
+ Unrecorded purchases at cost	4,000		(on the date of fire)		
		1,54,000			
To Gross profit c/d. (25% on sales i.e. Rs.400000)		50,000			
		2,69,000			2,69,000

IV. Ascertainment of stock destroyed by fire i.e. fire claim.

Statement of fire insurance claim.

	Rs.
Normal stock	69,000
Add : abnormal item at original Cost (1/2 of Rs.9000)	4,500
	73,500
Less : Value of stock salvaged	6,000
Value of stock destroyed by fire	67,500

Note : Fire Insurance claim will be equal to Rs.67,500 in the absence of any average clause.

Fix claim	Rs. 67,500

Illustration – 9

On 15th May 2020 the premises of Pune Ltd. were destroyed by fire but sufficient records were saved from which the following information was obtained.

	Rs.
Stock on 1.1.2019	76,800
Purchases during the year 2019	3,20,000
Sales during the year 2019	4,05,200
Stock on 31.12.2019	63,600
Purchases from 1.1.2020 to 15.5.2020	1,08,000
Sales from 1.1.2020 to 15.5.2020	1,22,800

An item of stock purchased in 2018 at cost Rs.20,000 was valued at Rs.12,000 on 31.12.2018. Half of this stock was sold in 2011 for Rs.5,200, the remaining was valued at Rs.4,800 on 31.12.2019. One fourth of the original stock was sold on 15.3.2020 for Rs.2,800 and remaining stock was considered to be worth 60% of the original cost. The salvaged stock was worth Rs.24,000. The amount of policy was Rs.60,000 and there was an average clause in the policy. Find the amount of claim.

Solution :

I. Preparation of Trading A/c. for the year 2019 to find out Gross profit.

Trading Account for the year ended 31.12.2019.

	Rs.	Rs.		Rs.	Rs.
To Opening stock	76800		By Sales	405200	
Less: Value of			Less: Sale of half		
abnormal Item	12,000	64,000	of abnormal item	5200	4,00,000
To Purchases		3,20,000	By Closing Stock	63,600	
To Gross Profit c/d		74,000	Less : Value of	48,000	
(Balancing figure)			remaining amnormal		
			item	4,800	58,800
		4,58,800			**4,58,800**

II. Calculation of Gross Profit Rate.

$$\text{Gross profit rate} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

$$= \frac{74,000}{4,00,000} \times 100$$

$$= 18.5\%$$

III. Preparation of Memorandum Trading Account to find out stock burnt on the date of fire.

Memorandum of Trading Account.

(for the period from 1.1.2020 to 15.5.2020, i.e. the date of fire)

	Rs.		**Rs.**
To Opening stock	58,800	By Sales	1,22,800
To Purchases	1,08,000	Less: Sale of abnormal	
To Gross Profit c/d.	22,200	item(remaininghalf)	2,800
(18.5% on sales			1,20,000
i.e.Rs.120000)		By Closing stock on the	
		date of fire. (balancing figure)	69,000
	1,89,000		**1,89,000**

IV. Ascertainment of Loss of stock by fire.

	Rs.
Normal stock on the date of fire	69,000
(as per memorandum Trading A/c.)	
Add : Abnormal items (60% of Rs.5000)	3,000
	72,000
Less : Stock salvaged	24,000
Value of stock destroyed by fire, i.e. loss	48,000

V. Application of Average clause to find out net fire claim.

$$\text{Claim} = \frac{\text{Insurance Policy}}{\text{Actual value of stock}} \times \text{Amount of loss.}$$

$$= \frac{60,000}{72,000} \times 48,000$$

$$= 40,000$$

Working Note on Abnormal items :

		Rs.
1.	Total Abnormal item of stock	20,000
2.	Half of the stock was sold in 2011	5,200
3.	Half of the remaining half (i.e.1/4 was sold in March 2012 Rs.5,000)	2,800
4.	Remaining ¼ was considered to be valued for claim at 60% of the original cost, i.e. 60% of Rs.5000)	3,000

3.3 Computation of Insurance Claim Under Loss of Profit Policy :

When a fire occurs, the business is dislocated for a certain period of time and the normal business cannot be achieved. During this period of dislocation, the sales are comparatively less than what they are supposed to be under normal working conditions. When sales are reduced, the corresponding profits are also reduced. Consequential loss insurance indemnifies the insured any loss of profit suffered by him, consequent on the destruction of business by fire. An ordinary fire insurance policy does not cover loss of profit due to reduction in sales on account of fire. So a separate policy known as consequential loss policy is taken to cover the following losses due to fire.

1. Loss of profit due to reduction in turnover / output.
2. Payment of standing charges.

3. Increased cost of working (which is necessary to avoid or diminish reduced turnover)

3.3.1 Important Terms :

3.3.1.1 Indemnity Period :

Indemnity period means the period for which the policy is taken. It is the expected period during which the business is likely to be dislocated resulting reduction in sales. The loss of profit on account of reduced sales during the indemnity period only, would be compensated by the insurance company.

3.3.1.2 Short Sales :

The term short sales refer to the loss of sales on account of fire resulting in dislocation of business. This is the difference between the standard sales and actual sales during the period of fire.

3.3.1.3 Standard Sales :

The term standard sales refers to the sales for the period corresponding with the indemnity period during the preceding accounting year adjusted in view of trends noticed during the accounting year in which fire occurred.

3.3.1.4 Gross Profit :

The term Gross profit for loss of profit has got a different meaning than that of what is commonly understood. It refers to the ratio of net profit and insured standing charges to the sales during the preceding financial year.

$$\text{Gross Profit Ratio} = \frac{\text{Net profit + Insured standing charges of last year}}{\text{Sales of the previous year}} \times 100$$

In case of net loss, the rate of gross profit will be determined as under :

$$\text{Gross Profit Rate} = \frac{\text{Insured standing charges - Net loss}}{\text{Sales of the previous year.}} \times 100$$

3.3.1.5 Standing Charges :

It means fixed charges, which continue irrespective of reduction in sales. It is just opposite of variable charges which fluctuate with the sales, e.g. wages and salaries of permanent staff, rent, rate tax and insurance, directors fees and auditors fee etc.

3.3.1.6 Increased Cost of Working :

The insured may have to incur certain additional expenses to keep the business running during the indemnity period. Such increased working expenses will be allowed subject to a limit, which is the least of two figures resulting from the following.

a) $$\frac{\text{Net Profit + Insured standing charges}}{\text{Net profit + All standing charges.}} \times \text{Increased cost of working}$$

b) Short sales avoided through increased cost of working + Rate of Gross profit.

3.3.1.7 Saving in Expenses :

Any saving in expenses will have to be deducted from the amount of loss of profit to arrive the Gross claim under Loss of Profit Policy.

3.3.1.8 Average Clause :

The amount of Gross fire claim will be proportionately reduced if the sum insured under the Policy is less than the amount for which the policy should have been taken. The amount for which policy should have been taken is determined by applying the rate of gross profit to turnover for 12 months immediately preceding the date of fire. Such turnover may have to be adjusted keeping in view the trend of sales in the accounting year in which the fire occurs.

3.3.2 Procedure for Calculating the Fire Claim under Loss of Profit :

Following procedure is followed for ascertaining fire claim –

3.3.2.1 : **Ascertain the amount of short sales, i.e. excess of standard sales over actual sales during dislocation of business.**

Sales in the previous year for a period corresponding to the indemnity period	xxx
Add : Expected increase in the current year, if any.	xxx
	xxx
Less: Actual sales during indemnity period	xxx
Short sales	xxx

3.3.2.2 : Calculate the Gross Profit Rate :

The gross profit rate is found out by applying the following formula-

$$\text{Gross Profit Rate} = \frac{\text{Net Profit of Previous year + Insured standing charges}}{\text{Sales during the previous year.}} \times 100$$

3.3.2.3 : Ascertain the increased cost of working and add it.

If all the standing charges are not insured, the claim in respect of increased cost of working must be reduced proportionately with the help of following formula-

$$\text{Claim} = \frac{\text{Net profit + Insured standing charges}}{\text{Net profit + All standing charges}} \times \text{Increased cost of working.}$$

But the claim in respect of increased cost of working must not exceed the sum produced by applying the rate of Gross profit, the amount of reduction in sales.

3.3.2.4 : Deduct the amount of saving in the insured standing charges during the period of indemnity.

3.3.2.5: Apply the test of Average Clause to the sum ascertained as under:

$$\text{Net Claim} = \frac{\text{Amount of policy}}{\text{Gross profit on annual sales.}} \times \text{Loss of profit.}$$

Note : When the amount of policy is less than the gross profit, it applied average clause.

Alternatively, lower of two following percentages may be applied to short sales in order to ascertain loss of profit due to fire.

1) $$\text{Gross profit Ratio} = \frac{\text{Net profit + Insured standing charges of last accounting year.}}{\text{Sales for the last accounting year.}} \times 100$$

2) $$\text{Indemnity Ratio} = \frac{\text{Policy value.}}{\text{Sales of 12 months immediately preceding fire as adjusted for trend.}} \times 100$$

3.3.2.6 Problems on ascertaining fire claim under Loss of Profit Policy:

Illustration – 1 :

Mr.Shashtri had taken a loss of profit policy for Rs.1,20,000. The period of indemnity being 6 months after the fire. On 16^{th} May 2018 his office premises were destroyed by fire. The following information is available from his books.

	Rs.
Net profit for the year ended 2017	72,000
Standing charges for the year ended 2017	24,000
Sales for the year ended 2017	14,40,000
Sales from the year ending on 15 May 2018	15,00,000
Sales from 16^{th} May to 15^{th} Nov. 2017	9,00,000
Sales from 16^{th} May 2018 to 15^{th} Nov. 2018	3,00,000

Calculate the amount of fire claim.

Solution :

I. Calculation of Short sales :

	Rs.
Sales in the previous year, i.e. from 16 May to 15 Nov. 2017	9,00,000
Actual sales, i.e. from 16 May 2018 to 15^{th} Nov.2018	3,00,000
Short sales	6,00,000

II. Calculation of Gross profit Rate or Earning Ratio :

$$\text{Gross Profit Rate} = \frac{\text{Net Profit + Standing charges}}{\text{Sales for the previous year}} \times 100$$

$$= \frac{72{,}000 + 24{,}000}{14{,}40{,}000} \times 100$$

$$= \frac{96,000}{14,40,000} \times 100$$

$$= 6.67\%$$

III. Calculation of Indemnity Ratio.

$$\text{Indemnity Ratio} = \frac{\text{Policy Amount}}{\text{Sales of 12 months immediately preceding the date of fire.}} \times 100$$

$$= \frac{1,20,000}{15,00,000} \times \frac{100}{1}$$

$$= 8\%.$$

IV. Calculation of Loss Profit :

Loss Profit = Short Sales x Lower of the two ratios.

= 6,00,000 x 6.67%

= 40,200

Claim for Loss of Profit = Rs. 40,020/-

Illustration – 2 :

A businessman took out a Loss of Profit Policy for Rs.90,000 with an indemnity period of Six months. His net profit for the last financial year was Rs.56,000 after deducting standing charges of Rs.14,000, and the sales for that period was Rs.2,80,000.

A fire occurred on 31 March 2019. His turnover for six months immediately following the fire was Rs.1,80,000. As compared with the turnover of corresponding months in the previous year, it was short by Rs.3,20,000. His turnover for 12 months immediately preceding fire was Rs.4,50,000.

Calculate the amount of claim lodged with Insurance Company.

Solution :

I. Calculation of Short Sales.

Short sales given in the problem = Rs. 3,20,000

II. Calculation of Gross Profit Rate.

$$\text{Gross Profit Rate} = \frac{\text{Net Profit + Standing charges}}{\text{Sales of the previous year}} \times 100$$

$$= \frac{56{,}000 \times 14{,}000}{2{,}80{,}000} \times 100$$

$$= \frac{70{,}000 \times 100}{2{,}80{,}000} \times 100$$

$$= 25\%.$$

III. Calculation of Indemnity Ratio.

$$\text{Indemnity Ratio} = \frac{\text{Amount of Policy}}{\text{Sales for 12 months immediately preceding the date of fire.}} \times 100$$

$$= \frac{90{,}000}{4{,}50{,}000} \times 100$$

$$= 20\%.$$

IV. Calculation of Amount of claim under Loss of Profit.

Loss of Profit = Short sales x Lower of the two ratios.

= 3,20,000 x 20%

= 3,20,000 x 20 / 100

= 64,000

∴ Amount of claim lodged with Insurance Company Rs.64,000.

Illustration – 3 :

On 1.7.2018 Modern Furniture Dealers Ltd. Took out a profit Insurance Policy for Rs.1,50,000 with a period of indemnity of six months. Net profit of the company for the year ended 30.6.2018 was Rs.1,20,000 and the turnover for the period was Rs.4,80,000. Standing charges for that period amounted to Rs.24,000 and those were fully insured.

On 30.9.2018 a fire broke out and the normal turnover could not be restored before the end of six months. As a result the reduction in turnover during the period of indemnity was Rs.48,000 when compared with the corresponding period in the previous year. In an effort to maintain the turnover the increased cost of working was ascertained at Rs.7,200 although these had been a saving of Rs.800 in insured standing charges over the same period. Moreover, the turnover for the twelve months ended 30.9.2018 amounted to Rs.4,90,000 indicating an increase in turnover for the 2017-18 financial year. Calculate the claim under loss of profit policy.

Solution :

I. Calculation of short sales during the period of Indemnity.

Short sales given in the problem Rs.48,000.

II. Calculation of Gross Profit Rate.

$$\text{Gross Profit Rate} = \frac{\text{Net Profit + Insured standing charges}}{\text{Turnover for the last year}} \times 100$$

$$= \frac{1,20,000 + 24,000}{4,80,000} \times 100$$

$$= 30\%$$

III. Calculation of amount of Gross Claim.

Gross Profit on short sales. (30% on Rs.48,000)	=	14,400
+ Increased cost of working	=	7,200
		21600
- Saving in insured standing charges	=	800
Amount of Gross Claim	=	20,800

IV. Application of Average Clause.

Turnover for 12 month ending preceding the date of fire	Rs.4,90,000
Gross profit – 30% on sales (30% of Rs.49,000)	Rs.1,47,000
Policy Value	Rs.1,50,000
It is fully covered by the policy hence amount of	Rs. 20,800

Note : There is no application of average clause, since the amount of policy is more than the Gross profit.

Illustration – 4 :

From the following information, calculate the amount of claim under loss of profit policy.

1. Date of fire 1 April 2020.
2. Period of indemnity : 4 months.
3. Policy amount Rs.3,00,000.
4. Sales from 1.1.2019 to 31.12.2019, Rs.18,00,000.
5. Sales from 1.4.2019 to 31.3.2020, Rs.20,00,000.
6. Net profit for the year ended 31.12.2019 – Rs.2,00,000 and standing charges Rs.2,00,000 (out of which Rs.40,000 were uninsured)
7. Sales during the dislocation period Rs.2,00,000 and during the corresponding period in the last year Rs.6,00,000.

Solution :

I. Calculation of short sales during the period of Indemnity.

Sales in previous year i.e. 1-4-2019 to 31-7-2019	Rs. 6,00,000
Less : Actual sales during indemnity period	
(1-4-2020 to 31-7-2020)	Rs. 2,00,000
Short Sales	Rs. 4,00,000

II. Calculation of Gross Profit Rate.

$$\text{Gross Profit Rate} = \frac{\text{Net profit + Insured standing charges}}{\text{Sales of the previous year}} \times 100$$

$$= \frac{2,00,000 + 1,60,000\ (200000\text{-}40000)}{18,00,000} \times 100$$

$$= \frac{3,60,000}{18,00,000} \times 100$$

$$= 20\%.$$

III. Calculation of Loss of Profit on Sale.

Loss of Profit = Short sales x Gross profit Rate.

= 4,00,000 x 20%.

Gross Claim = 80,000.

IV. Calculation of Net claim by applying Average clause.

a) Insurance cover required = 20% on sales for 12 months ending on the date of fire.

= 20% on sales Rs. 20,00,000

= Rs. 4,00,000

b) Net claim. $= \dfrac{\text{Policy Amount}}{\text{Insurance cover required}} \times$ Gross claim i.e. loss of profit.

$$= \frac{3,00,000}{4,00,000} \times 80,000$$

= Rs.60,000

Note : No need to calculate Indemnity ratio when average clause is applied for calculating average clause.

Illustration – 5 :

Mr. Sanjay holds a loss of profit policy. From the following information calculate the amount of claim under loss of profit policy.

1. The accounts are prepared annually on 31st December.
2. The net profit plus insured standing charges for the year ended 31st Dec. 2020 amounted to Rs.50,000.
3. A fire occurred on 30th April 2021, the period of Indemnity is 6 months.
4. The sales for the year ended 30th April 2021 were Rs.1,40,000 and For the year ended 31st Dec. were Rs.1,25,000.
5. The sales during the period of dislocation were Rs.20,000 and fro the corresponding period in the preceding year were Rs.45,000.
6. The expenses incurred to mitigate loss was Rs.2,000.
7. The saving in insured standing charges due to fire amounted to Rs.500.
8. The amount of policy was Rs.40,000.

Solution :

I. Calculation of short sales during the period of Indemnity.

	Rs.
Sales of previous period, i.e. 1.5.2020 to 31.10.2020	45,000
Less : Actual sales i.e. 1.5.2021 to 31.10.2021	20,000
Short Sales	25,000

II. Calculation of Gross Profit Rate.

$$\text{Gross Profit Rate} = \frac{\text{Net profit + Insured standing charges}}{\text{Sales of the previous year}} \times 100$$

$$= \frac{50,000}{1,25,000} \times 100$$

$$= 40\%.$$

III. Calculation of Loss of profit on sales.

Loss of Profit = Short sales x Gross profit Rate

= 25,000 x 40 / 100

= 10,000.

IV. Calculation of Amount of Gross Claim.

	Rs.
Loss of Profit calculated as above	10,000
Add – Increase in expenses	2,000
	12,000
Less – Saving in insured standing charges	500
Gross Claim	11,500

V. Calculation of Net claim by application of Average clause.

a) Insurance cover required = Gross profit at 40% on the sales for 12 months ending on date of fix

Rs.140000.

= 40% on Rs.140000.

= 56000.

b) $$\text{Net claim} = \frac{\text{Amount of policy}}{\text{Insurance cover required.}} \times \text{Gross loss i.e. loss of profit.}$$

$$= \frac{40,000}{56,000} \times 11,500$$

Net claim = Rs.8,214.

Illustration – 6 :

M/s.Patil Traders are insured under loss of profit policy for Rs.1,26,000. Their books of accounts are closed on 31st Dec. each year. The fire occurred in the premises of the business on 1.7.2018. The record saved disclosed the following information.

	Rs.
Sales during the year ended 30.6.2018	14,40,000
Sales during the year ended 31.12.2017	12,00,000
Sales from 1.7.2018 to 30.9.2018	60,000
Sales in the corresponding period from 1.07.2017 to 31.12.2017	3,60,000
Standing charges for the year ending 31.12.17	72,000
Net profit for the year ending 31.12.2017	48,000
Period of Indemnity	3 months.

In has been ascertained that the business has consistently an increase of 25% in sales in the month preceding the fire over corresponding period of the previous year. Calculate the amount of claim.

Solution :

I. Calculation of short sales during the period of Indemnity:

	Rs.
Sales of Previous period Expected (from 1.7.2017 to 30.9.17)	3,60,000
Add- 25% increase anticipated	90,000
	4,50,000
Less : Actual sales during Indemnity period	
(for 1.7.2018 to 30.09.2018)	60,000
Short sales	3,90,000

II. Calculation of Gross Profit Rate :

$$\text{Gross Profit Rate} = \frac{\text{Net Profit + Insured standing charges}}{\text{Sales in the last accounting year.}} \times 100$$

$$= \frac{48,000 + 72,000}{12,00,000} \times 100$$

$$= 10\%.$$

III. Calculation of Loss of Profit :

Loss of Profit = Short sales x Gross profit Rate.

= 3,90,000 x 10/100

Gross claim = 39,000.

IV. Application of Average Clause.

a) Insurance cover required = 10% of Sales for 12 months ending on the date of fire + 25% increase.

= 10% of Rs.14,40,000 + 3,60,000.

= 10% of Rs.18,00,000

= 1,80,000.

$$\text{b) Net claim} = \frac{\text{Policy Amount.}}{\text{Insurance cover require.}} \times \text{Gross claim i.e. Loss of profit.}$$

$$= \frac{1,26,000}{1,80,000} \times 39,000$$

$$= 27,300.$$

Claim for Los of Profit is Rs. 27,300.

3.4 Summary

Hire Purchase Agreement is an agreement in writing between hire vendor and hire purchaser which includes the terms and conditions of hire purchase deal. Down payment is the initial payment by the hire purchaser at the time of entering into a hire purchase agreement. Cash is the amount to be paid for purchase of Assets. It is the original price of the assets, which includes cost and profit of the hire vendor. Interest means interest payable by hire purchaser to hire vendor. Calculated on outstanding Balance of each instalment. Hire purchase price is the total amount payable by the hire purchaser to the hire vendor. It includes cash price and interest.

3.5 Check your progress

A) Select the most appropriate answer.

1. The main object of average clause is to ....

   a) encourage full insurance. b) encourage under insurance,
   c) discourage full insurance.

2. In case of average clause the loss is suffered by both the insurer and the insured ......

   a) in the ratio of risk covered. b) in equal ratio
   c) only by insurer.

3. A plant worth Rs.40,000 has been insured for Rs.30,00, the loss on account of fire is Rs.25,000. The insurance company will bear loss to the extent of ....

   a) Rs.30,000 b) Rs.25,000 c) Rs.18,750

4. In case the net profit is Rs.10,000 insured standing charges Rs.5,000 and sales Rs.1,00,000, the rate of gross profit will be ... .

   a) 10% b) 15% c) 5%

5. Cost of goods sold is calculated by deducting gross profit from ....

   a) Purchase b) Closing stock c) Sales.

6. In case of Loss of Profit Policy, Gross Profit is equal to net profit .... changes.

   a) Insured standing charges b) Un-insured standing charges
   c) Increased cost of working.

B) State whether each of the following statement is True or False.

1. The loss of profit policy covers loss of profit due to loss of sales as well as loss of standing charges due to their non-recovery.

2. The insertion of average clause in an insurance policy results in bearing a part of loss by the insured himself.

3. It is not necessary to make any adjustment in the standard sales of the preceding period in the light of any change in future prospects.

4. The term gross profit in case of a Loss of Profit Policy is different from the term gross profit as used in loss of stock policy.

5. Any saving in expenses is to be deducted for determining the final claim.

6. Actual loss of stock is equal to total stock on the date of fire less stock salvaged.

7. Loss of Profit is calculated on short sales multiplied by rate of gross profit when under insurance.

3.6 Answers to Check your progress

A) 1) a 2) a 3) c 4) b 5) c 6) a

B) 1) True 2) True 3) False 4) False

5) True 6) True 7) True

3.7 Exercises

3.7.1 Questions for Self Study.

1. Explain the necessity of Loss of Stock Policy.
2. How to calculate claims under Loss of Stock Policy?
3. Explain the steps involved in calculation of claims under Loss of Profit Policy.
4. **Write Short Notes on –**
    1. Loss of Profit Policy.
    2. Indemnity Ratio.
    3. Loss of Stock Policy.
    4. Standard Sales.
    5. Average Clause.

3.7.2 Practical Problems for Self Study.

3.7.2.1 Problems on Loss of Stock Policy.

1. The godown of Purple Ltd. caught fire on 15th June 2020. Records saved fromfire showed the following particulars.

	Rs.
Stock at cost on 1st January 2019	60,000
Stock at cost on 31st December 2019	88,000
Purchases Less Returns for the year 2019	5,68,000
Sales Less Return for the year 2019	7,20,000
Purchases Less Returns from 1st Jan to 15th Jan. 2020.	1,80,000
Sales Less Returns from 1st Jan to 15th June 2020.	2,46,000

Gross profit had remained at uniform rate. The stock salvaged were worth Rs.7,200 and they were retained by Purple Ltd. The godown was insured. Show the amount of claim.

2. A fire occurred in the godown of X Ltd. on 9th March 2020, destroying the entire stock. The books and records were salvaged from which the following particulars were ascertained.

Sales for the year 2019	10,01,000
Sales for the period 1.1.2020 to 8.3.2020	3,00,000
Purchases for the year 2019	8,00,000
Purchases for the period 1.1.2020 to 8.3.2020.	1,25,000
Stock on 1.1.2019	3,31,100
Stock on 31.12.2019	3,85,000

The company has been following the practice of valuing the stock of good at actual cost plus 10%. Included in the stock on 1.1.2019 were some shop-sold goods, which originally cost Rs.2000 but were valued at Rs.1100. These goods were sold during the year 2019 for Rs.1000. Subject to these the rate of gross profit and basis of valuation of stock were uniform.

You are required to ascertain the value of stock destroyed.

3. A fire occurred on 15.9.2019 in the premises of Godrej Ltd. From the following figures calculate the amount of claim to be lodged with the insurance company for Loss of Stock.

	Rs.
Stock on 1.1.2018 (at cost)	20,000
Stock on 1.1.2019 (at cost)	30,000
Purchases for the year ended 2018	40,000
Purchases from 1.1.2019 to 15.9.2019	88,000
Sales for the year ended 2018	60,000
Sales from 1.1.2019 to 15.9.2019	1,05,000

During the current year cost of purchases have increased by 10% above last years level. Selling price has gone up by 5%. Salvaged stock amounted to Rs.6000.

4. Fire occurred in the premises of Badluck Ltd. on 10.4.2007. From the following particulars ascertain the claim for loss of stock.

	Rs.
Stock on 1.1.2016	72,000
Stock on 31.12.2016	45,000
Purchases during the year 2016	2,90,000
Sales during the year 2016	4,00,000
Purchases from 1.1.2017 to 9.4.2017	2,92,000
Sales from 1.1.2017 to 9.4.2017	3,78,000
Salvaged stock	14,000

The company follows the practice of stocks at cost less 10%.

3.7.2.2. Practical Problems on Loss of Profit Policy.

1. From the following particulars find out the amount of claim of Loss of Profit Policy.

		Rs.
1.	Date of fire 30.6.2020	
2.	Period of Indemnity – 6 months.	
3.	Sum Insured	40,000
4.	Net profit for the accounting year ending 31.3.2020	12,500
5.	Sales for the year ended 30.6.2020	2,00,000
6.	Standing charges for the accounting year ending 31.3.2020	28,500
7.	Sales for the year ending 31.3.2020 1,98,000	
8.	Sales for the indemnity period for 1.7.2020 to 31.12.2020	56,000
9.	Sales for the period 1.7.2019 to 31.12.2019	1,10,000

The sales of the year 2020–21 had shown tendency of increase of 10% over the turnover of preceding year.

2. From the following data calculate the claim under Loss of Profit Policy.

    1. Financial year ends on 31st December.
    2. Turnover Rs.2,00,000
    3. Indemnity period 6 months.
    4. Period of interruption – 1st July to 31st October.
    5. Net profit Rs.18000.
    6. Standing charges Rs.42,000 out of which Rs.10,000 have not been insured.
    7. Sum Assured – Rs.50,000.
    8. Standard Turnover Rs.65,000.
    9. Turnover in the period of Interruption Rs.25000 out of which 6000 was from a rented place at Rs.600 per month.
    10. Annual Turnover Rs.240000.

11. Saving in standing charges Rs.4725 per annum.

12. Date of fire – Night of 30th June.

13. It was agreed between the insurer and the insured that the business trends would lead to an increase of 10% in the turnover.

3. A fire occurred on 1st July 2020 in the premises of Silver Ltd. and business was practically dis-organized up to 30th Nov. 2020. From the books of account, following information was extracted.

		Rs.
1.	Actual turnover from 1.7.2020 to 30 Nov. 2020	60,000
2.	Turnover from 1st July to 30th Nov. 2019	2,00,000
3.	Net profit for the financial year	90,000
4.	Insured standing charges for the last financial year	60,000
5.	Turnover for the last financial year	5,00,000
6.	Turnover for the year ending 30th June 2019	5,50,000
7.	Total standing charges for the year	72,000

The company incurred additional expenses amounted to Rs.9000 which reduced the loss in turnover. There was also a savings during the indemnity period of Rs.2486.

The company holds a loss of profit policy for Rs.1,65,000 having an indemnity period for 6 months. There has been a considerable increase in trade and it has been agreed that an adjustment of 20% be made in respect of upward trend in Turnover.

Compute the claim under Loss of Profit Policy.

3.8 References for Additional Reading :

1. B.Com. Accountancy, Volume-III; by P.V. Rathnam, Himalaya Publishing House.
2. Advanced Accountancy; by S.P. Jain and K.L. Narang, Kalyani Publishers.
3. Advanced Accountancy, Vol. II; by S.K.R. Paul, Central Publication.
4. Advanced Accountancy; by Maheshwari & Maheshwari Sultanchand Publication.

❑❑❑

Unit 4

GST Accounting with Practical's using Tally Part-I

Structure

Theory

4.0 Objectives:

After studying this unit we will be able to understand

1. GST Taxation System
2. Dual GST
3. Structure of GST
4. GSTIN Structure
5. Tax Invoice
6. Input Tax Credit Set Off
7. GST Payment
8. GST Reports & Returns

4.1 Introduction:

GST is known as the Goods and Services Tax. It is an indirect tax which has replaced many indirect taxes in India such as the excise duty, VAT, services tax, etc. The Goods and Services Tax Act was passed in the Parliament on 29th March 2017 and came into effect on 1st July, 2017.

In other words, Goods and Service Tax (GST) is levied on the supply of goods and services. Goods Services Tax Law in India is a comprehensive, multi-stage, destination-based tax that is levied on every value addition. GST is a single domestic indirect tax law for the entire country.

4.2 Presentation of Subject Matter

4.2.1 Indirect Taxes prior GST

In India, a consumer earlier paid several indirect taxes including sales tax, services tax, central excise duty, additional customs duty, state-level value added tax and octroi tax, among others. With the implementation of the Goods and Services Tax (GST) from 1st July 2017, almost all the indirect taxes, have been subsumed under GST. Now, all these taxes are paid as one tax called the GST.

However, there are some indirect taxes which have not been brought under the radar of GST. Customs duty, security transaction tax, building and welfare cess and electricity duty levied by local authorities and state governments are some of them.

Below is a list of indirect taxes that are levied on the supply of good and services in India, which now is taxed under the common name of GST

1. EXCISE DUTY

Excise duty is levied on goods and services that are produced in India. This is a tax on manufacturing which is paid by the manufacturer to the government. The manufacturer distributes and passes this tax on the end consumers.

2. VALUE-ADDED TAX

It is a tax on the consumption of a product and it is levied on its value when additional or margin value is added to the product during the subsequent stages of production, starting from the point of production to the point of sale. The tax goes on adding at every stage of production as per the value addition.

3. SERVICE TAX

Service tax is a tax levied on the service providers. It is levied on services like air-conditioned restaurants, accommodation provided by the hotel, inns, services provided by travel agents, cab services, cable services, etc. The idea behind service tax is similar to that of excise duty. The incidence of this tax applies to the disbursement of services.

4.2.2 GST Implementation in India

The year 2017 will forever be etched in Indian history as the year that saw the implementation of the biggest and most important economic reform since Independence - the Goods and Services Tax (GST). The reform that took more than a decade of intense debate was finally implemented with effect from 1 July 2017, subsuming almost all indirect taxes at the Central and State levels.

GST, which was publicized as 'One nation, One tax' by the government, aims to provide a simplified, single tax regime in line with the tax framework applicable in several major economies across the Globe. This single tax has helped streamline various indirect taxes and brought in more efficiency in business. GST law in India is a comprehensive, multi-stage, destination-based tax that is levied on every value addition.

4.2.3Why GST was introduced in India?

One of the main reasons for GST being introduced in India is the tax burden that falls both on companies and consumers. With the current tax system, there are multiple taxes added at each stage of the supply chain, without taking credit for taxes paid at previous stages. As a result, the end cost of the product does not clearly show the actual cost of the product and how much tax was applied. This cascading structure is too complex and inefficient.

GST will integrate most taxes into a single one that will be applied to the sale and purchase of goods and services, with deductions for taxes paid at previous supply chain stages. This structure is predicted to be easier to track both for the government and business owners

4.2.4 Understanding GST Taxation System

The goods and services tax (GST) is an indirect federal sales and tax that is applied to the cost of certain goods and services. The business adds the GST to the price of the product, and a customer who buys the product pays the sales price plus the GST. The GST portion is collected by the business or seller and forwarded to the Government. It is also referred to as value added tax (VAT) in some countries.

4.2.5 Dual GST

Many countries in the world have a single unified GST system i.e. a single tax applicable throughout the country. However, in federal countries like Brazil and Canada, a dual GST system is prevalent whereby GST is levied by both the federal and state or provincial governments. In India, a dual GST is proposed whereby a Central Goods and Services Tax (CGST) and a State Goods and Services Tax (SGST) will be levied on the taxable value of every transaction of supply of goods and services

4.2.6 Structure of GST

SGST

1. State GST
2. Collected by the State government

CGST

1. Central GST
2. Collected by the Central government

IGST

1. Integrated GST
2. Collected by the Central government on interstate supply of goods and Services.

4.2.7 Determination of Tax

GST is destination based tax i.e. consumption tax, which means tax will be levied where goods and services are consumed and will accrue to that state.

Under GST, there are three levels of Tax, IGST, CGST & SGST and based on the 'place of supply' so determined, the respective tax will be levied. IGST is levied where transaction is inter-state and CGST & SGST are levied where the transaction is intra-state. For understanding Place of Supply for Services the following two concepts are very important namely:

1. Location of the recipient of services
2. Location of the supplier of services

4.2.8 Registration

Registration Procedure under GST (u/s 25 of CGST):

Every person who is liable to be registered shall for registration within 30 days from the date on date on which he become liable to registration, before applying for registration declare

1. Legal name of business
2. PAN
3. Mobile number
4. Email address
5. State or union territory

In part A of from GST REG -01 on common portal, on successful verification of these numbers, a reference number will be generated application shall submit part B of from GST REG-01 duly signed, along with documents specified in the said from at the common portal from GST REG -02: acknowledgement of application if these documents are found to be in order the proper office shall approve the registration within 3 working days from the date of submission.

4.2.9 GSTIN Structure:

Every taxpayer under the GST regime is provided with a State + PAN-based 15-digit Goods and Services Taxpayer Identification Number (GSTIN). Here is the breakdown of the GSTIN format:

1. The first 2 digits of the 15 digit GSTIN represent the state code.
2. The next 10 digits are the PAN Number of the person or the business entity.
3. The thirteenth digit is based on the number of registrations done by the firm within a state under the same PAN.
4. The fourteenth digit will be the alphabet "Z" by default
5. The last digit is called the check code to detect errors and can be denoted by either a number of an alphabet

4.2.10 Business liable to register under GST:

The whole system of GST depends on the people who are supposed to get registered under GST. I would rather say, registered people are the backbone of any taxation system. Our government has broadly specified two categories of people who are required to register under GST,they are:

1. Normal Category
2. Mandatory Category

1. Normal Category:

Following businesses are required to get registration under GST:

1. Supplier whose aggregate turnover exceeds 20 lakh in a financial year (Rs. 10 lakh for North East states)
2. Person holding registration under any Indirect tax law (VAT, Service tax, Excise duty etc.)
3. Successor, in case of demerger aggregate turnover means the aggregate value of all taxable supplies (excluding the value of inward supplies on which tax is payable by a person on reverse charge basis) exempt supplies, export of goods or services or both and interstate supplies of persons having the same Permanent Account Number, to be computed on all India basis but excludes Central tax, State tax, Union territory tax, Integrated tax and Cess.

2. Mandatory Category:

For the following persons, GST registration is mandatory:

1. A person making an inter-state (one state to another state) taxable supply of a good. Inter-state supplier of services has been excluded by notification no 10/2017 IGST.
2. Casual taxable persons making taxable supply
3. Persons who are required to pay tax under reverse charge.
4. Every electronic commerce operator like Amazon.
5. Goods supplier on electronic commerce platform.
6. Non-resident taxable person making taxable supply.
7. Any person who is required to deduct TDS under GST
8. Person making taxable supply on behalf of other taxable people
9. Input service distributor.
10. Every person supplying online information and database access or retrival services from a place outside India to a person in India, other than a registered person.
11. Any other person or class of persons as may be notified by the Government on the recommendation of the council.

4.2.11 Tax Invoice:

The tax invoice issued must clearly mention information under the following 16 headings:

1. Name, address and GSTIN of the supplier
2. Tax invoice number (it must be generated consecutively and each tax invoice will have a unique number for that financial year)
3. Date of issue
4. If the buyer (recipient) is registered then the name, address and GSTIN of the recipient
5. If the recipient is not registered AND the value is more than Rs. 50,000 then the invoice should carry:
    i. name and address of the recipient
    ii. address of delivery

iii. state name and state code

6. HSN code of goods or accounting code of services**
7. Description of the goods/services
8. Quantity of goods (number) and unit (meter, kg etc.)
9. Total value of supply of goods/services
10. Taxable value of supply after adjusting any discount
11. Applicable rate of GST(Rates of CGST, SGST, IGST, UTGST and Cess Clearly mentioned)
12. Amount of tax(With breakup of amounts of CGST, SGST, IGST, UTGST and Cess)
13. Place of supply and name of destination state for inter-state sales
14. Delivery address if it is different from the place of supply
15. Whether GST is payable on reverse charge basis
16. Signature of the supplier

4.2.12 Bill of Supply:

A business registered under GST issues a tax invoice to the buyer. Such an invoice mentions the GST rate charged on the goods and services sold.

However, some businesses registered under GST cannot charge any tax on the invoice issued by them. Such dealers have to issue a Bill of Supply.

A Bill of Supply is issued when GST is not applicable on a transaction or when GST is not to be recovered from the customers.

4.2.13 Supplementary Invoice:

Supplementary tax invoice is a type of invoice that is issued by a taxable person in case where any deficiency is found in a tax invoice already issued by a taxable person. It can be in form of a debit note or a credit note.

4.2.14 Input Tax Credit Set Off:

As per CGST (Amendment) Act 2018, the priority of set-off of ITC is as below:

1. For CGST Output- First set off thru ITC of IGST, then CGST

2. For SGST Output – First set off thru ITC of IGST, then SGST

3. For IGST Output – First set off thru ITC of IGST, then CGST & then SGST

Following new sections have been inserted thru CGST (Amendment) Act 2018:

As per Section 49A,

Notwithstanding anything contained in section 49, the input tax credit on account of central tax, State tax or Union territory tax shall be utilized towards payment of integrated tax, central tax, State tax or Union territory tax, as the case may be, only after the input tax credit available on account of integrated tax has first been utilized fully towards such payment.

As per Section 49B,

Notwithstanding anything contained in this Chapter and subject to the provisions of clause (e) and clause (f) of sub-section (5) of section 49, the Government may, on the recommendations of the Council, prescribe the order and manner of utilization of the input tax credit on account of integrated tax, central tax, State tax or Union territory tax, as the case may be, towards payment of any such tax.

Let us understand the same with help of an example:

Head	Output Liability	Input Tax Credit available (ITC)	As per old Set-off rules		As per revised Set-off rules (applicable from 1st Feb 2019)	
			Paid thru ITC	Paid thru Cash	Paid thru ITC	Paid thru Cash
CGST	800	500	CGST-500 IGST-300	0	IGST- 800	0
SGST	400	200	SGST-200 IGST-200	0	SGST- 200	200
IGST	0	800	–	0	–	

4.2.15 Accounting for Goods:

Practical

In this practical we will learn following terms in Tally

1. Company set up
2. Enabling GST
3. Ledger Creation
4. Stock Item Creation
5. Voucher Entry
    a. Purchase
    b. Sales
6. GST Reports
    a. Tax Payment
    b. GSTR1
    c. GSRT2
    d. GSTR3B

4.3 Summary:

Actually, in Tally, We do not need to create a GST return. It is automatically created if we create the sales and purchase bills correctly in a proper way.

The best thing is we can start entering Purchase and Sales bills in Tally while we are in our shop, since the interface is similar to creating a sales bill and anyone can do it once we know how to do it.

There is a very low learning curve. It doesn't feel that we are creating a GST return, but just feels that we are creating a sales bill. It feels easy and simple.

Illustration

1. Purchased following material from Vaibhav Traders (RD from Karnataka) on credit, @ 2% Discount, Invoice No. 136, GST @ 18%
    a. 18.5" Monitor - 50 Qty. - 3800/- each
    b. 19.5" Monitor - 50 Qty. - 4100/- each

2. Sold following material to Maruti Traders (RD from Maharashtra) on credit, @ 2% Discount, Invoice No. 613, GST @18%

   a. 18.5" Monitor - 50 Qty. - 4350/- each

   b. 19.5" Monitor - 50 Qty. - 4650/- each

<u>Working Notes& Entries</u>

1. In above transaction No. 1 Material purchased from Vaibhav Traders who is from Karnataka i.e. purchase made from interstate therefore IGST is applicable and 2% discount on assessable value which is to be deducted.

Purchase 1. 18.5" Monitor 50 X 3800 = 1,90,000.00 2. 19.5" Monitor 50 X 4100 = 2,05,000.00	3,95,000.00
Less – Discount Received (2% on 3,95,000.00)	7,900.00
Add – IGST (18% on 3,95,000.00)	71,100.00
Vaibhav Traders	4,58,200.00

Entry

Purchase A/c	Dr.	3,95,000.00	
IGST A/c	Dr.	71,100.00	
To Vaibhav Traders A/c			4,58,200.00
To Discount Received A/c			7,900.00

2. In above transaction No. 2 Material sold to Maruti Traders who is from Maharashtra i.e. sale made in intrastate therefore CGST & SGST are applicable and 2% discount on assessable value which is to be deducted.

Sales 1. 18.5" Monitor 48 X 4350 = 2,08,800.00 2. 19.5" Monitor 48 X 4650 = 2,23,200.00	4,32,000.00
Less – Discount Received (2% on 4,32,000.00)	8,640.00
Add – CGST (9% on 4,32,000.00) Add – SGST (9% on 4,32,000.00)	38,880.00 38,880.00
Maruti Traders	5,01,120.00

Entry

Maruti Traders A/c	Dr.	5,01,120.00	
Discount Allowed A/c	Dr.	8,640.00	
To Sales A/c			4,32,000.00
To CGST A/c			38,880.00
To SGST A/c			38,880.00

Tax Payment

Particulars	Amount	Amount	Amount
Tax Collection			
Tax on Sales		77,760.00	
1. IGST	00.00		
2. CGST	38,880.00		
3. SGST	38,880.00		77,760.00
Less – Tax on Sales Return			
1. IGST	00.00		
2. CGST	00.00		
3. SGST	00.00		
Input Tax Credit			
Tax on Purchase		71,100.00	
4. IGST	71,100.00		
5. CGST	00.00		
6. SGST	00.00		71,100.00
Less - Tax on Purchase Return			
1. IGST	00.00		
2. CGST	00.00		
3. SGST	00.00		
Tax Payment			**6,660.00**

Following is the procedure to solve above given illustration in tally

1. Create a company
2. Set GST features to 'Yes'

a. Goods & Services Tax – Yes
b. Set/Alter GST options –Yes

3. Create Ledgers

a. Purchase	– Purchase Account
b. Sales	– Sales Account
c. Discount Received	– Indirect Incomes
d. Discount Allowed	– Indirect Expenses
e. Vaibhav Traders	– Sundry Creditors
f. Maruti Traders	– Sundry Debtors
g. IGST	– Duties & Taxes
h. CGST	– Duties & Taxes
i. SGST	– Duties & Taxes

4. Create Stock Item

a. 18.5" Monitor
b. 19.5" Monitor

(Note – before creating stock item we should create 'Units of Measure')

5. Voucher Entry

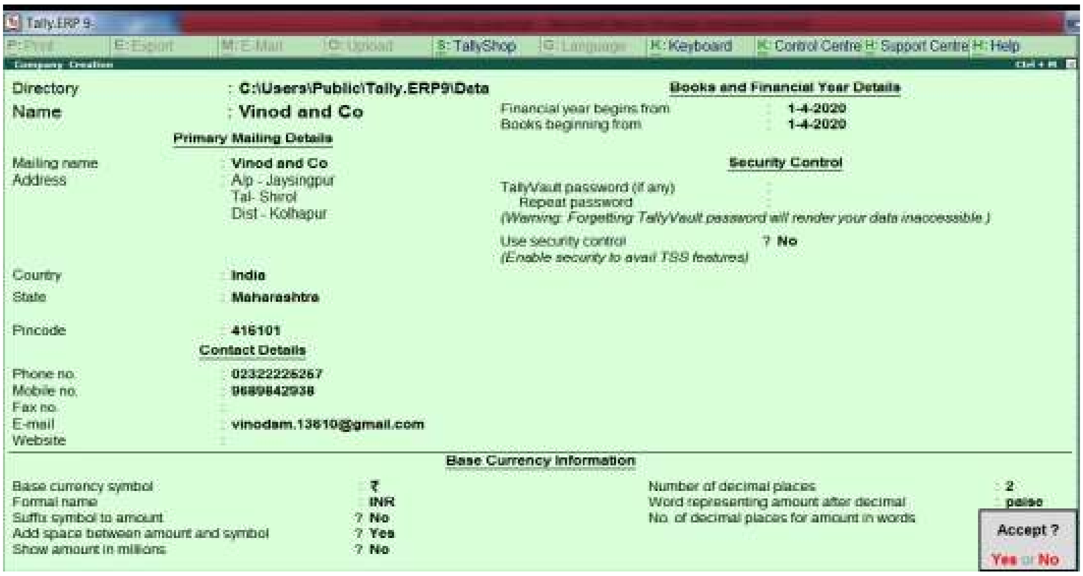
a. Purchase Voucher	– F9
b. Sales Voucher	– F8

6. Reports

a. Tax Payment (As per above calculation)
b. GST Reports

Company Creation

Go to Gateway of Tally screen → Press Alt+F1 → Select Create option



Fill up all required detail and save this

GST features

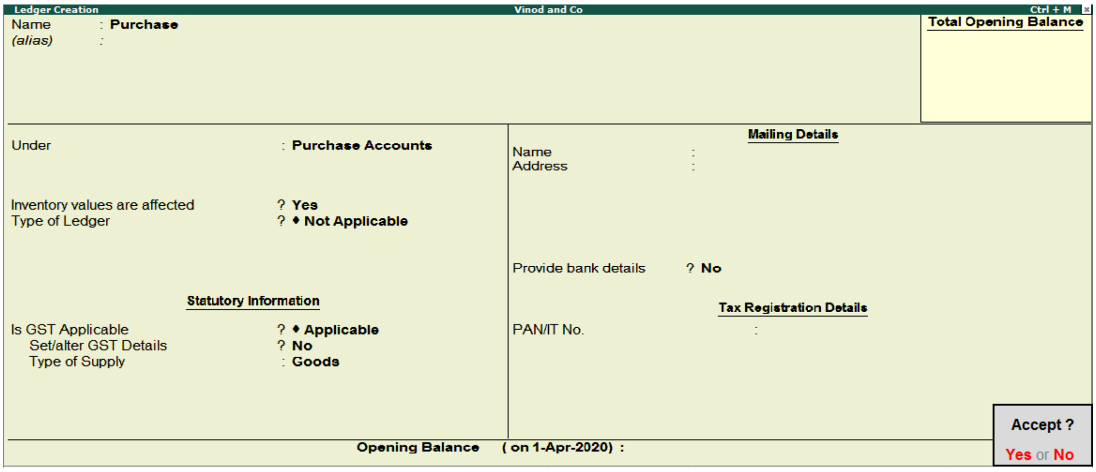
To activate GST Go to Gateway of Tally screen → Press F11 → Select Statutory & Taxation → Set GST options to Yes which is shown as below

Fill all required information and save this

Ledger Creation

To create ledger Go to Gateway of Tally screen → Enter into Accounts Info option → select Ledger → Select Create option to create new ledgers

Purchase ledger



Name – Purchase

Under – Purchase Account

Inventory values are affected – Yes

Type of ledger – Not Applicable

Statutory Information

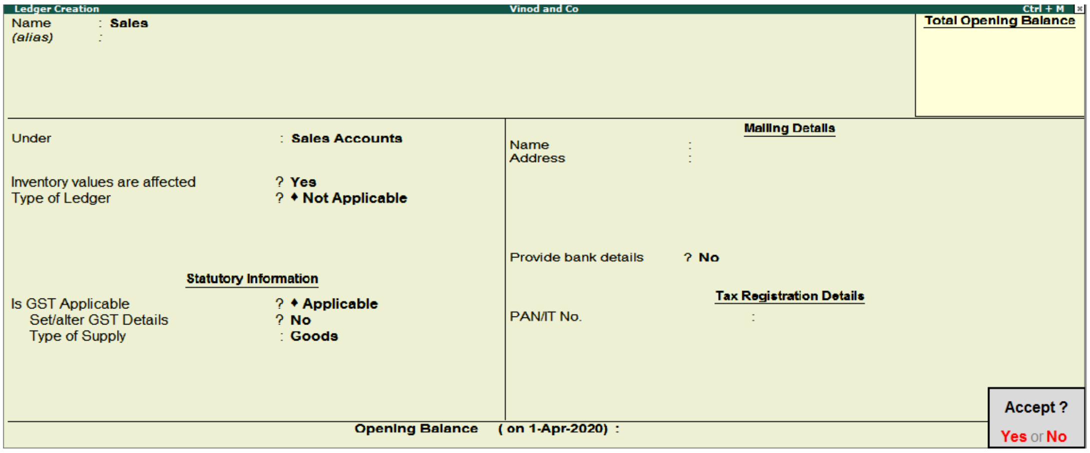
Is GST Applicable – Applicable

Set/Alter GST Details – No

Type of supply – Goods

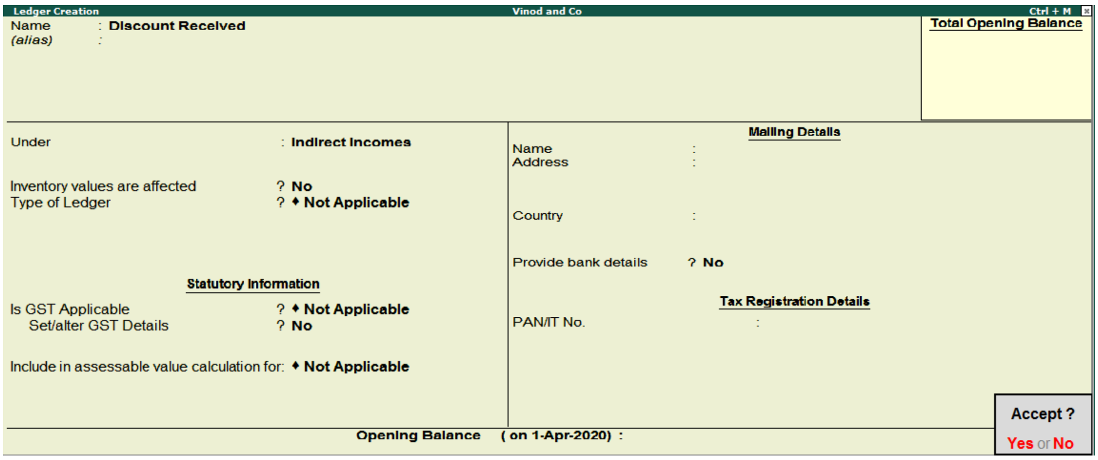
After filling above all information we have to save this

Sales ledger



Fill all information as per Purchase ledger just we have to change Group i.e. Sales Account which is shown in above image.

Discount Received



Name – Discount Received

Under – Indirect Incomes

Inventory values are affected – No

Type of ledger – Not Applicable

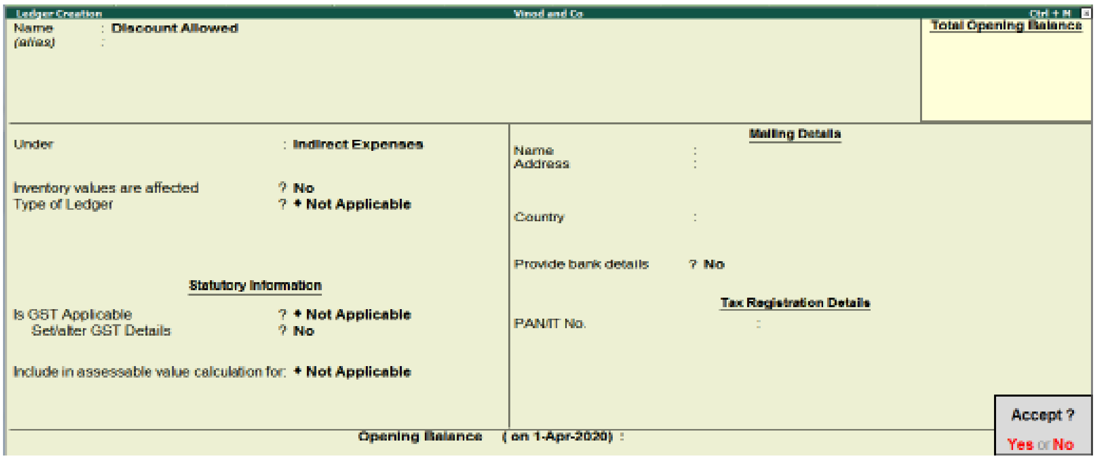
Statutory Information

Is GST Applicable – Not Applicable

Set/Alter GST Details – No

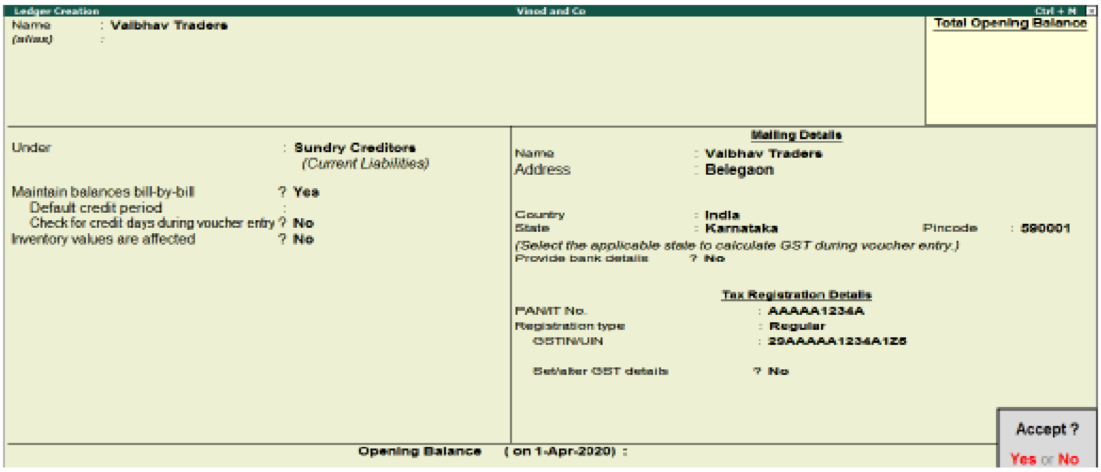
Include in assessable value calculation for – Not Applicable

<u>Discount Allowed</u>



Fill all information as per Discount Received ledger just we have to change Group i.e. Indirect Expenses which is shown in above image.

Vaibhav Traders



Name – Vaibhav Traders

Under – Sundry Creditors

Maintain balance bill by bill - Yes

Default credit period – leave blank

Check for credit days during entry – No

Inventory values are affected – No

Mailing Details

Name – Vaibhav Traders

Address – Belgaon

Country – India

State – Karnataka (Note – GST code start with 29 for Karnataka)

Pincode – 590001

Provide bank details – No

Tax Registration Details

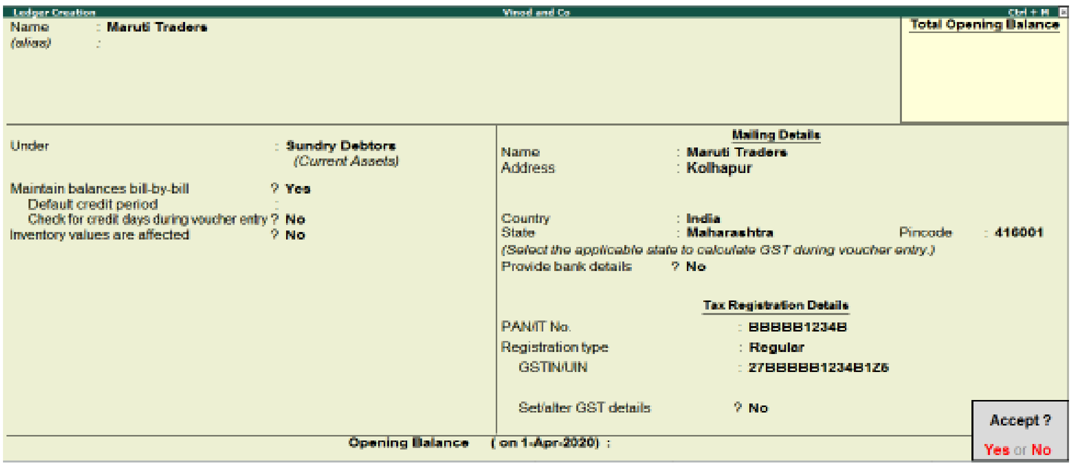
PAN/ IT No. – AAAAA1234A

Registration Type – Regular (as given in illustration)

GSTIN/UIN – 29AAAAA1234A1Z5

Set/Alter GST details – No

Maruti Traders



Fill up all information same as above Vaibhav Traders just we have make little changes which are shown below

Name – Maruti Traders

Under – Sundry Debtors

State – Maharashtra (GST code start with 27 for Maharashtra)

Tax Registration Details

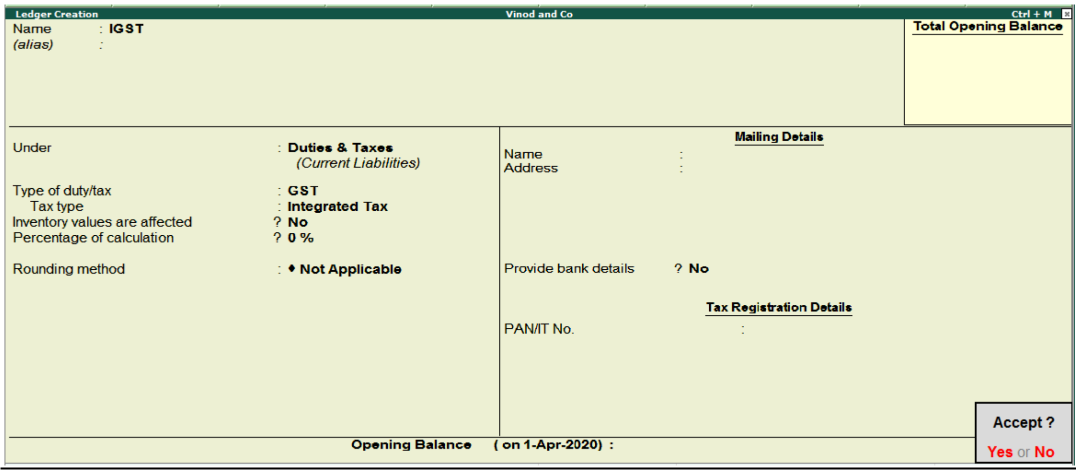
PAN/ IT No. – AAAAA1234A

Registration Type – Regular (as given in illustration)

GSTIN/UIN – 29AAAAA1234A1Z5

Set/Alter GST details – No

IGST ledger



Name – IGST

Under – Duties & Taxes

Type of Duty/Tax – GST

Tax Type – Integrated Tax

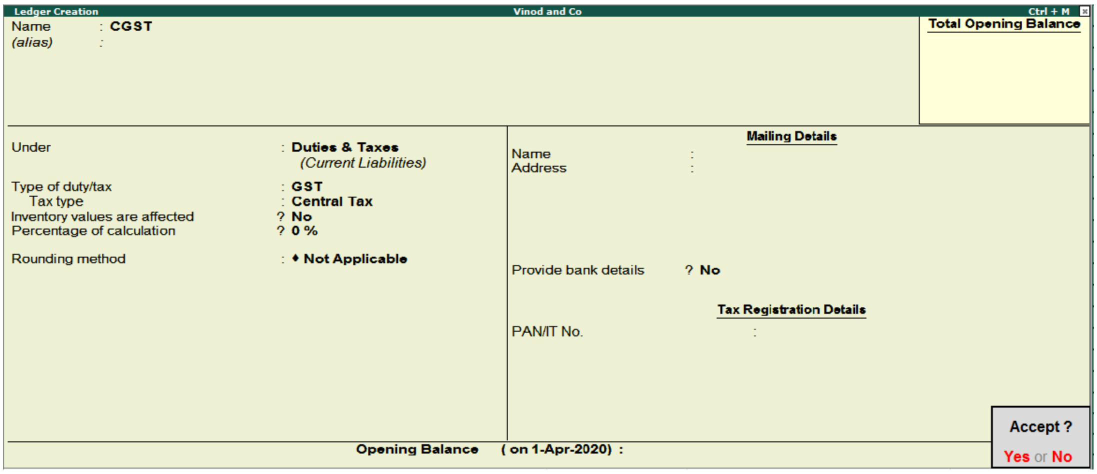
Inventory Values are affected – No

Percentage of calculation – 0%

Rounding Method – Not Applicable

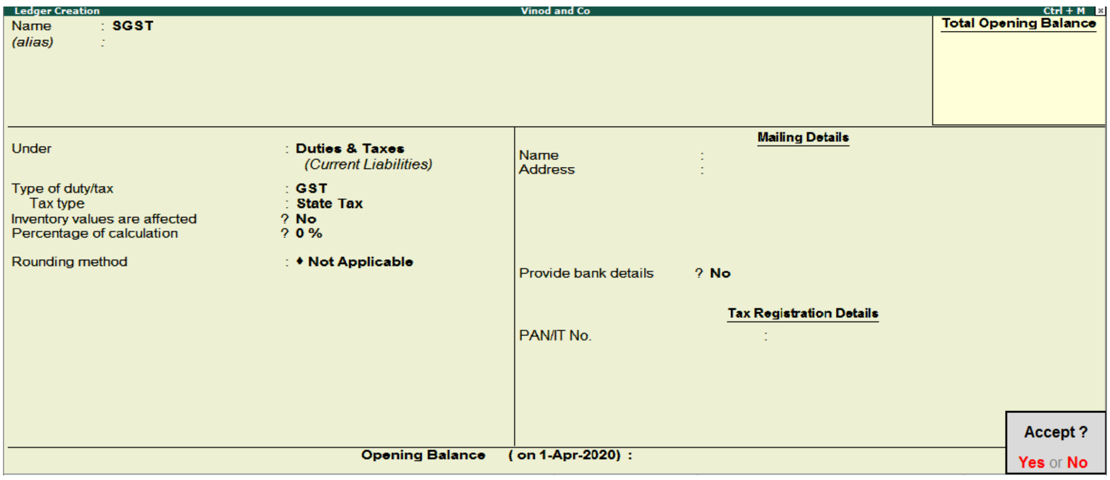
After filling all details we have to save this

CGST ledger



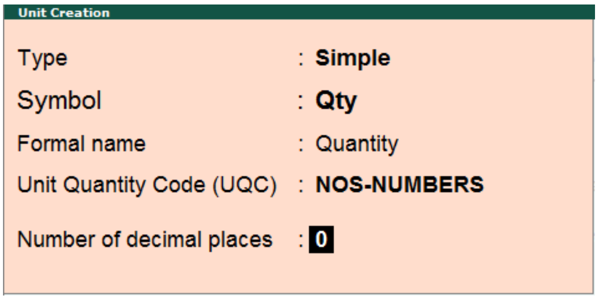
Fill up all details same as above IGST ledger just we have change Tax type to Central Tax

<u>SGST ledger</u>



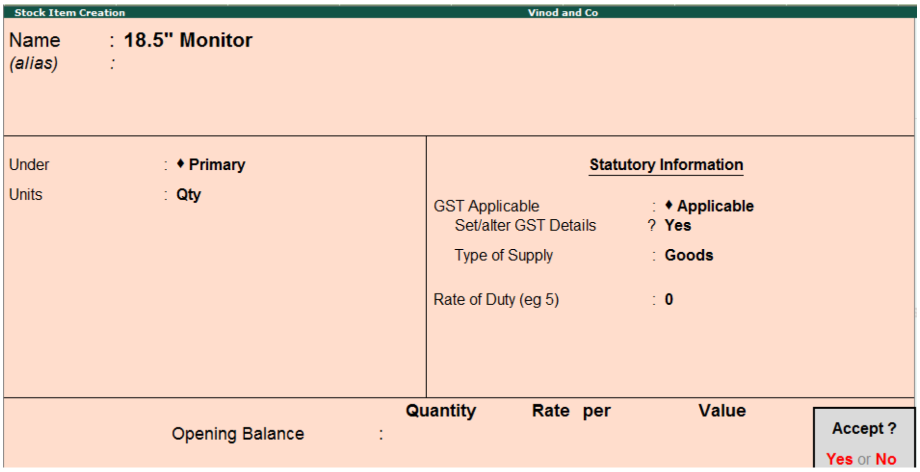
Again here we have to create SGST ledger same as above two tax ledgers just we have to change Tax type to State Tax.

After creating all ledgers we have to create Stock Item but before creating Stock Item we have to create Units first. To create Units Go to Gateway of Tally screen → Select Inventory Info → Select Units of Measure → Create



After filling above all details we have to save this

<u>Stock Item</u>



Name – 18.5" Monitor

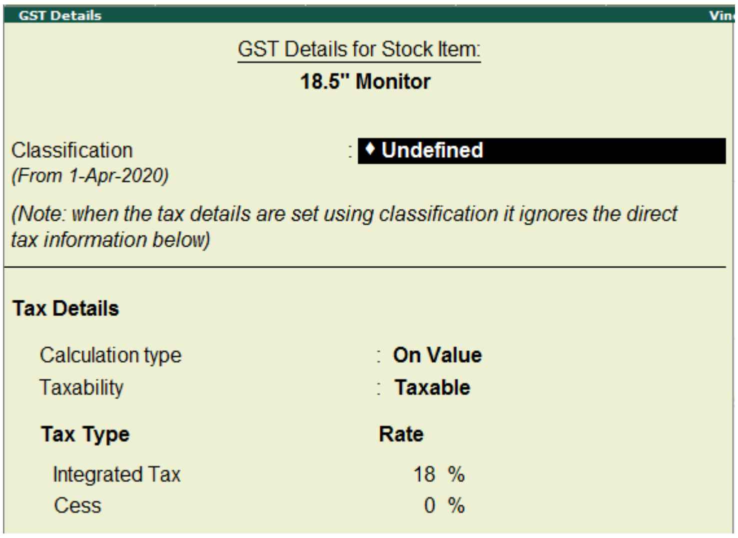
Under – Primary

Units – Qty

Statutory Information

GST Applicable – Yes

Set/Alter GST details – Yes (and fill all details shown as in below image)



Type of supply – Goods

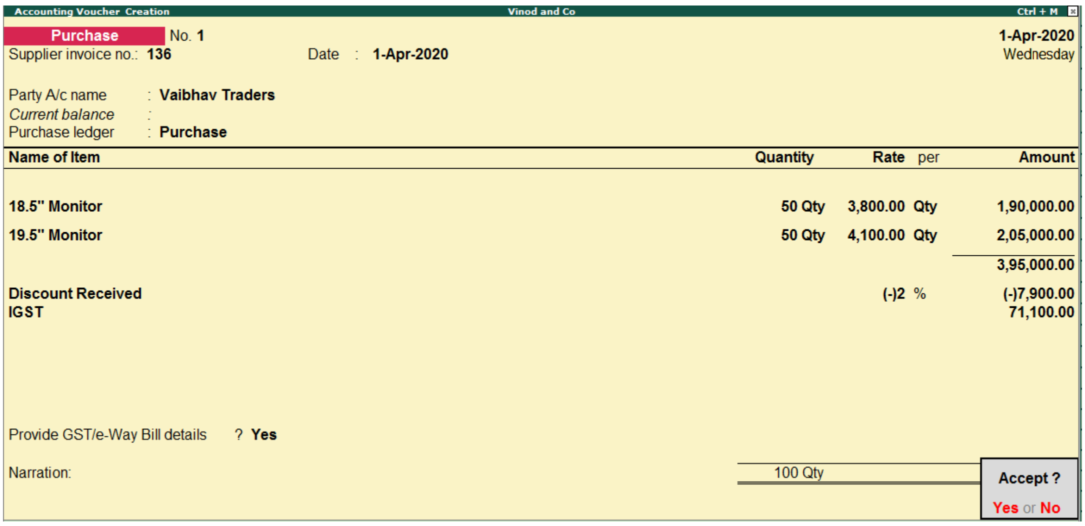
Rate of duty – 0%

After filling above all details we have to save this and create remaining stock item by same way

After creating all Masters we will learn how to record GST transactions in Tally which are shown below

To make Purchase entry in Tally Go to Gateway of Tally → Select Accounting Vouchers → Press F9 (Purchase Voucher)

<u>Purchase entry</u>



Suppliers Invoice No – 136

Date – 1-Apr-2020

Party Name – Vaibhav Traders

Purchase ledger – Purchase

Then select Stock Item, quantity and rate

Then select Discount Received ledger and Press '-2' which amount will calculate automatically

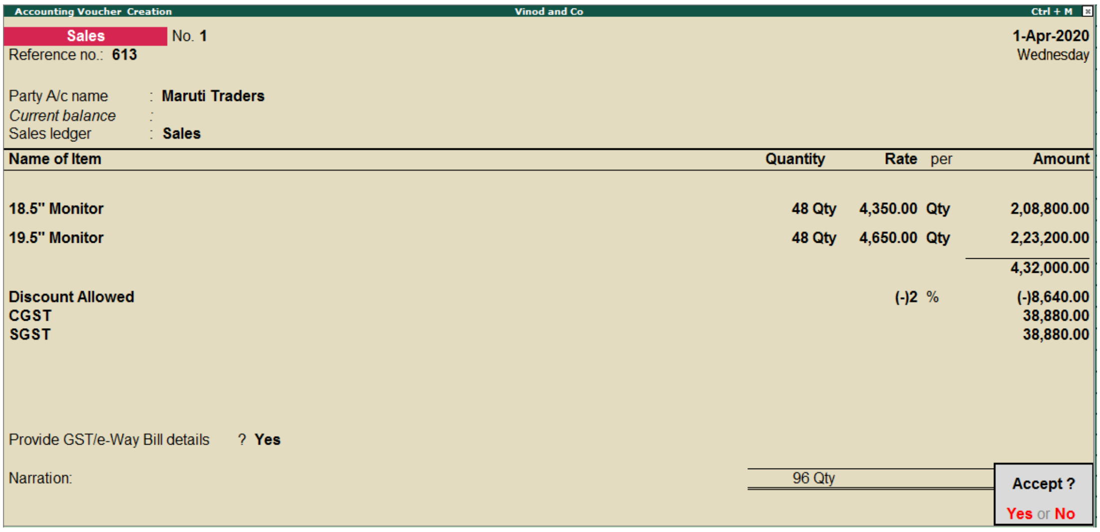
After that also select IGST ledger and amount of IGST will calculate as per given rate which is defined while creating stock item

Then provide GST/e-Way Bill details – Yes

After filling above all details we have to save this

To make Sale entry press F8 (Sales Voucher)

<u>Sales entry</u>



Reference No – 613

Party A/c Name – Maruti Traders

Sales Ledger – Sales

Then select Stock Item, quantity and rate

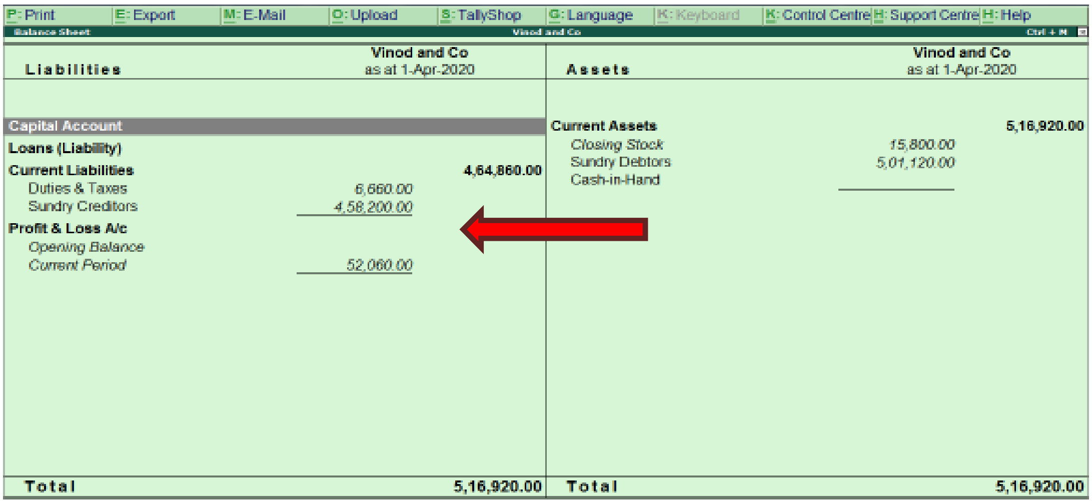
Then select Discount Allowed ledger and Press '-2' which amount will calculate automatically

After that also select CGST & SGST ledgers and amount of CGST & SGST will calculate as per given rate which is defined while creating stock item

Then provide GST/e-Way Bill details – Yes

After filling above all details we have to save this

4.17 GST Reports and Returns: Tax payment as per calculation

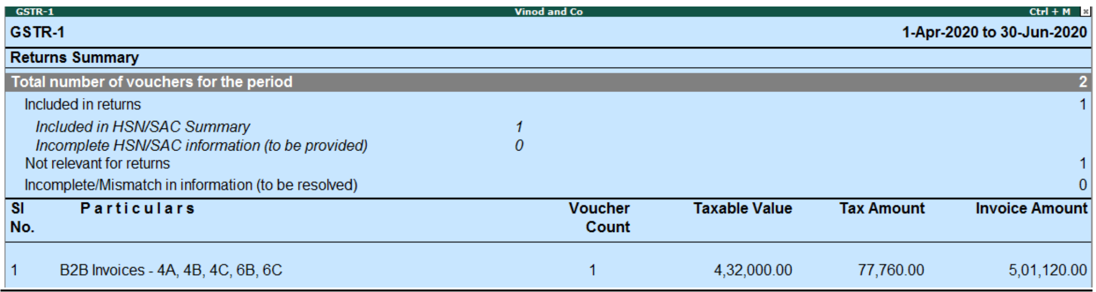


P: Print | E: Export | M: E-Mail | O: Upload | S: TallyShop | G: Language | K: Keyboard | K: Control Centre | H: Support Centre | H: Help

Balance Sheet — Vinod and Co — Ctrl + M

Liabilities		Vinod and Co as at 1-Apr-2020	Assets		Vinod and Co as at 1-Apr-2020
Capital Account			Current Assets		5,16,920.00
Loans (Liability)			*Closing Stock*	*15,800.00*	
Current Liabilities		4,64,860.00	Sundry Debtors	5,01,120.00	
Duties & Taxes	6,660.00		Cash-in-Hand		
Sundry Creditors	4,58,200.00				
Profit & Loss A/c					
Opening Balance					
Current Period	*52,060.00*				
Total		**5,16,920.00**	**Total**		**5,16,920.00**

GSTR1(Display →Statutory Reports→GST→GSTR-1)



GSTR-1 — Vinod and Co — Ctrl + M

GSTR-1 — **1-Apr-2020 to 30-Jun-2020**

Returns Summary

Total number of vouchers for the period		**2**
Included in returns		1
Included in HSN/SAC Summary	*1*	
Incomplete HSN/SAC information (to be provided)	*0*	
Not relevant for returns		1
Incomplete/Mismatch in information (to be resolved)		0

Sl No.	Particulars	Voucher Count	Taxable Value	Tax Amount	Invoice Amount
1	B2B Invoices - 4A, 4B, 4C, 6B, 6C	1	4,32,000.00	77,760.00	5,01,120.00

GSTR2(Display →Statutory Reports→GST→GSTR-2)

GSTR-2	Vinod and Co	Ctrl + M
GSTIN/UIN : 27AAAAA1234A1Z5		1-Apr-2020 to 30-Apr-2020

Returns Summary		
Number of vouchers for the period		2
Included in returns		1
Invoices ready for returns	*0*	
Invoices with mismatch in information	*1*	
Not included in returns due to incomplete information		0
Not relevant for returns		1
Incomplete HSN/SAC information (to be provided)		0

Particulars	No. of Invoices	Taxable Value	Total Tax	Total ITC Available	Reconciliation Status
To be reconciled with the GST portal					
B2B Invoices - 3, 4A	1	3,95,000.00	71,100.00	71,100.00	

GSTR3B(Display →Statutory Reports→GST→GSTR-3B)

GSTR-3B	Vinod and Co	Ctrl + M
GSTR-3B		1-Apr-2020 to 30-Apr-2020

Returns Summary		
Total number of vouchers for the period		2
Included in returns		2
Participating in return tables	*2*	
No direct implication in return tables	*0*	
Not relevant for returns		0
Incomplete/Mismatch in information (to be resolved)		0

Table No.	Particulars	Taxable Value	Tax Amount
3.1	Outward supplies and inward supplies liable to reverse charge	4,32,000.00	77,760.00
3.2	Of the supplies shown in 3.1 (a) above, details of inter-state supplies made to unregistered persons, composition taxable persons and UIN holders		
4	Eligible ITC		71,100.00

Problems for Practice

Problem No. 1

1. Purchased following material from A Traders (RD from Maharashtra) on credit, @ 3% Discount, Invoice No. 152, GST @ 12%

a. Single Line Note Book 100 pgs 1000 Qty. 27/- each

b. Single Line Note Book 200 pgs 1000 Qty. 52/- each

c. Double Line Note Book 100 pgs 1000 Qty. 29/- each

d. Double Line Note Book 200 pgs 1000 Qty. 56/- each

2. Sold following material to B Traders (RD from Karnataka) on credit, @ 3% Discount, Invoice No. 522, GST @12%

a. Single Line Note Book 100 pgs 1000 Qty. 27/- each

b. Single Line Note Book 200 pgs 1000 Qty. 52/- each

c. Double Line Note Book 100 pgs 1000 Qty. 29/- each

d. Double Line Note Book 200 pgs 1000 Qty. 56/- each

Problem No. 2

1. Purchased following material from X Traders (RD from Karnataka) on credit, @ 5% Discount, Invoice No. 2254, GST @ 18%

a. 32" LED TV 10 Qty. 8,560/- each

b. 40" LED TV 10 Qty. 16,350/- each

c. 32" Smart LED TV 10 Qty. 10,280/- each

d. 40" Smart LED TV 10 Qty. 18,940/- each

2. Sold following material to Y Traders (RD from Karnataka) on credit, @ 5% Discount, Invoice No. 6521, GST @ 18%

a. 32" LED TV 05 Qty. 9,150/- each

b. 40" LED TV 05 Qty. 16,850/- each

c. 32" Smart LED TV 05 Qty. 10900/- each

d. 40" Smart LED TV 05 Qty. 19450/- each

3. Sold following material to Z Traders (RD from Maharashtra) on credit, @ 5% Discount, Invoice No. 6522, GST @ 18%

a. 32" LED TV 05 Qty. 9,150/- each

b. 40" LED TV 05 Qty. 16,850/- each

c. 32" Smart LED TV 05 Qty. 10,900/- each

d. 40" Smart LED TV 05 Qty. 19,450/- each

4.3 Summary:

Actually, in Tally, We do not need to create a GST return. It is automatically created if we create the sales and purchase bills correctly in a proper way.

The best thing is we can start entering Purchase and Sales bills in Tally while we are in our shop, since the interface is similar to creating a sales bill and anyone can do it once we know how to do it.

There is a very low learning curve. It doesn't feel that we are creating a GST return, but just feels that we are creating a sales bill. It feels easy and simple.

4.4 Check your progress:

1. The Goods and Services Tax Act was passed in the Parliament on …………..

   a) 29^{th} March 2017 b) 1^{St} July 2017

   c) 29^{th} March 2020 d) 1^{St} July 2020

2. ………. is levied where transaction is inter-state

   a) IGST b) CGST c) SGST d) None of these

3. GSTIN number is based on ………………………

   a) PAN b) State c) PAN State d) State PAN

4. ITC stands for ………………..

   a) International Tax Credit b) Input Tax Credit

   c) Indian Tax Credit d) None of these

5. For inter-state supply following tax is applicable

   a) CGST b) IGST c) SGST d) CGST+SGST

4.5 Terms to remember

1. IGST
2. CGST
3. SGST
4. GSTIN
5. Input Tax Credit
6. GST Return

4.6 Answers to check your progress:

MCQ – (1- a, 2-a, 3-d, 4-b, 5-b)

4.7 Exercise

a) Broad Question

1. Explain GST Implementation in India

2. What is GST Taxation System in India?
3. Explain GST types of Dealer
4. Explain Input Tax Credit with Example
5. Explain the Tax Invoice

b) Shorts Notes

1. Why GST was introduced in India?
2. Explain Dual GST
3. Tax Invoice
4. Input Tax Credit Set Off
5. Structure of GST

4.8 References:

1. Vineet chouhan, Pushapkant Shakdwipee, Shagufta khan (2017) Measuring awareness about implementation of GST: "Survery of small Business owners of Rajasthan"-Pacific business Review international.
2. Rajeevchari (2017) "GST impact on service providers" impact on service providers with implementation of GST- Numberz.in
3. R.Rupa – (2017) "GST in India an overview" international education and research journal (IERJ)-E-ISSN No:2454-9916/volume-31issue:2017
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SHIVAJI UNIVERSITY, KOLHAPUR

CENTRE FOR DISTANCE EDUCATION

B. Com. Part-III

Advanced Accountancy

Semester-V : Paper-I (DSE-A1)
Semester-VI : Paper-III (DSE-A3)

(From Academic Year 2021-22 onwards)

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Preface

Accounting is a language of business to communicate financial performance of the organisation. This book intend to disseminate knowledge and skills regarding specific topics of accounting, especially for those students who have an opportunity to learn on distance mode.

This book is divided into two sections Semester-wise such as four units in Semester-V and four units in Semester-VI of B. Com. Part-III. The first section consists off units on final accounts of banking companies, farm accounting (including crop account, fishery, poultry, dairy and livestock etc.), hire purchase system, accounting for insurance claims and GST accounting with practicals using Tally Part-I, whereas the second section includes the units such as element of cost, financial statement analysis through ratio analysis, cash flow analysis and Tally with GST (Practical) Part-II.

We hope this book will be useful to students on distance mode. Though, we appeal them to refer standard reference books for additional inputs desired. We expect suggestions from all corners of the society for improvement in it in further edition.

We are thankful to Prof. (Dr.) D. T. Shirke, Hon. Vice-Chancellor; Prof. (Dr.) P. S. Patil, Hon. Pro-Vice-Chancellor; Dr. V. N. Shinde, I/c. Registrar and Dr. D. K. More, Director, Centre for Distance Education for availing us an opportunity to edit this book.

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B. Com Part-III

Semester V and VI

SIM IN ADVANCED ACCOUNTANCY PAPER I AND III

INDEX

Each Unit begins with the section 'Objectives' -

Objectives are directive and indicative of :

1. What has been presented in the Unit and
2. What is expected from you
3. What you are expected to know pertaining to the specific Unit once you have completed working on the Unit.

The self check exercises with possible answers will help you to understand the Unit in the right perspective. Go through the possible answer only after you write your answers. These exercises are not to be submitted to us for evaluation. These are provided to you as Study Tools to help keep you in the right track as you study the Unit.

Unit 1

Bank Final Accounts (Vertical Format only)

Structure of Unit :

1.0 Objectives :

After studying this unit you will be able to understand the :

- Meaning of Bank
- Scope of banking business
- Various statutory provisions of Banking Regulation Act 1949
- Method of presenting final accounts in prescribed forms

1.1 Introduction :

Bank business in India is governed by the banking Regulation Act 1949, which came into force from 16th March 1949. As per section 2 of this Act, provisions of companies Act 1956, are also applicable to Banking companies. Bank is a commercial institution, licensed to accept deposits and acts as a safe custodian of the funds of its customers, banks are mainly concerned with receiving, collection, transferring, buying, lending, investing, exchanging, servicing money and claims to money both domestically and internationally. The principal activities of a bank are operating current accounts, receiving deposits, and advancing loans.

1.2 Presentation of Subject Matter

1.2.1 Meaning and Definition of Bank :

As per section 5(b) of the Banking Regulation Act 1949, 'Banking' means the accepting, for the purpose of lending or investment, of deposits of money from the public repayable on demand or otherwise, and withdrawable by cheque, drafts, order or otherwise.

Section 5(c) of banking Regulation Act defines 'banking companies' as "any company which transacts the business of banking in India" However the definition given by the Act is too narrow. In modern world banking is not restricted merely to acceptance of deposits and lending Advances. Section 6 of the Act also recognises this fact and has accordingly laid down that in addition to the usual banking business, a banking company may carry on any additional business as specified by section 6

1.2.2 Scope of banking business :

As per the provisions of section 6 of the Banking Regulation Act, 1949 a banking company may engage in any one of the following forms of business. In addition to the banking business. These are

1) Borrowing, raising money, advancing money either upon or without security, dealing in bills of exchange, granting and issue of letter of credit, travellors cheques and circular notes, selling and dealing in bullion and specie, buying and selling of foreign exchange including foreign bank notes, dealing in stock, shares, debenture, purchasing and selling of bonds providing of safe deposit vaults, the collecting and transmitting of money and securities.

2) Acting as an agent for any Government or local authority or any other person, acting as an attorney on behalf of customers.

3) Contracting for public and private loans and negotiating and issuing the same.

4) Insuring, guaranteeing, underwriting any issue of any company, corporation or association and lending of money for the purpose of such issue.

5) Carring on and transacting every kind of guarantee and indemnity business.

6) Selling any property which is acquired in satisfaction of claims.

7) Acquiring and holding any property or right in any property against any loans connected with such security.

8) Undertaking and executing trusts.

9) Establishing and supporting any institution, funds, trusts to benefit employees or ex-employees of company.

10) The acquisition, construction, maintenance and alteration of any building for the purpose of the company.

11) Selling, leasing, mortgaging, disposing all or any property and rights of the company.

12) Doing all such other things as are incidental or conductive to the promotion or advancement of the business of the company.

13) Any other form of business which the Central Government may, by notification in the Official Gazette, specify as a form of business.

Restriction on Bank Business -

As per section 8 of the Banking Regulation Act 1949, certain restrictions are laid down on the business of banking company These are-

a) No banking company shall directly or indirectly deal in the buying, selling or bartering of goods, except in connection with the realisation of security given to or held by it.

b) No banking company can engage in any trade or buy, sell or barter goods for others otherwise than in connection with bill of exchange, received for collection or negotiation or with such of its business.

1.2.3 Statutory provisions of Banking Regulations Act :

1) Minimum Capital and Reserves

As per the section of 11 (2) of the Banking Regulation Act 1949, the aggregate value of paid up capital and reserves of a banking company in corporate outside India, shall not be less than 15 lakhs rupees, and it has a place of business in city of Mumbai or Calcutta, then it shall not be less than 20 lakhs rupees. It should be noted that such sum and 20% of the net profit of each year shall be kept deposited with Reserve. Bank of India is cash or in the form of men cumbered approved securities, or partly in cash and partly in the form of such securities.

However in case of a banking company which is incorporated in India, the aggregate value of capital and reserves shall not be less than the stated amount according to place of business.

2) Restriction on commission, Brokerage etc. :

No banking company shall pay out directly or indirectly by way of commission, brokerage in any form in respect of shares issued by it, any amount exceeding 2.5% of paid up value of shares.

3) Statutory Reserve :

According to section 17 of the banking Regulation Act, 1949, every banking company incorporated in India shall create a reserve and transfer to it at least 20% of its annual profit before any dividend is declared.

4) Cash Reserve :

Every banking company not being a schedule bank, has to maintain a cash reserve of at least 3% of the total of its demand and time liabilities in India, as on last Friday of the Second proceeding fortnight.

5) Restrictions on loans and advances :-

No banking company shall,

i) grant any loans or advances on the security of its own shares.

ii) grant any loan or advances to any of its directors, or any of the firm in which any of its director is interested as partner, employee or manager.

6) Restriction on Payment of Dividend :

No banking company shall pay any dividend on its shares until all its capitalized expenses have been completely written off.

7) Books of Accounts :

Bank has to adopt a specialized system of book-keeping which will ensure dimidiated entry of numerous transactions and keep an internal check on the books of accounts. For this, bank generally maintain a large number of subsidiary and memorandum books in addition to principal books of accounts.

Principal books of accounts :

Cash book and general ledger are the principal books of accounts of any bank. Cash book records all cash transactions and general ledger contains control accounts of all subsidiary ledgers and different assets and liabilities account.

8) Final Accounts :

According to section 29 of the Banking Regulation Act, 1949, every banking company is required to prepare with reference to that year a balance sheet and profit and loss account on the last working day of the year in the Form 'A' and Form 'B' respectively as given in schedule III

1.2.4 Form of Balance Sheet (Vertical)

Third Schedule

(Section - 29)

Form 'A'

Form of Balance Sheet

Balance Sheet of .... Bank

as on 31-3-………

Particulars	Schedule No.	Current Year	Previous Year
Capital and Liabilities			
Capital	1		
Reserve and Surplus	2		
Deposits	3		

Borrowings	4		
Other liabilities and provisions	5		
Total			
Assets			
Cash in hand and Balance with R.B.I.	6		
Balance with other banks, money at call	7		
Investments	8		
Advances	9		
Fixed Assets	10		
Other Assets	11		
Total			
Contingent Liabilities	12		
Bills for collection			

1) **Capital :** It is a first item of Liabilities. It's details are given in schedule-1. Which contain authorized capital, issued, subscribed, called up and paid up capital.

2) **Reserves and Surplus** : It includes statutory reserves, capital reserves, share premium, profit and loss account balance. The details of this are given in schedule No. 2

3) **Deposits** : It contains demand deposits, saving bank deposits / accounts, term deposits. The details are given in schedule No. 3

4) **Borrowings** : It includes borrowings from Reserve Bank of India, borrowing from other banks and institutions and agencies. The details about it are given in schedule No. 4

5) **Other liabilities and provisions** : It includes Bills payables, Branch Office / interoffice adjustment credit balance, interest outstanding / accrued on deposits, provision for taxations, Rebate on bills discounted etc. and shown in schedule No. 5

6) **Cash in hand and balance with R.B.I.** - It includes cash in hand including foreign currency notes, and balance with Reserve Bank of India. Details are given in Schedule No. 6

7) **Balance with other banks, Money at call and short notice -** It contains balance with other banks, money at call and short notice. These are shown in schedule No. 7

8) **Investments** - Investment in Government securities, other approved securities, investment in shares / debentures and bonds, gold are shown under this heading. The details are given in schedule No. 8

9) **Advances** - It gives details about loans and advances granted by bank. It includes loans cash credit and overdraft, Term loans, bills purchased and discounted. The details are given in schedule No. 9

10) **Fixed Assets** - Premises, Furniture and Fixtures and other fixed assets are shown under this head. The details are given in schedule No. 10.

11) **Other Assets** - It includes advance taxes, stationery and stamps on hand, Branch adjustment (Dr. bal.), Interest accrued on advances, non banking assets etc. Details are given in schedule No. 11

12) **Contingent Liabilities** - It indicate the liabilities which are not provided in Balance Sheet. It includes liabilities on partly paid shares, claims against bank not acknowledged as debts; acceptances endorsement and other obligations etc. Details are given in schedule No. 12

13) **Bills for collection** - It includes bills receivables received on behalf of customers for collection. These are shown outside the Balance Sheet.

1.2.5 Form of Profit and Loss Account (Vertical)

Form 'B'

Form of Profit and Loss Account

For the year ended on 31-3-…………….

Particulars	**Schedule No.**	**Current Year**	**Previous Year**
I. Income			
Interest earned	13		
Other Income	14		
Total			

II. Expenditure Interest expended Operating expenses Provisions and Contingencies	15		
Total			
III. Profit/Loss Profit/Loss brought forward (op. bal) Net profit/loss for current year			
Total			
IV. Appropriations 20% transfer to Statutory Reserve Transfer to other reserves Proposed Dividend/Interim Dividend Balance carried over to Balance Sheet			
Total			

I) Income : It includes interest earned or discount received by bank on advances or bills discounted, income on Investments, Interest on balance with R.B.I, etc. It is shown under schedule-13

Other Income : Includes commission exchange and brokerage, profit on sale of investments, profit on revelation of assets, Dividend from subsidiaries. These are shown in schedule No. 14.

II) Expenditure : These are shown under three different heads viz. interest expended, operating expenses and provisions. Interest expended includes interest paid by bank on deposits and borrowings. It is shown under schedule No. 15. Operating Expenses of bank such as salaries and allowances to staff and officers, Rent taxes rates, printing & stationery, Advertisement, depreciations on bank property etc. are shown under schedule -16, Provisions include provision made for dorebuttul debts, tax provisions and other contingencies.

III) Profit / Loss : It shows the profit or loss balance of last year and current year Net Profit (i.e. difference between Income and expenditures)

IV) Appropriations : Amount transferred to statutory reserve and other reserves, proposed dividends are shown under this heading.

1.2.6 Various Schedules :

Schedule No. 1 – **Capital**

Particulars	**Current Year**	**Previous Year**
Authorised Capital		
.... shares of Rs. .... each	....	
Issued Capital		
.... shares of Rs. .... each	....	
Subscribed Capital		
.... shares of Rs. .... each	....	
Called up capital		
.... shares of Rs. .... each		
Less : Calls in arrears		
Add : fortified shares	....	
Total		

Schedule No. 2 - **Reserves & Surplus**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
I. Statutory Reserves		
Opening Balance		
Additions during the year		
Deductions during the year		
II. Capital Reserves		
Opening Balance		
Additions during the year		
Deductions during the year		
III. Shares Premium		
Opening Balance		

Additions during the year		
Deductions during the year		
IV. Revenue and other Reserves		
Opening Balance		
Additions during the year		
Deductions during the year		
V. Balance in Profit and Loss Accounts		
Total (I + II + III + IV + V)		

Schedule No. 3 – **Deposits**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
A. I. Demand Deposits		
(i) From banks		
(ii) From others		
II. Savings Bank Deposits		
III. Term Deposits		
(i) From banks		
(ii) From others Total		
(I + II + III)		
B. (i) Deposits of branches in India		
(ii) Deposits of branches outside India		
Total		

Schedule No. 4 – **Borrowings**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
I. Borrowings in India		
(i) Reserve Bank of India		
(ii) Other banks		
(iii) Other institutions and agencies		

II. Borrowing outsides India		
Total (I + II)		
Secured borrowings included in I & II above Rs.		

Schedule No. 5 - **Other Liabilities and Provisions**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
I. Bills payable II. Inter-office adjustments (net). (cr.) III. Interest accrued IV. Others (including provisions)		
Total		

Schedule No. 6 - **Cash & Balances with Reserve Bank of India**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
Cash in hand (including foreign currency notes) **Balances with RBI** (i) in Current Account (ii) in Other Accounts		
Total (I + II)		

Schedule No. 7 **- Balances with Banks & Money at call & short Notice**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
India I. Balances with banks (a) In Current Accounts (b) In other Deposit Acocunts II. Money at Call and Short Notice		

(a) With banks		
(b) With other institutions		
Total		
Outside India		
(i) In Current Accounts		
(ii) In other Deposit Accounts		
(iii) Money at Call and Short Notice		
Total		
Grand Total (I + II)		

Schedule No. 8 – **Investments**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
I. Investments in India in		
(i) Government securities		
(ii) Other approved securities		
(iii) Shares		
(iv) Debentures and Bonds		
(v) Subsidiaries and/or joint ventures		
(vi) Others (to be specified)		
Total		
II. Investments outside India in		
(i) Government securities (including local authorities)		
(ii) Subsidiaries and/or joint ventures abroad		
(iii) Other investments (to be specified)		
Total Grand Total (I + II)		

Schedule No. 9 – **Advances**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
i) Bills purchased and discounted		
ii) Cash credits, overdrafts and loans repayable on demand		
iii) Term loans		
Total		
i) Secured by tangible assets		
ii) Covered by Bank/Government guarantees		
iii) Unsecured		
Total		
C. I. Advances in India		
(i) Priority Sectors		
(ii) Public Sector		
(iii) Banks		
(iv) Others		
II. Advances Outside India		
(i) Due from banks		
(ii) Due from others		
(a) Bills purchased and discounted		
(b) Syndicated loans		
(c) Others		
Total		
Grand Total (C. I. + C. II)		

Schedule No. 10 - **Fixed Assets**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
I. Premises		
At cost an on 31st March of the preceding		

year Additions during the year Deductions during the year Depreciation to date **II. Other Fixed Assets** (Including furniture & fixtures) At cost as on 31st March of the preceding year Additions during the year Deductions during the year Depreciation to date		
Total (I + II)		

Schedule No. 11 - **Other Assets**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
I. Inter-office adjustment (net) II. Interest accrued III. Tax paid in advance/tax deducted at source IV. Stationery and stamps V. Non-banking assets acquired in satisfaction of claims VI. Others.		
Total		

Schedule No. 12 - **Contingent Liabilities**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
I. Claims against the bank not acknowledged as debts II. Liability for partly paid investments III. Liability on account of outstanding forward		

exchange contracts.		
IV. Guarantees given on behalf of constituents		
(a) In India		
(b) Outside India		
V. Acceptances, endorsements and other obligations		
VI. Other items for which the bank is contingently liable		
Total		

Schedule No. 13 – **Interest Earned**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
Interest/discount on advances/bills		
Income on investments		
Interest on balances with		
Reserve Bank of India and		
Other inter-bank funds		
Others		
Total		

Schedule No. 14 – **Other Income**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
Commission, exchange and brokerage		
Profit on sale investments		
Less : **Loss on sale of investments**		
Profit on revaluation of investments		
Less : **Loss on revaluation of investments**		
Profit on sale of Land, Building and other assets		
Less : **Loss on sale of land, Building and other assets**		

Profit on exchange transactions Less : **Loss on exchange transactions** Income earned by way of dividends etc. From subsidiaries/companies and/or Joint ventures abroad/in India Miscellaneous Income		

Schedule No. 15 **- Interest Expended**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
Interest on deposits Interest on Reserve Bank of India/ Inter – bank borrowings others		
Total		

Schedule No. 16 **- Operating Expenses**

Particulars	**As on 31-3-.... (Current Year)**	**Previous Year**
I. Payment to and provisions for employees II. Rent, taxes and lighting III. Printing & Stationery IV. Advertisement & Publicity V. Depreciation on bank's property VI. Directors fees, allowances and expenses VII. Auditors fees and expenses (including branch auditors fees and expenses) VIII. Law charges IX. Postages, telegrams, telephones etc. X. Repairs and maintenance XI. Insurance XII. Other expenditure		
Total		

1.2.7 R.B.I. Guidelines for Compilation of Financial Statement

Item	Schedule	Coverage	Notes and Instructions for compilation
(1)	(2)	(3)	(4)
Capital	1.	**Nationalized Banks** Capital (fully owned by Central Government)	The capital owned by Central Government as on the date of the Balance Sheet, including contribution from Government if any, for participating in World Bank Projects, should be shown,
		Banking Companies incorporated outside India.	(i) The amount brought in by banks way of start-up capital as prescribed by RBI, should be shown under this head. (ii) The amount or deposits kept with RBI under subsection 2 of Section 11 of the Banking Regulation Act, 1949 should also be shown.
		Other Banks (Indian) Authorised capital (... Shares of Rs.... each) Issued Capital (... Shares of Rs. ... each) Subscribed Capital (........... Shares of Rs. .... each) Called-up Capital (............ Shares of Rs............ each) *Less :* **Calls unpaid** *Add :* **Forfeited** *Shares* **: Paid-up Capital**	Authorised, Issued, Subscribed. Called-up Capitals should be given separately. Calls-in-arrears will be deducted from Called-up Capital while the paid-up value of forfeited shares should be added, thus arriving at the paid-up capital, the necessary items which can be combined should be shown under one head, for instance, "Issued and Subscribed capital". **Notes**: General The changes in the above items, if any, during the years, say fresh contribution made by the Government, fresh issue of capital, capitalisation of reserves, etc. may be explained in the notes.

Reserve and Surplus	2	**(I) Statutory Reserves**	Reserves created in terms of Section 17 or another section of Banking regulation Act, must be separately disclosed.
		(II) Capital Reserves	The expression 'capital reserve' shall not include any amount regarded as free for distribution through the Profit and Loss Account. Surplus on revaluation should be treated as Capital Reserve. Surplus on translation of the financial statements of foreign branches (which includes fixed assets also) is of a revaluation reserve.
		(III) Share Premium	Premium on issue of share capital may be shown separately under this head.
		(IV) Revenue and other Reserves	The expression 'Revenue Reserve' shall mean any reserve other than capital reserve. This item will include all reserves, other than those separately classified. This expression 'reserve' shall not include any amount, written-off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability.
		(V) Balance of Profit	Includes balance of profit after appropriation. In case of loss the balance may be shown as a deduction. **Notes**: General Movement in various categories of reserves should be shown as indicated in the schedule.
Reserve and Surplus	3	**A. (I) Demand Deposits** (i) from banks (ii) from others	Includes all bank deposits repayable on demand. Includes all demand deposits of the non-banking sectors. Credit balance in overdrafts, cash

		(II) Saving Bank Deposits	credit accounts, deposits payable at call, overdue deposits, inoperative current accounts, matured time deposits and cash certificates, certificate of deposits, etc. are to be included under this category. Includes all savings bank deposits (including inoperative savings bank accounts) Includes all types of bank deposits repayable after specified term.
		(III) Term Deposits (i) from banks (ii) from others	Includes all types of deposits of the non-banking sector, repayable after a specified term. Fixed deposits, cumulative and recurring deposits, annuity deposits, deposits mobilised under various schemes, ordinary staff deposits, foreign currency non-resident deposit accounts, etc., are to be included under this category.
		B. (i) Deposits of branches in India **(ii) Deposits of branches outside India**	The total of these two items will agree with the total deposits. **Notes :** General (a) Interest payable on deposits which is accrued but not due should but be included but shown under other liabilities. (b) Matured time deposits and cash certificates, etc., should be treated as demand deposits. (c) Deposits under special schemes should be included under the term deposits, if they are not payable on demand. When such deposits have matured for payment they should be shown under demand deposits. (d) Deposits from banks will include deposits from the banking system in

			India, co-operative banks, foreign banks, which may or may not have presence in India.
Borrowings	4	**(I) Borrowings in India** (i) Reserve Bank of India (ii) Other Banks (iii) Outside Institutions and agencies **(II) Borrowings outside India** Secured borrowings included above	Includes borrowing / refinance obtained from Reserve Bank of India. Includes borrowings / refinance obtained from -commercial banks (including co-operative banks). Includes borrowings / refinance obtained from Industrial Development Bank of India, Export-Import of Bank of India, National Bank for Agriculture and Rural Development and other institutions, agencies (including liability against participation certificates, if any). Includes borrowings of Indian branches abroad as well as borrowing of foreign branches. This item will be shown separately. Includes secured borrowings/refinance in India and outside India. Notes: General (i) The total of I and II will agree with the total borrowings shown in the Balance Sheet. (ii) Inter-office transactions should not be shown as borrowings. (iii) Funds raised by foreign branches by way of certificates of deposits, notes, bonds, etc., should be classified depending upon documentation, as ‘deposits’, ‘borrowings’, etc. (iv) Refinance obtained by banks from Reserve Bank of India and

			various institutions arc being brought under the head 'Borrowings'. Hence, advances will be shown at the gross amount on the assets side.
Borrowings	5	I. Bills Payable	Includes drafts telegraphic transfers, traveler cheques, mail transfers payable, pay slips, bankers cheques and other miscellaneous items.
		II. Inter-office Adjustments	The inter-office adjustments balance, if the credit, should be shown under this head. Only net position of inter-office accounts, inland as well as foreign, should be shown here.
		III. Interest Accrued	Includes interest accrued but not due on deposits and borrowings.
		IV. Others (including provisions)	Includes net provision for income tax and other taxes like interest tax (less advance payment, tax deducted at source etc.,) surplus in aggregate in provisions for Bad Debts Provision Account, surplus in aggregate in provisions for depreciation in securities, contingency funds which are not disclosed as reserves but arc actually in the nature of reserves but are actually in the nature of reserves, proposed dividend/transfer to Government, other liabilities which arc not disclosed under any of the major heads such as unclaimed dividend, provisions and funds kept for specific purpose, unexpired discount, outstanding charges like rent, conveyance, etc. Certain types of deposits like staff security deposits margin deposits etc., where the repayment is not free, should also

			be included under this head. **Notes :** General (i) For arriving at the net balance of inter-office adjustments all connected inter-office accounts should be aggregated and the net balance should only be shown, representing mostly items in transit and unadjusted items. (ii) the interest accruing on all deposits, whether the payment is due or not, should be treated as a liability. (iii) it is proposed to show only pure deposits under the head deposits; and hence, all surplus provisions for bad and doubtful debts, contingency funds, secret reserves, etc. which are not netted off against the relative assets, should be brought under the head 'others' (including provisions).
Cash and Balance with the Reserve Bank of India	6.	**I. Cash in hand** (including foreign currency notes) II. Balance with RBI (i) in Current Account (ii) in Other Accounts	Includes cash in hand, including foreign currency notes and also of foreign branches in the case of banks having such branches.
Balance with banks and money at call and short notice	7.	**I. In India** (i) Balance with Banks (a) in current accounts (b) in other deposit accounts	Includes all balance with banks in India (including co-operative banks). Balance in current accounts and deposit accounts should be shown separately.
		(ii) Money at call and short notice (a) with banks (b) with other	Includes deposits repayable within 15 days notice, lent in the inter-bank call money market.

		institutions	
		II. Outside India (i) Current accounts (ii) Deposits (iii) Money at call and short notice	Includes balances held by foreign branches and balances held by Indian branches of the banks outside India. Balance held with foreign branches by other branches of the bank, should not he shown under this head but should be included in the inter-branch accounts. The amounts held in current accounts' and 'deposit accounts should be shown separately. Includes deposits usually classified in foreign currencies as money at call and short notice.
Investment	8.	**I. Investment in India** (i) Government Securities	Includes Central and State Government securities and Government treasury bills. These securities should be at the book value. However, the difference between the book value and market value should be given in the notes to the Balance Sheet.
		(ii) Other approved securities	Securities other than Government securities, which according to the Banking regulation Act 1949, are treated as approved securities, should be included here.
		(iii) Shares	Investment in shares of companies and corporation not included in item (ii) should be included here.
		(iv) Debentures and Bonds	Investments in debentures and bonds of Companies, Corporations not included in item (ii) should be included here.
		(v) Investments in subsidiaries/Joint ventures	Investment in subsidiary/joint ventures (including R.R.Bs) should be in included here.
		(vi) Others	Includes general investments, if any,

			kike gold, commercial paper and other instruments in the nature of shares / debentures / bonds.
		II. Investment Outside India (i) Government securities (including loal authorities) (ii) Subsidiaries and/or joint ventures abroad (iii) Others	All foreign Government securities issued by local authorities may be classified under this head. All investments made in the share capital of subsidiaries, floated outside India and/or joint ventures abroad, should be classified under this head. All other investments outside India by shown under this head.
Advances	9	**A.** (i) Bills purchased and Discounted (ii) Cash credits, overdrafts and loans repayable on demand (iii) Term loans	In classification under Section 'A', all outstanding in India as well as outside-less provisions made, will be classified under three heads as indicated, and both secured and unsecured advances will be included under these heads, including overdue installments.
		B. (i) Secured by tangible assets	All advances or part of advances which are secured by tangible asseta may be shown here. The item will include advances in India and outside India.
		(ii) Covered by Bank/Government Guarantee	Advances in India and outside India to the extent they are covered by guarantees of Indian and foreign governments and Indian and foreign banks and DICGS & ECGC are to be included.
		(iii) Unsecured	All advances not classified under (i) and (ii) will be included here, total of

			'A' should tally with the total of 'B'.
		C. I. Advances in India (i) Priority sectors (ii) Public sectors (iii) Banks (iv) Others	Advances should be broadly classified into 'Advances in India' and 'Advances outside India'. Advances in India will be further classified on the sectorial basis as indicated.
		II. Advances Outside India (i) Due form banks (ii) Due from others (a) Bills purchased and discounted (b) Syndicated loans (c) Others	Advances to sectors which for the time being are classified as priority sectors according to the instructions of the Reserve Bank are to be classified under the head 'Priority sectors'. Such advances should be excluded from the item (ii) i.e., advance to public sector. Advances to Central and State Governments and other Government undertakings including Government companies and corporations, which are, according to the statutes, to be treated as Public sectors companies are to be included in the category 'Public sectors companies are to be included in the category 'Public sector'. All advances to the banking sector including co-operative banks, will come under the dead 'Banks'. All the remaining advances will be included under the head. 'Others' and typically this category will include non-priority advances to the private, joint and co-operative sectors. Notes: general (i) The gross amount of advances including refinance and rediscounts but excluding provisions made to the satisfaction of auditors, should be

			shown as advances. (ii) Term loans will be loans not repayable on demand. (iii) Consortium advances would be shown net of share from other participating banks/institutions.
Fixed Assets	10	**I. Premises** (i) At cost as on 31st March of the preceding year (ii) Addition during the year (iii) Deductions during the year (iv) Depreciation to due	Premises wholly or partly owned by the banking company for the purpose of business, including residential premises should be shown against 'premises'. In the case of premises and other fixed assets, the previous balance, additions thereto, deductions there from, during the year, and also the total depreciation written-off should be shown. Where sums have been written-off on reduction of capital and revaluation of assets. every Balance Sheet after the first Balance Sheet, subsequent to the reduction or revaluation should show the revised figures for a period of five years, with the date and amount of revision made.
		II. Other Fixed Assets (including furniture and fixtures) (i) At cost on 31st March of the preceding year (ii) Additions during the year (iii) Deductions during the year (iv) Depreciation to date	Motor vehicles and all other fixed assets other than premises but including furniture and fixtures should be shown under this head.
Other Assets	11	I. Inter-office Adjustment (net)	The inter-office adjustment balance, if in debit, should be shown under this head. Only net position of inter-

			office accounts inland as well as foreign, should be shown here. For arriving at the net balance of inter-office adjustment accounts all connected inter-office accounts should be aggregated and the net balance, if in debit, only should be shown, representing mostly items in transit and unadjusted items.
		II. Interest Accured	Interest accrued but not due on investments and, advance and interest due but not collected on investment, will be the main components of this item. As banks normally debit, the borrowers' accounts with interest due on the balance sheet date, usually there may not be any account of interest due on advances. Only such interest as can be realised in the ordinary course should be shown under this head.
		III. Tax paid in advance/tax deducted at source	The amount of tax deducted at source on securities, advance tax paid etc. to the extent that these items are not set off against relative tax provision should be shown against this item.
		IV. Stationery and Stamps	Only exceptional items of expenditure on stationery like bulk purchase of security paper, loose leaf or other ledgers, etc. which are shown as quasi-asset to be written-off over a period of time, should be shown here. The value should be on a realistic basis and cost escalation should not be taken into account, as these items are for internal use.
		V. Non-banking assets acquired in	Immovable properties/tangible assets acquired in satisfaction of claims are

		satisfaction of claims	to be shown under this head.
		VI. Others	This will include items like claims which have not been met for instance, clearing items, debit items representing addition to assets or reduction in liabilities, which have not been adjustment for technical reasons, want of particulars, etc. advances given to staff by a bank as an employer and not as a banker, etc. Items which are in the nature of expenses, which are pending adjustments, should be provided for and the provision netted against this item, so that only realisable value is shown under this head. Accrued income other than interest may also be included here.
Contingent Liabilities	12	I. Claims against the bank not acknowledged as debts	
		II. Liabilities for partly paid Investments	Liabilities on partly paid shares, debentures, etc. will be included in this head.
		III. Liabilities on account of outstanding forward exchange contracts	Outstanding forward exchange contracts may be included here.
		IV. Guarantees given on behalf of constituents (i) in India (ii) outside India	Guarantees given for constituents in India and outside India may be shown separately.
		V. Acceptances, endorsement and other obligations	This item will include letters of credit and bills accepted by the bank on behalf of customers.
Bill for		**VI. Other items for which the Bank is**	Arrears of cumulative dividends,

Collection		**contingently liable**	bills rediscounted under under-writing contracts, estimated amounts of contracts remaining to be executed on Capital Account and riot provided for, etc., are to be included here. Bills and other items in the course of collection and not adjusted will be shown against this item in summary version only, a separate schedule is proposed.
Profit and Loss Account			
Interest earned	13	I. Interest/discount on advances bills	Includes interest and discount on all types of loans and advances, cash credit, demand loans, overdrafts, export loans, term loans, domestic and foreign bills purchased and discounted (including those rediscounted), over interest and also interest subsidy, if any, relating to advances/bills.
		II. Income on investments	Includes all income derived from the investment portion folio by way of interest and dividend.
		III. Interest on balances with the Reserve Bank of India and other inter-bank fund	Includes interest on balances with Reserve Bank and other banks, call loans, money market placements, etc.
		IV. Others	Includes any other interest / discount income not included in the above heads.
Other Income	14	I. Commission, exchange and Brokerage	Includes all remuneration on services such as commission on collections, commission/exchanges on remittances and transfers, commission on letters of credit, letting out of lockers and guarantees,

			commission on Government business, commission on other permitted agency business including consultancy and other services, brokerage, etc., on securities. It does not include foreign exchange income.
		II. Profit on sale of investments, *Less* : Loss on sale of investments III. Profit on revaluation of investments. *Less* : Loss on revaluation of investments. IV. Profit on sale of land, buildings and other assets. *Less* : Loss on sale of land, buildings and other assets	Includes profit/loss on sale of securities, furniture, land and buildings, motor vehicle, gold, silver, etc. Only the net position should be shown. If the net position is a loss, the amount should be shown as a deduction. The net profit/loss on revaluation of assets may also be shown under this item.
		V. Profit on exchange Transactions. *Less* : Loss on sale of land, buildings and other assets.	Includes profit/loss on dealing in foreign exchange, all income earned by way of foreign exchange, commission and charges on foreign exchange transactions excluding interest which will be shown under interest. Only the net position should be shown. If the net position is a loss, it is to be shown as a deduction.
		VI. Income earned by way of dividends etc., from subsidiaries, companies, joint ventures abroad/in India.	

		VII. Miscellaneous income	Includes recoveries from constituents for godown rents, income from bank's properties, security charges, insurance, etc., and any other miscellaneous income. In case, any item under this head exceeds one percentage of the total income, particulars may be given in the notes.
Interest Expended	15	I. Interest on deposits	Includes interest paid on all types of deposits including deposits from banks and other institutions.
		II. Interest on Reserve Bank of India / Inter-bank borrowings	Includes discount/interest on all borrowings and refinance from the Reserve Bank of India and other banks.
		III. Others	Includes discount / interest on all borrowings / refinance from financial institutions. All other payments like interest on participation certificates, penal interest paid, etc. may also be included here.
Operating Expenses	16	I. Payments to and provisions for employees	Includes staff salaries/wages, allowances, bonus, and other staff benefits, like provident fund, pension, gratuity, live ness to staff, leave fare concessions, staff welfare, medical allowance to staff, etc.
		II. Rent, taxes and lighting	Includes rent paid by the banks on buildings and other municipal and other taxes paid (excluding income-tax and interest tax) electricity and other similar charges and levies, House rent allowance and other similar payments to staff should appear under the head 'Payments to and Provisions for Employees'

		III. Printing and Stationery	Includes books and forms, and stationery used by the bank and other printing charges, which are not incurred by way of publicity expenditure.
		IV. Advertisement and Publicity	Includes expenditure incurred by the bank for advertisement and publicity purposes including printing charges or publicity matter.
		V. Depreciation on Bank's property	Includes depreciation on bank's own property, motor cars and other vehicles, furniture, electric fittings, vaults, lifts, lease hold properties, non-banking assets, etc.
		VI. Director's fees, allowances and expenses	Includes sitting fees and all other items of expenditure incurred on behalf of the directors. The daily allowance, hotel charges, conveyance charges, etc. which though in the nature of reimbursement of expenses incurred, may be included under this head. Similar expenses of Local Committee members may also be included under this head.
		VII. Auditor's fees and expenses (including branch auditor's fees and expenses)	Includes the fees paid to the statutory auditors and branch auditors for the professional services rendered and also all expenses for performing their duties, even though they may be in the nature of reimbursement of expenses. If external auditors have been appointed by the banks themselves for internal inspections and audits and other services. the expenses incurred in that context including fees may not be included

			under this head but should be shown under 'other expenditure'
		VIII. Law charges	All legal expenses and reimbursement of expenses incurred in connection with legal services arc to be included here.
		X. Postage, telegraphs, telephones, etc.	Includes all postal charges like stamps, telegrams, telephones, etc.
		XI. Repairs and maintenance	Includes repairs to bank's property, their maintenance charges, etc.
		XII. Insurance	Includes insurance charges on bank's property, insurance premier paid to Deposit Insurance and Credit Guarantee Corporation, etc. to the extent they are not recovered from the concerned parties.
		XIII. Other expenditure	All expenses other than those not included in any of the other heads, like, licence fees, donations, dubscriptions to papers, periodicals, entertainment expenses, travel expenses, etc. may be included under this head. In case, any particular item under this head exceeds one percentage of the total income, the particulars may be given in the notes.
Provisions and contin-gencies			Includes all provisions made for bad and doubtful debts, provisions for taxation, provisions for diminution in the value of investments, transfers to contingencies and other similar items.

Disclosure of Accounting Policies

In order that the financial position of banks represent a true and fair view, the Reserve Bank of has directed the banks to disclose accounting policies regarding the key areas of operations along with the notes of account in their financial statements for the accounting year ending 31-3-1991 and onwards, on a regular basis. The accounting policies disclosed may contain the following aspects subject to reflection by individual banks:

1. General :

The accompanying financial statements have been prepared on the historical cost and conform to the statutory provisions and practices prevailing in the country.

2. Transactions involving Foreign Exchange :

a) Monetary assets and liabilities have been translated at the exchange rates, prevailing at the close of the year. Non-monetary assets have been carried in the books at the historical cost.

b) Income and expenditure items in respect of Indian branches have been translated at the exchange rates, ruling on the date of the transaction and in respect of overseas branches at the exchange rates prevailing at the close of the year.

c) Profit or loss on pending forward contracts have been accounted for.

3. Investments :

a) Investment in governments and other approved securities in India are valued at the lower of cost or market value.

b) Investments in subsidiary companies and associate (i.e. companies in which the bank holds at least 25 percent of the share capital) have been accounted for on the historical cost basis.

c) All other investments are valued at the lower of cost or market value.

4. Advances :

a) Provisions for doubtful advances have been made to the satisfaction of the auditors:

i) In respect of identified advances, based on a periodic review of advances and after taking into account the portion of advance guaranteed by the Deposit Insurance and Credit Guarantee Corporation, the Export Credit and Guarantee Corporation and similar statutory bodies;

ii) In respect of general advances, as a percentage of total advances taking into account the guidelines issued by the Government of India and the Reserve Bank of India.

b) Provisions in respect of doubtful advances have been deducted from the advances to the extent necessary and the excess have been included under "Other Liabilities and Provisions".

c) Provision have been made on a gross basis. Tax relief, which will be available when the advance is written-off, will be accounted for in the year of write-off.

5. Fixed Assets :

a) Premises and other fixed assets have been accounted for at their historical cost. Premises which have been revalued are accounted for at the value determined on the basis of such revaluation made by the professional values, profit arising on revaluation has been credited to Capital Reserve.

b) Depreciation has been provided for on the straight line/diminishing balance method.

c) In respect of revalued assets, depreciation is provided for on the revalued figures and an amount equal to the additional depreciation consequent of revaluation is transferred annually from the Capital Reserve to the General Reserve / Profit and Loss Account.

6. Staff Benefits :

Provision for gratuity pension benefits to staff have been made on an accrual casual basis. Separate funds for gratuity / pension have been created.

7. Net Profit :

a) the net profit disclosed in the Profit and Loss Account in after:

i) provisions for taxes on income, in accordance with the statutory requirements,

ii) provisions for doubtful advances.

iii) adjustments to the value of "current investments" in government and other approved securities in India, valued at lower of cost of market value,

iv) transfers to contingency funds.

v) other usual or necessary provisions.

b) Contingency funds have teen grouped in the Balance Sheet under the head "Other Liabilities and Provisions".

Some Special Transactions

Interest on Doubtful Debts

When a debt is found to be doubtful at the end of the accounting year, a question may arise whether the interest on that should be credited to interest Account or not. There is no doubt that interest has accrued; but It is equally clear that the realization of this interest is doubtful. Therefore, as prudent accounting policy, such interest should be transferred to Interest Suspense Account.

1.2.8 Important Adjustments/items and their effects in Bank Final Accounts:

1) Depreciation on bank property :

If it is asked to charge on original cost but written down value of asset is given then add amount of depreciation to the W.D.V. for getting original cost of asset.

a) Show the asset at its original cost in schedule No. 10 and deduct the total amount of depreciation from original cost.

b) Show the amount of depreciation of current year in operating expenses schedule No. 16

2) Rebate on bills discounted / Unexpired discount :

If it is given in trial balance - show in Schedule No. 5 if it is given for adjustment:-

a) Deduct the amount of rebate from Interest and discount in Schedule No. 13

b) Show the amount of rebate in other liabilities and provisions in Schedule No. 5

If it is overvalued then deduct from rebate amount and add in interest and discount in Schedule No. 13

If it is under - valued then add the amount in rebate and deduct from the interest and discount in Schedule-13

3) Provision for bad and doubtful debts :

Deduct the amount of provision from loans, cash credit and overdrafts in Schedule No. 9 and put the amount of provision in P & LA/c under the head provision

4) Provision for Taxation :

Show the amount of provision for tax in profit & loss account (Form 'B') under provision or other provisions and show the same amount of Provision in Schedule No. 5 (other Liab. and Provisions)

5) Statutory Reserve :

To transfer to statutory reserve is a statutory provision and hence not clearly stated in adjustments: Therefore every year transfer 20% of current years profit to statutory reserve.

Firstly add in statutory reserve in Schedule No. 2 and then show in appropriations (P & L A/c)

6) Acceptances, Endorsements on behalf of Customers :

It is a contingent liability and not actual liability hence it is shown only in Schedule No. 12 as it has no effect on tally of Balance Sheet.

7) Bills for Collection :

These are bill send by customers to bank for collection. These are not asset or liabilities of bank. Bank is just acting as an agent in this regard. It is shown outside the Balance Sheet just below the contingent liability.

8) Gold/Silver :

Gold is shown in Schedule NO. 8 (Investment) while silver is shown in Schedule No. 11 (Other Assets)

9) Accrued Interest on investment-

If it is given in trial balance, show it in Schedule No. 11 (Other Assets)

If it is given for adjustment then show in Schedule No. 13 and Schedule No. 11

1.2.9 Illustrative Examples on Bank Final Accounts

Illustration - I

1. From the following balances extracted from the books of Tushar Bank Ltd., Akola, prepare the Profit and Loss Account for the year ended 31st March 2021 and the Balance Sheet as on that date.

Particulars	Rs.
Current accounts	1,60,00,000
Savings Accounts	60,00,000
Fixed and time deposits	19,00,000
Acceptances	4,00,000
Unclaimed dividend	60,000
Dividend 2013-2020	1,00,000
Profit and Loss A/c (Credit) on 1-4-2021	4,20,000
Reserve fund	7,00,000
Share Capital : 20,000 shares of Rs. 50 each	10,00,000
Interest and discount received	15,00,000
Interest paid	4,00,000
Borrowings from other banks	14,00,000
Money at call	6,00,000
Investments (Market value Rs. 62,00,000)	60,00,000
Premises	24,00,000
(After depreciation upto 31-3-2020 Rs. 2,00,000)	
Sundry creditors	60,000
Bills payable	16,00,000
Bills for collection	2,80,000
Salaries	1,60,000
Rent and taxes	40,000
Audit fee	4,000

Printing	10,000
General expenses	6,000
Cash in hand	1,20,000
Cash with R.B.I.	30,00,000
Cash with other banks	26,00,000
Bills discounted and purchased	12,00,000
Loans, overdrafts and cash credits	1,40,00,000

Adjustments :

1) Authorised share capital is Rs. 20,00,000 divided into 40,000 shares of Rs. 50 each.
2) Rebate on bills discounted amounted to Rs. 10,000.
3) Create a provision for taxation Rs. 2,00,000.
4) Provision for bad and doubtful debts is required to be made at Rs. 60,000.
5) Provide 5% depreciation on the original amount of premises.

Tushar bank Ltd.

Profit and Loss Account

For the year ended 31st March 2021

Particulars	Schedule No.	Current Year	Previous Year
I. Income			
Interest earned	13	14,90,000	
Other Income	14	Nill	
Total		**14,90,000**	
II. Expenditure			
Interest expended	15	4,00,000	
Operating expenses	16	3,50,000	
Provision (tax)		2,00,000	
Other provisions		60,000	
Total		**10,10,000**	
III. Profit/Loss			
Profit brought forward		4,20,000	
Net profit for the year		4,80,000	

Total		**9,00,000**	
IV. Appropriations			
Transfer to Reserve fund		96,000	
Dividend for last year		1,00,000	
Balance c/d.		7,04,000	
Total		**9,00,000**	

Form 'A'

Balance Sheet of Tushar Bank Ltd.

As on 31-3-2021

Particulars	**Schedule No.**	**Current Year**	**Previous Year**
Capital and Liabilities			
Capital	1	10,00,000	
Reserve and surplus	2	15,00,000	
Deposits	3	2,39,00,000	
Borrowings	4	14,00,000	
Other liabilities and provisions	5	19,30,000	
Total		**2,97,30,000**	
Assets			
Cash in hand and with R.B.I.	6	31,20,000	
Balance with other banks, money at call and short notice	7	32,00,000	
Investments	8	60,00,000	
Advances	9	1,51,40,000	
Fixed Assets	10	22,70,000	
Other Assets	11	Nill	
Total		**2,97,30,000**	
Contingent Liabilities	12	4,00,000	
Bills for collection	--	2,80,000	

Working Details :

Schedule No. 1 : **Capital**

Particulars	Current Year	Previous Year
Authorised Capital		
40,000 shares of Rs. 50 each	20,00,000	
Issued Capital		
20,000 shares of Rs. 50 each fully paid	10,00,000	
Total	**10,00,000**	

Schedule No. 2 : **Reserve and Surplus**

Particulars		Current Year	Previous Year
Reserve Fund	7,00,000		
Add 20% addition	96,000	7,96,000	
Balance of P & L Appropriation Ac.		7,04,000	
Total		**15,00,000**	

Schedule No. 3 : **Deposits**

Particulars	As on 31-3-... (Current Year)	Previous Year
Current Accounts	1,60,00,000	
Saving Account	60,00,000	
Fixed and time deposits	19,00,000	
Total	**2,39,00,000**	

Schedule No. 4 : **Borrowings**

Particulars	As on 31-3-... (Current Year)	Previous Year
Borrowing from other Banks	14,00,000	
Total	**14,00,000**	

Schedule No. 5 : **Other Liabilities and Provisions**

Particulars	Current Year	Previous Year
Unclaimed dividend	60,000	
Sundry Creditors	60,000	
Bills payables	16,00,000	
Rebate on bills discounted	10,000	
Provision for taxation	2,00,000	
Total	**19,30,000**	

Schedule No. 6 : **Cash in hand and with R.B.I.**

Particulars	Current Year	Previous Year
Cash in hand	1,20,000	
Cash with R.B.I.	30,00,000	
Total	**31,20,000**	

Schedule No. 7 : **Balance with other Banks, Money at call & Short Notice.**

Particulars	Current Year	Previous Year
Money at call	6,00,000	
Cash with other Banks	26,00,000	
Total	**32,00,000**	

Schedule No. 8 : **Investments**

Particulars	Current Year	Previous Year
Investments (Market Value Rs. 6,20,000)	60,00,000	
Total	**60,00,000**	

Schedule No. 9 : **Advances**

Particulars		Current Year	Previous Year
Loans overdrafts & cash credits	1,40,00,000		
Less : provision	60,000	1,39,40,000	
Bills discounted and purchased		12,00,000	
	Total	**1,51,00,000**	

Schedule No. 10 : **Fixed Assets**

Particulars		Current Year	Previous Year
Premises	24,00,000		
Less : Depreciation	1,30,000	22,70,000	
(5% on original cost)			
	Total	**22,70,000**	

Schedule No. 11 : **Other Assets**

Particulars	Current Year	Previous Year
	Nil	
Total	**Nil**	

Schedule No. 12 : **Contingent Liabilities**

Particulars	Current Year	Previous Year
Acceptances on behalf of customer	4,00,000	
Total	**4,00,000**	

Schedule No. 13 : **Interest earned**

Particulars		Current Year	Previous Year
Interest and Discount	15,00,000		
Less Rebate on bill discount	10,000	14,90,000	
	Total	**14,90,000**	

Schedule No. 14 : **Other Incomes**

Particulars	Current Year	Previous Year
	Nil	
Total	**Nil**	

Schedule No. 15 : **Interest Expended**

Particulars	Current Year	Previous Year
Interest Paid	4,00,000	
Total	**4,00,000**	

Schedule No. 16 : **Operating Expenses**

Particulars	Current Year	Previous Year
Salaries	1,60,000	
Rentals Taxes	40,000	
Audit Fees	4,000	
Printing	10,000	
General Expenses	6,000	
Depreciation on Premises	1,30,000	
Total	**3,50,000**	

Illustration-II

1. From the following balances of Mahindra Bank Ltd., as on 31st March 2021, prepare Profit and Loss A/c for the year ended 31st march 2021 and Balance sheet as on that date.

Particulars	**Rs.**
Equity share capital of Rs. 100 each	
Rs. 50 paid up (Authorised and Issued 40,000 shares)	20,00,000
Profit and Loss A/c (Cr. on 1-4-2020)	8,00,000
Current Deposit A/c	68,20,000
Fixed Deposit A/c	78,00,000

Saving Bank A/c	51,30,000
Director's fees	90,000
Audit fees	20,000
Furniture (Cost Rs. 20,00,000)	17,40,000
Interest and discount received	42,00,000
Commission and exchange	20,00,000
Reserve fund	7,00,000
Printing and Stationery	80,000
Salary (including Manager's Rs. 4,00,000)	14,00,000
Building (Cost Rs. 60,00,000)	45,00,000
Cash in hand	3,20,000
Cash with RBI	70,00,000
Cash with Other bank	65,00,000
Law charges	30,000
Investment at cost	24,00,000
Loans, cash credit and overdraft	60,00,000
Bills discounted and purchased	28,00,000
Interest paid	30,00,000
Borrowing from Laxmi Bank Ltd.	40,00,000
Branch Adjustment A/c (Cr.)	26,00,000
Rent and Taxes	

Following additional information is available:

1) The Bank has accepted on behalf of the customers bills worth Rs. 30,00,000 against the securities or Rs. 38,00,000 lodged with the Bank.

2) Rebate on bills discounted to Rs. 1,10,000

3) Provide depreciation on building by 10% and on furniture by 5% on cost.

4) Provide Rs. 30,000 for bad and doubtful debts.

Mahindra Bank Ltd.
Profit and Loss Account
For the year ended 31st March 2021

Particulars	Schedule No.	Current Year	Previous Year
Income			
Interest earned	13	40,90,000	
Other Income	14	20,00,000	
Total		**60,90,000**	
Expenditure			
Interest expended	15	30,00,000	
Operating expenses	16	24,90,000	
Provisions		30,000	
Other provisions			
Total		**55,20,000**	
Profit/Loss			
Profit brought forward		8,00,000	
Net profit for the year		5,70,000	
Total		**13,70,000**	
Appropriations			
Transfer to Reserve fund		1,14,000	
Balance C/d.		12,56,000	
Total		**13,70,000**	

Form 'A'
Balance Sheet of Mahindra Bank Ltd.
as on 31-3-2021

Particulars	Schedule No.	Current Year	Previous Year
Capital and Liabilities			
Capital	1	20,00,000	
Reserve and surplus	2	20,70,000	
Deposits	3	1,97,50,000	

Borrowings	4	40,00,000	
Other liabilities and provisions	5	27,10,000	
Total		**3,05,30,000**	
Assets			
Cash in hand and with R.B.I.	6	73,20,000	
Balance with other banks, money at call and short notice	7	65,00,000	
Investments	8	24,00,000	
Advances	9	87,70,000	
Fixed Assets	10	55,40,000	
Other Assets	11	Nill	
Total		**3,05,30,000**	
Contingent Liabilities	12	30,00,000	
Bills for collection	--	--	

Working Details :

Schedule No. 1 : **Capital**

Particulars	**Current Year**	**Previous Year**
Authorised Capital		
40,000 shares of Rs. 1 00 each	40,00,000	
Issued and Paid up Capital		
40,000 shares of Rs. 1 00 each Rs. 50 paid	20,00,000	
Total	**20,00,000**	

Schedule No. 2 : **Reserve and Surplus**

Particulars		**Current Year**	**Previous Year**
Reserve Fund	7,00,000		
Add 20% addition	1,14,000	8,14,000	
Balance of P & L Appropriation A/c.		12,56,000	
Total		**20,70,000**	

Schedule No. 3 : **Deposits**

Particulars	Current Year	Previous Year
Current Deposits A/c	68,20,000	
Fixed Deposit A/c	78,00,000	
Saving Bank A/c	51,30,000	
Total	**1,97,50,000**	

Schedule No. 4 : **Borrowings**

Particulars	Current Year	Previous Year
Borrowing from other Banks	40,00,000	
Total	**40,00,000**	

Schedule No. 5 : **Other Liabilities and Provisions**

Particulars	Current Year	Previous Year
Branch Adjustment	26,00,000	
Rebate on bills discounted	1,10,000	
Total	**27,10,000**	

Schedule No. 6 : **Cash in hand and with R.B.I.**

Particulars	Current Year	Previous Year
Cash in hand	3,20,000	
Cash with R.B.I.	70,00,000	
Total	**73,20,000**	

Schedule No. 7 : **Balance with other Banks, Money at call & Short Notice.**

Particulars	Current Year	Previous Year
Cash with other Banks	65,00,000	
Total	**65,00,000**	

Schedule No. 8 : **Investments**

Particulars	Current Year	Previous Year
Investments at Cost	24,00,000	
Total	**24,00,000**	

Schedule No. 9 : **Advances**

Particulars		Current Year	Previous Year
Loans Cash Credits and overdrafts	60,00,000		
Less : provision	30,000	59,70,000	
Bills discounted and purchased		28,00,000	
	Total	**87,70,000**	

Schedule No. 10 : **Fixed Assets**

Particulars		Current Year	Previous Year
Furniture at cost	20,00,000		
Less : Depreciation upto date	3,60,000	16,40,000	
Building at cost	60,00,000		
Less De. upto date	21,00,000	39,00,000	
	Total	**55,40,000**	

Schedule No. 11 : **Other Assets**

Particulars	Current Year	Previous Year
	Nil	
Total	**Nil**	

Schedule No. 12 : **Contingent Liabilities**

Particulars	Current Year	Previous Year
Acceptances on behalf of customers	30,00,000	
Total	**30,00,000**	

Schedule No. 13 : **Interest earned**

Particulars		Current Year	Previous Year
Interest and Discount Received	42,00,000		
Less Rebate on bill discount	1,10,000	40,90,000	
	Total	**40,90,000**	

Schedule No. 14 : **Other Incomes**

Particulars	Current Year	Previous Year
Commission and Exchange	20,00,000	
Total	**20,00,000**	

Schedule No. 15 : **Interest Expended**

Particulars	Current Year	Previous Year
Interest Paid	30,00,000	
Total	**30,00,000**	

Schedule No. 16 : **Operating Expenses**

Particulars	Current Year	Previous Year
Directors fees	90,000	
Audit fees	20,000	
Printing and Stationery	80,000	
Managers Salary	4,00,000	
Staff Salary	10,00,000	
Law Charges	30,000	
Rent and Taxes	1,70,000	
Depreciation on Furniture	1,00,000	
Depreciation on Building	6,00,000	
Total	**24,90,000**	

Illustration - III

The following is the Trial Balance of Lalu Bank Ltd.,

as on March 31st 2021

Particulars	Rs.	Particulars	Rs.
Loans, cash credits and		Share Capital :	
overdrafts	28,50,000	50,000 equity shares of	
Premises	5,00,000	Rs. 100 each fully paid	
Indian Government	41,70,000	Reserve Fund	50,00,000
Securities		Current Deposit	25,00,000
Salaries	2,80,000	Fixed Deposit	10,00,000
General Expenses	2,74,000	Savings Bank Deposit	12,50,000
Rent, Rates and Taxes	23,000	Profit & Loss A/c	5,00,000
Director's Fees	18,000	(1-4-2020)	1,60,000
Stock of Stationery	85,000	Interest and Discount	
Bill Purchased and		Recurring Deposits	12,80,000
Discounted	4,60,000		2,00,000
Shares	5,00,000		
Cash in hand and with			
Reserve Bank	19,30,000		
Money at call and short			
notice	8,00,000		
	1,10,90,000		**1,18,90,000**

The following information should be considered :

a) Provision for bad and doubtful debts is required, amounting to Rs. 50,000

b) Interest accrued on investments was Rs. 80,000

c) Unexpired discount amounts of Rs. 3,800

d) Endorsement made on behalf of customers totalled Rs. 11,50,000

e) Authorised capital was 80,000 equity shares of Rs. 100 each,

f) Rs. 1,00,000 were added to the premises during the year.

Depreciation at 5% on the opening balance is required,

g) Market Value of Indian Government Securities was Rs. 39,00,000

Prepare Profit and Loss Account for the year ended 31st March 2021 and Balance Sheet as on that date in the prescribed form.

Lalu Bank Ltd.

Profit and Loss Account

For the year ended 31st March 2021

Particulars	Schedule No.	Current Year	Previous Year
Income			
Interest earned	13	13,56,200	
Other Income	14	Nil	
Total		**13,56,200**	
Expenditure			
Interest expended	15	Nil	
Operating expenses	16	6,15,000	
Provisions		50,000	
Other provisions		--	
Total		**6,65,000**	
Profit/Loss			
Profit brought forward		1,60,000	
Net profit for the year		6,91,200	
Total		**8,91,200**	
Appropriations			
Transfer to Reserve fund		1,38,240	
Balance C/d.		7,12,960	
Total		**8,51,200**	

Form 'A'

Balance Sheet of Lalu Bank Ltd.

For the year ended on 31st March, 2021

Particulars	Schedule No.	Current Year	Previous Year
Capital and Liabilities			
Capital	1	50,00,000	
Reserve and surplus	2	33,51,200	
Deposits	3	29,50,000	

Borrowings	4	Nil	
Other liabilities and provisions	5	3,800	
Total		**1,13,05,000**	
Assets			
Cash in hand and with R.B.I.	6	19,30,000	
Balance with other banks, money at call and short notice	7	8,00,000	
Investments	8	46,70,000	
Advances	9	32,60,000	
Fixed Assets	10	4,80,000	
Other Assets	11	1,65,000	
Total		**1,13,05,000**	
Contingent Liabilities	12	11,50,000	
Bills for collection	--	--	

Working Details :

Schedule No. 1 : **Capital**

Particulars	**Current Year**	**Previous Year**
Authorised Capital		
80,000 shares of Rs. 100 each	80,00,000	
Issued and Paid up Capital		
50,000 shares of Rs. 100 each Fully paid	50,00,000	
Total	**50,00,000**	

Schedule No. 2 : **Reserve and Surplus**

Particulars		**Current Year**	**Previous Year**
Reserve Fund	25,00,000		
Add 20% addition	1,38,200	26,38,240	
Balance of P & L Appropriation A/c.		7,12,960	
Total		**33,51,200**	

Schedule No. 3 : **Deposits**

Particulars	Current Year	Previous Year
Current Deposits A/c	10,00,000	
Fixed Deposit A/c	12,50,000	
Saving Bank A/c	5,00,000	
Recurring Deposits	2,00,000	
Total	**29,50,000**	

Schedule No. 4 : **Borrowings**

Particulars	Current Year	Previous Year
	Nil	
Total	**Nil**	

Schedule No. 5 : **Other Liabilities and Provisions**

Particulars	Current Year	Previous Year
Unexpired Discount	3,800	
Total	**3,800**	

Schedule No. 6 : **Cash in hand and with R.B.I.**

Particulars	Current Year	Previous Year
Cash in hand and with R.B.I.	19,30,000	
Total	**19,30,000**	

Schedule No. 7 : **Balance with other Banks, Money at call & Short Notice.**

Particulars	Current Year	Previous Year
Money at call and short notice	8,00,000	
Total	**8,00,000**	

Schedule No. 8 : **Investments**

Particulars	Current Year	Previous Year
Indian Government securities		
(Market value 39,00,000	41,70,000	
Shares	5,00,000	
Total	**46,70,000**	

Schedule No. 9 : **Advances**

Particulars		Current Year	Previous Year
Loans Cash Credits and overdrafts	28,50,000		
Less : Provision	50,000	28,00,000	
Bills discounted and purchased		4,60,000	
	Total	**32,60,000**	

Schedule No. 10 : **Fixed Assets**

Particulars		Current Year	Previous Year
Premises Opening Bal.	4,00,000		
Add : Addition during year	1,00,000		
	5,00,000		
Less Dep. on Op. Bal. 5%	20,000	4,80,000	
	Total	**4,80,000**	

Schedule No. 11 : **Other Assets**

Particulars	Current Year	Previous Year
Stock of Stationery	85,000	
Interest accrued on Investment	80,000	
Total	**1,65,000**	

Schedule No. 12 : **Contingent Liabilities**

Particulars	**Current Year**	**Previous Year**
Endorsement on behalf of customers	11,50,00	
Total	**11,50,000**	

Schedule No. 13 : **Interest earned**

Particulars		**Current Year**	**Previous Year**
Interest and Discount	12,80,000		
Less : Unexpired Discount	3,800	12,76,200	
Interest on Investment		80,000	
	Total	**13,56,200**	

Schedule No. 14 : **Other Incomes**

Particulars	Current Year	**Previous Year**
	Nil	
Total	Nil	

Schedule No. 15 : **Interest Expended**

Particulars	**Current Year**	**Previous Year**
	Nil	
Total	**Nil**	

Schedule No. 16 : **Operating Expenses**

Particulars	**Current Year**	**Previous Year**
Depreciation on Premises	20,000	
Salaries	2,80,000	
General Expenses	2,74,000	
Rent. Rate and Taxes	23,000	
Director Fees	18,000	
Total	**6,15,000**	

Illustration - IV

From the following balances extracted from the books of Karodpati Bank Ltd, Solapur prepare the Profit & Loss Account for the year ended 31st March, 2021 and the Balance Sheet as on that date.

Particulars	Rs.
Salaries and allowances (including remuneration to General Manager Rs. 9,00,000 and Director's Fees Rs. 1,00,000	25,00,000
Sundry expenses	1,50,000
Interest paid on deposits	21,25,000
Commission, exchange (credit)	17,00,000
Interest and discount received	48,00,000
Statutory Reserved fund	20,00,000
Deposits : a) Fixed	87,50,000
b) Savings	60,00,000
c) Current	90,00,000
Loans, cash-credits and over drafts	2,30,00,000
Bills discounted and purchased	15,00,000
Investment fluctuation fund	5,00,000
Cash in hand	17,50,000
Cash with RBI	25,00,000
Cash with Vijay Bank Ltd.	2,50,000
4% Government securities	60,00,000
Silver	5,00,000
Gold	21,00,000
Bills for collection	10,00,000
Interest accrued on investments	3,00,000
Acceptances, endorsements and other obligations	20,00,000
Profit and Loss account (credit banlance on 1-4-2020)	30,00,000
Shares in Telco Co. Ltd.	10,00,000
Interim divided paid	3,00,000
Drafts payable	8,00,000

Share capital (authorised and issued)	10,00,000
2,00,000 shares or Rs. 100 each Rs. 50 paid	
Rent and taxes paid	2,00,000
Premises	25,00,000
Furniture and fixtures	7,50,000
Provident fund	8,00,000
Rebate on bills discounted	75,000
Unclaimed dividend	1,00,000

Adjustments :

1. Provide Rs. 4,00,000 for taxation and Rs. 2,50,000 for bad and doubtful debts.
2. Rebate on bills discounted is over calculated by Rs. 25,000
3. An interim dividend declared was at 4% actual.
4. The market value of 4% Govt. securities on 31-3-2021 was Rs. 58,25,000 and was to be shown at this figure in the B/S.
5. Current Accounts include Rs. 4,00,000 debits balance being overdraft.

Solution :

Karodpati Bank Ltd.
Profit and Loss Account
For the year ended 31st March 2021

Particulars	Schedule No.	Current Year	Previous Year
Income			
Interest earned	13	48,25,000	
Other Income	14	17,00,000	
Total		**65,25,000**	
Expenditure			
Interest expended	15	21,25,000	
Operating expenses	16	28,50,000	
Provisions		2,50,000	
Other provisions		4,00,000	

Total		**56,25,000**	
Profit/Loss			
Profit brought forward		30,00,000	
Net profit for the year		9,00,000	
Total		**39,00,000**	
Appropriations			
Transfer to Reserve fund		1,80,000	
Balance C/d.		33,20,000	
Total		**39,00,000**	

Form 'A'
Balance Sheet of Karodpati Bank Ltd.
as on 31-3-2021

Particulars	Schedule No.	Current Year	Previous Year
Capital and Liabilities			
Capital	1	1,00,00,000	
Reserve and surplus	2	58,25,000	
Deposits	3	2,41,50,000	
Borrowings	4	Nil	
Other liabilities and provisions	5	21,50,000	
Total		**4,21,25,000**	
Assets			
Cash in hand and with R.B.I.	6	42,50,000	
Balance with other banks, money at call and short notice	7	2,50,000	
Investments	8	89,25,000	
Advances	9	2,46,50,000	
Fixed Assets	10	32,50,000	
Other Assets	11	8,00,000	
Total		**4,21,25,000**	
Contingent Liabilities	12	20,00,000	
Bills for collection	--	10,00,000	

Working Details :

Schedule No. 1 : **Capital**

Particulars	**Current Year**	**Previous Year**
Authorised Capital		
2,00,000 shares of Rs. 100 each	2,00,00,000	
Issued and Paid up Capital		
2,00,000 shares of Rs. 100 each Rs. 50 paid	1,00,00,000	
Total	**1,00,00,000**	

Schedule No. 2 : **Reserve and Surplus**

Particulars		**Current Year**	**Previous Year**
Statutory Reserve Fund	20,00,000		
Add 20% transfer	1,80,000	21,80,000	
Investment flaction fund	5,00,000		
Less : loss on revaluation of Investment	1,75,000	3,25,000	
Balance of P & L Appropriation A/c.		33,20,000	
	Total	**58,25,000**	

Schedule No. 3 : **Deposits**

Particulars		**Current Year**	**Previous Year**
Fixed Deposits		87,50,000	
Saving Deposits		60,00,000	
Current Deposits	90,00,000		
Add overdrawn	4,00,000	94,00,000	
	Total	**2,41,50,000**	

Schedule No. 4 : **Borrowings**

Particulars		Current Year	Previous Year
		Nil	
	Total	**Nil**	

Schedule No. 5 : **Other Liabilities and Provisions**

Particulars		Current Year	Previous Year
Drafts Payabla		8,00,000	
Provident Fund		8,00,000	
Rebate on bills discounted	75,000		
Less over calculated	25,000	50,000	
Provision for tax		4,00,000	
Unclaimed Dividend		1,00,000	
	Total	**21,50,000**	

Schedule No. 6 : **Cash in hand and with R.B.I.**

Particulars		Current Year	Previous Year
Cash in hand		17,50,000	
Cash with R.B.I.		25,00,000	
	Total	**42,50,000**	

Schedule No. 7 : **Balance with other Banks, Money at call & Short Notice.**

Particulars		Current Year	Previous Year
Cash with Millions Banks		2,50,000	
	Total	**2,50,000**	

Schedule No. 8 : **Investments**

Particulars		Current Year	Previous Year
4% Govt. securities	60,00,000		
Less loss on revaluation	1,75,000	58,25,000	

Gold		21,00,000	
Shares in Ltd. Co.		10,00,000	
	Total	**89,25,000**	

Schedule No. 9 : **Advances**

Particulars		**Current Year**	**Previous Year**
Loan Cash Credits and overdrafts	2,30,00,000		
Less : Provision	2,50,000		
	2,27,50,000		
Add : Overdrawn Current A/c	4,00,000	2,31,50,000	
Bills purchased and discounted		15,00,000	
	Total	**2,46,50,000**	

Schedule No. 10 : **Fixed Assets**

Particulars	**Current Year**	**Previous Year**
Premises	25,00,000	
Furniture and fixtures	7,50,000	
Total	**32,50,000**	

Schedule No. 11 : **Other Assets**

Particulars	**Current Year**	**Previous Year**
Silver	5,00,000	
Interest accrued on Investment	3,00,000	
Total	**8,00,000**	

Schedule No. 12 : **Contingent Liabilities**

Particulars	**Current Year**	**Previous Year**
Acceptances, endorsement and other obligations	20,00,000	
Total	**20,00,000**	

Schedule No. 13 : **Interest earned**

Particulars		**Current Year**	**Previous Year**
Interest and Discount Received	48,00,000		
Add over calculated rebate	25,000	48,25,000	
	Total	**48,25,000**	

Schedule No. 14 : **Other Incomes**

Particulars	**Current Year**	**Previous Year**
Commission and Exchange	17,00,000	
Total	**17,00,000**	

Schedule No. 15 : **Interest Expended**

Particulars	**Current Year**	**Previous Year**
Interest paid on deposits	21,25,000	
Total	**21,25,000**	

Schedule No. 16 : **Operating Expenses**

Particulars	**Current Year**	**Previous Year**
General managers remuneration	9,00,000	
Directors fees	1,00,000	
Staff salaries and allowances	15,00,000	
Sundry Expenses	1,50,000	
Rent and taxes paid	2,00,000	
Total	**28,50,000**	

Illustration – 5

The following are the figure extracted from the books of Ichalkaranji Bank Limited, as on 31-3-2021 :

Particulars	Rs.
Interest and Discount Received	37,05,738
Interest paid on Deposits	20,37,452
Issued and Subscribed Capital	10,00,000
Salaries and Allowances	2,00,000
Director's fee and allowances	30,000
Rent and taxed paid	90,000
Postage and telegrams	60,286
Statutory reserve fund	8,00,000
Commission, exchange & brokerage	1,90,000
Rent received	65,000
Profit on sale of investments	2,00,000
Depreciation on Bank's properties	30,000
Stationery expenses	40,000
Other expenses	25,000
Auditor's Fee	5,000

Other Information:

a) A customer to whom a sum of Rs. 10 lakhs had been advanced has become insolvent and it is expected that only 50% can be recovered from his estate.

b) Also there were other debts, for which a provision of Rs. 1,50,000 was found necessary by the auditors.

c) Rebate on bills discounted on 31-3-2020 was Rs. 12,000 and or 31-3-2021 was Rs. 16,000.

d) Provide Rs. 6,50,000 for Income tax.

e) The directors desire to declare 10% dividends.

Prepare the Profit and Loss Account of Ichalkaranji Bank Ltd. for the year ended on 31-3-2021.

Solution - 5

Ichalkaranji Bank Ltd.

Profit and Loss Account

For the year ended 31st March 2021

Particulars	Schedule No.	Current Year	Previous Year
Income			
Interest earned	13	37,01,738	
Other Income	14	4,55,000	
Total		**41,56,738**	
Expenditure			
Interest expended	15	20,37,452	
Operating expenses	16	4,80,286	
Provisions (Bad & doubtful)		6,50,000	
Other provisions (Tax)		6,50,000	
Total		**38,17,738**	
Profit/Loss			
Profit brought forward		--	
Net profit for the year		3,39,000	
Total		**3,39,000**	
Appropriations			
Transfer to Reserve fund		67,800	
Proposed Dividend (10%)		1,00,000	
Balance C/d.		1,71,200	
Total		**3,39,000**	

Schedule No. 13 : **Interest earned**

Particulars		Current Year	Previous Year
Interest and Discount Received	37,05,738		
Add Opening balance of rebate on bills discounted	12,000		

	37,17,738		
Less : Closing balance of rebate on bills discounted	16,000	37,01,738	
	Total	**37,01,738**	

Schedule No. 14 : **Other Incomes**

Particulars	**Current Year**	**Previous Year**
Commission Exchange and brokerage	1,90,000	
Rent received	65,000	
Profit on sale of investment	2,00,000	
Total	**4,55,000**	

Schedule No. 15 : **Interest Expended**

Particulars	**Current Year**	**Previous Year**
Interest on deposits	20,37,452	
Total	**20,37,452**	

Schedule No. 16 : **Operating Expenses**

Particulars	**Current Year**	**Previous Year**
Salaries and allowances	2,00,000	
Directors fees and allowances	30,000	
Rent and taxes paid	90,000	
Postage and telegrams	60,286	
Depreciation on bank property	30,000	
Stationery expenses	40,000	
Auditors fees	5,000	
Other expenses	25,000	
Total	**4,80,286**	

Illustration – 6

Friends Bank Ltd. gives you the following particulars from their books for the year ended 31-3-2021. You are required to prepare Balance Sheet as on 31-3-2021 in the prescribed form.

Particulars	Debit Rs.	Credit Rs.
Cash in hand	1,50,000	
Share Capital		25,00,00
Investments in Equity Shares (Fully paid Rs. 3 lakhs Partly paid Rs. 2 lakhs)	5,00,000	
General Reserve		3,00,000
Statutory Reserve		6,00,000
Investments in Government securities (Central and State Government)	5,75,000	
Interest accrued on Investments	15,000	
Balances with Reserve Bank of India	2,00,000	
Balance with Other Banks – (Current Accounts)	1,50,000	
Borrowings from Central Bank of India (unsecured)		4,00,000
Bills Payable		2,00,000
Fixed Deposits		25,00,000
Current Accounts		40,00,000
Contingency Accounts		4,00,000
Loans	50,00,000	
Cash Credits	80,00,000	
Overdrafts	7,70,000	
Savings Accounts		65,00,000
Unclaimed Dividends		25,000
Bills Discounted & Purchased	15,00,000	
Branch Adjustments		74,000
Profit & Loss A/c (1-4-2020)		1,00,000
Advances	7,50,000	
Premises (less depreciation)	6,00,000	
Furniture (less depreciation)	2,00,000	
Provision for taxation		3,91,000
Profit for 31-3-2021		4,20,000
	1,84,10,000	**1,84,10,000**

Following further information is given.

a) Authorised Capital is Rs. 1,00,00,000 (2,00,000 Shares of Rs. 50 each.)

b) Issued Capital is half of the Authorised Capital. All Shares are fully subscribed on which Rs. 25 per share are paid up.

c) Constituents 'Liabilities for Acceptances and Endorsements Rs. 22,00,000.

d) Bills for collection Rs. 15,00,000.

e) Contingent liability for partly paid shares Rs. 2,00,000.

f) Provide for doubtful loans Rs. 20,000.

g) Market value of Investment on 31-3-2021 were

   i) Shares in companies Rs. 5,25,000

   ii) Government securities Rs. 6,00,000

Solution - 6

Form 'A'

Balance Sheet of Friends Bank Ltd.

as on 31-3-2021

Particulars	Schedule No.	Current Year	Previous Year
Capital and Liabilities			
Capital	1	25,00,000	
Reserve and surplus	2	14,00,000	
Deposits	3	1,34,00,000	
Borrowings	4	4,00,000	
Other Liabilities and Provisions	5	6,90,000	
Total		**1,83,90,000**	
Assets			
Cash in hand and with R.B.I.	6	3,50,000	
Balance with other banks, money at call and short notice	7	1,50,000	
Investments	8	10,75,000	
Advances	9	1,60,00,000	

Fixed Assets	10	8,00,000	
Other Assets	11	15,000	
Total		**1,83,90,000**	
Contingent Liabilities	12	24,00,000	
Bills for collection	--	15,00,000	

Working Details :

Schedule No. 1 : **Capital**

Particulars	**Current Year**	**Previous Year**
Authorised Capital		
2,00,000 shares of Rs. 50 each	1,00,00,000	
Issued and Paid up Capital		
1,00,000 shares of Rs. 500 each Rs. 25 per share paid up	25,00,000	
Total	**25,00,000**	

Schedule No. 2 : **Reserve and Surplus**

Particulars		**Current Year**	**Previous Year**
General Reserve		3,00,000	
Statutory Reserve	6,00,000		
Add 20% of current profit	84,000	6,84,000	
Balance of Profit & Loss Appropriation A/c.		4,16,000	
Total		**14,00,000**	

Schedule No. 3 : **Deposits**

Particulars	**Current Year**	**Previous Year**
Fixed Deposits	25,00,000	
Current Accounts	40,00,000	
Contingency Accounts	4,00,000	

Saving Accounts	65,00,000	
Total	**1,34,00,000**	

Schedule No. 4 : **Borrowings**

Particulars	Current Year	Previous Year
Borrowing from Central Bank of India	4,00,000	
Total	**4,00,000**	

Schedule No. 5 : **Other Liabilities and Provisions**

Particulars	Current Year	Previous Year
Bills Payables	2,00,000	
Unclaimed dividend	25,000	
Branch adjustments	74,000	
Provision for taxation	3,91,000	
Total	**6,90,000**	

Schedule No. 6 : **Cash in hand and with R.B.I.**

Particulars	Current Year	Previous Year
Cash in hand	1,50,000	
Balance with Reserve Bank of India	2,00,000	
Total	**3,50,000**	

Schedule No. 7 : **Balance with other Banks, Money at call & Short Notice.**

Particulars	Current Year	Previous Year
Balance with other Bank	1,50,000	
Total	**1,50,000**	

Schedule No. 8 : **Investments**

Particulars	Current Year	Previous Year
Investment in shares (M.V. Rs. 5,25,000)	5,00,000	

Investment in Government securities (Market value Rs. 6,00,000)	5,75,000	
Total	**10,75,000**	

Schedule No. 9 : **Advances**

Particulars		**Current Year**	**Previous Year**
Loans	50,00,000		
Less : Provision	20,000	49,80,000	
Cash Credits		80,00,000	
Overdrafts		7,70,000	
Bills discounted and purchased		15,00,000	
Advances		7,50,000	
	Total	**1,60,00,000**	

Schedule No. 10 : **Fixed Assets**

Particulars	**Current Year**	**Previous Year**
Premises less depreciation	6,00,000	
Furniture less depreciation	2,00,000	
Total	**8,00,000**	

Schedule No. 11 : **Other Assets**

Particulars	**Current Year**	**Previous Year**
Interest accrued on Investment	15,000	
Total	**15,000**	

Schedule No. 12 : **Contingent Liabilities**

Particulars	**Current Year**	**Previous Year**
Contingent liabilities for Acceptances	22,00,000	
Liability for partly paid shares	2,00,000	
Total	**24,00,000**	

P & L Opening Balance		:	1,00,000
Add :	Current year profit	:	4,20,000
			5,20,000
Less :	Bad debt provisions	:	20,000
			5,00,000
Less :	Transfer to statutory reserve	:	84,000
			4,16,000

1.3 Summary

A Bank is a financial institution which deals with money and credit. It accept deposits and leads money to those who are in need of it. If helps to transfer money from one place to another. Banker is a person or company carring on the business of receiving money and collecting drafts for customers subject to the obligation of honouring the cheques drawn upon him from time to time by customers up to the amount available on their customers.

A Banking company closes its accounts on 31st March every year. So one financial year is 1st April to 31st March. A Banking companies work as per guidelines of RBI. So control is given to RBI i.e. Reserve Bank of India. According to section 29 of the Banking Regulation Act. 1949, every banking company is required to prepare with reference to that year a balance sheet and profit and loss account on the last working day of the year in the form 'A' and Form 'B' respectively as given in Schedule III.

1.4 Check your Progress

1. Banking Regulation Act ………………

   a) 1956 b) 2013 c) 1949 d) 1972

2. ………….. is accounting year for all banking Companies.

   a) 1st Jan to 31st December b) 1st March to 28th February

   c) 1st April to 31st March d) None of the above

3. According to the ……………… Banking Companies Act 20% of the profit must be transferred to the statutory reserve.

   a) Section 17 b) Section 18 c) Section 19 d) Section 20

4. Schedule No. 1 to 5 related to …………………

a) Assets b) Profit

c) Capital & Liabilities d) None of the above

5. NPA means ………………

a) Net profit on Assets b) Net profit Actual

c) Not Performing Assets d) Non Performing Assets

6. All fixed Assets shown in schedule No …………………..

a) Schedule No. 10 b) Schedule No. 5

c) Schedule No. 11 d) Non of these

1.5 Key Terms:

1) Non banking assets :

The assets which are not required for banking operation are called as non banking assets. These are acquired by bank against security of loans advanced.

2) Money at call and short notice :

Such loans are advanced by banks from surplus cash to the needy banks loans repayable within 24 hours are termed as 'Money at Call'. Loans repayable by a notice of seven days are termed as 'Money at Short Notice'.

3) Bad debts :

Such part of advances, which is irrecoverable from clients.

4) Rebate on bills discounted :

This is a amount of discount received in advance. Bank discounts the bill, gets discount on it, but some amount received on discounting of bill may relate to next year. Such amount of discount related to next year but received in current year is treated as rebate on bills discounted.

5) Contingent Liabilities :

This is a liability, which is not actual liability but may occur in future.

6) Letter of Credit :

It is a letter addressed by a banker certifying that a person named therein is entitled to draw on him a credit up to certain limit. Unpaid balance of this letter on the Balance Sheet date form s liability of the issuing bank.

7) Unclaimed Dividends :

It is a amount of dividend which is declared by bank but not collected by share holders it forms part of liability of a bank.

1.6 Answer to check your progress

1) c 2) c 3) a 4) c 5) d 6) a

1.7 Exercise

a) Theory Questions

1. What is mean by Banking Companies? Explain its schedules.
2. Define Bank and Explain Scope of Banking business.

b) Short Notes

1. Schedule & Investments
2. Income
3. Rebate on Bills Discounted

Exercise – 1

The following Trial Balance has been extracted from the books of Commercial Bank Ltd. as on 31st March, 2021.

Particulars	Debit Rs.	Credit Rs.
Cash with RBI	5,00,000	
Cash in hand	3,70,000	
Current and Contingency A/c		26,00,000
(Before setting off overdraft of Rs. 1,00,000)		
Savings Bank Account		40,00,000
Fixed Deposit Account		15,00,000
Bills Purchased and Discounted	20,00,000	
Loans, Cash Credits including overdrafts	91,00,000	
Rebate on Bills Discounted		1,50,000
Bills Payable		2,50,000

Investments in Securities	16,00,000	
Reserve Fund		12,00,000
Non-Banking Assets acquired	1,00,000	
Gold	2,00,000	
Furniture	1,25,000	
Premises	3,75,000	
Profit and Loss A/c.		1,40,000
Interest Accrued	40,000	
Outstanding Liabilities		60,000
Borrowings from Banks		2,00,000
Margin Money held against letter of credit issued		70,000
Issued and fully paid up Equity Share Capital		42,40,000
	1,44,10,000	**1,44,10,000**

With the help of the above trial balance, prepare the Balance Sheet as on 31st March 2021, Provide Rs. 5,50,000 for Doubtful Debts.

Bills for Collection outstanding on 31-3-2021 Rs. 2,25,000

Authorised Capital consists of 8,48,000 Equity Shares of Rs. 10 each. Acceptances, Endorsements and other obligations Rs. 3,00,000. Contingent liability for public issue of shares underwritten Rs. 4,00,000.

Exercise – 2

From the following balances which are extracted from the books of Hindustan Bank, prepare the Profit and Loss Account for the year ending 31 March 2015 and a Balance Sheet as on that date.

Particulars	Rs.
Share Capital : 2,000 Shares of Rs. 500 each Rs. 200 per Share paid up	4,00,000
Bad debts written off	25,742
Reserve fund investments	2,00,000
General expenses	36,484

Current Accounts	40,48,844
Interest paid on Deposits	32,104
Deposit Accounts	13,84,046
Profit and Loss A/c (Cr.)	45,868
Acceptance for customers	3,08,565
Discount	48,752
Endorsements and Guarantee	14,804
Commission, Exchange and Brokerage	8,848
Cash	45,308
Interest received	1,06,452
Cash with Reserve Bank	4,02,420
Endorsements and Guarantee as per Contra	14,804
Owing by Foreign correspondent	40,088
Customers Liabilities for Acceptances	3,08,564
Borrowings from other Banks	12,96,412
Loans and Advances to customers	30,91,340
Investments	19,76,508
Bills discounted	12,45,648
Premises	4,43,580
Statutory Reserve	2,00,000

The following information is relevant:

a) Reserve Rs. 6,438 as Rebate on bills discounted.

b) Provide Rs. 15,000 for taxation reserve.

Exercise - 3

Following balances were extracted from the books of Sadhana Bank Ltd. as on 31st March 2021.

Particulars	Rs.
Share Capital	6,00,000
Share Premium	1,80,000
Buildings	1,30,000
Deposits with RBI	1,50,000
Cash in Hand	22,700
Cash with other Banks	50,000
Investment in Government Securities	3,88,000
Other Investments	3,12,000
Gold Bullion	30,260
Bills for collection	87,000
Interest accrued on Investment	49,240
Loss on sale of Investment	60,000
Employees Security Deposits	30,000
Savings Deposits	14,840
Current Deposits	1,94,000
Fixed Deposits	46,100
Profit on Bullion	2,400
Acceptance and Endorsements	1,13,000
Miscellaneous Income	5,400
Non-Banking Assets	4,000
Statutory Reserve	2,80,000
Furniture	10,000
Postage and Telegram	100

Managing Director's Remuneration	24,000
Borrowings from other Banks	1,54,460
Money at Call and Short Notice	52,000
Director's Fees	2,400
Interest (Dr)	15,900
Advances	4,00,000
Loss on Sale of Furniture	2,000
Bills discounted and Purchased	25,000
Interest (Credit)	1,44,000
Discount (Credit)	84,000
Audit Fees	10,000
Salaries	42,400
Commission and Brokerage	50,600
Rent (Cr.)	1,200
Profit and Loss A/c (Cr.)	13,000

Prepare Profit and Loss Account and Balance Sheet after considering the following :

1. Provide for Taxation Rs. 20,000.
2. Claim by employees for Bonus Rs. 30,000 is to be provided.
3. As security of current deposits reveals that there are three accounts overdrawn to the extent of Rs. 50,000 and total of credit balance is Rs. 2,44,000
4. Allow 5% depreciation on buildings.
5. Provision for bad and doubtful debts is required amounting to Rs. 20,000.

Exercise – 4

From the following you are required to prepare the Profit and Loss Account and the Balance Sheet of the Shivaji Bank Limited as on 31 st March 2021 in prescribed form :

Particulars	Debit Rs.	Credit Rs.
Issued Capital 20,000 shares of Rs. 100 each		20,00,000
Money at call and short notice	8,00,000	
Reserve Fund		7,00,000
Cash in hand and with RBI	6,50,000	
Deposits		
a) Saving		10,00,000
b) Current		5,00,000
c) Fixed		10,00,000
Cash with other Banks	9,50,000	
Borrowing from SBI		5,00,000
Investment in Government Securities	9,00,000	
Secured Loans	15,00,000	
Cash Credits	5,00,000	
Premises less depreciation	5,80,000	
Furniture less depreciation	1,20,000	
Rent	5,000	60,000
Interest and discount		8,00,000
Interest paid on deposits	3,00,000	
Commission and brokerage		70,000
Salaries to the staff	1,50,000	
Interest paid on borrowings	50,000	
Audit Fees	10,000	
Directors Fees	8,000	
Bill discounted	80,000	
Depreciation on Bank's property	13,000	

Printing and Stationery	8,000	
Postage	6,000	
	66,30,000	**66,30,000**

Adjustments:

a) Provide Rs. 20,000 for doubtful debts.

b) Acceptances and endorsements on behalf of customers amounting to Rs. 4,00,000.

c) Provide Rs. 60,000 for taxation reserve.

d) Provide Rs. 10,000 on bill discounted but not matured on 31 March 2021

Exercise - 5

From the following balances extracted from the books of Laxmi Vishnu Bank Ltd., Solapur prepare the Profit and Loss Account for the year ended 31 st March 2021 and the Balance Sheet as on that date.

Particulars	Rs.
Share Capital (Authorised and Issued)	3,00,000
10,000 shares of Rs. 50 each, Rs. 30 paid	
Reserve Fund	1,00,000
Money at call and Short Notice	1,25,000
Investment at cost	10,000
Interest paid on Deposits and Borrowings	70,000
Law Charges	3,000
Postage and telegrams	2,000
Salaries (including remuneration to Managing Director	45,000
Rs. 10,000 and Directors Fees Rs. 6,000)	
Rent, Taxes and Insurance	4,000
General Expenses (Including Stationery Rs. 3,000, Auditor's fees Rs. 5,000 and other expenditure Rs. 2,000)	10,000
Deposits : a) Fixed	5,00,000
b) Saving	2,00,000

c) Current	23,00,000
Premises (after Depreciation upto 31-3-2020 Rs. 25,000)	1,75,000
Furniture (after Depreciation upto 31-3-2020 Rs. 5,000)	15,000
Cash in Hand	35,000
Cash with RBI	2,00,000
Cash with other Banks	3,00,000
Borrowings from other Banks	3,50,000
Interest and Discount	2,23,250
Profit and Loss Account (Credit balance on 1-4-2020)	50,000
Dividend for the year 2013-2020	30,000
Loans, Cash Credit and Overdrafts	16,14,250
Bills Payable	25,000
Bills discounted and Purchased	3,50,000
Unclaimed Dividend	5,000
Branch Adjustment (Cr.)	12,500
Commission and Exchanve	22,500
Library Books	6,000
Repairs to Bank Property	4,000
Non-Banking Assets	25,000
Gold Bullion	75,000

Adjustments :

1. Provide depreciation at 5% on Premises and at 10% on Furniture. (On original cost of the assets in question)
2. Provide Rs. 20,000 for Bad and Doubtful Debts.
3. Provide Rs. 25,000 for Taxation.
4. Rebate on Bills Discounted for unexpired period amounted to Rs. 750
5. The Bank has accepted on behalf of customers bills worth Rs, 1,00,000 and has Bills for collection being bills receivables, worth Rs. 50,000.

Exercise – 6

From the following balances extracted from the books of Dhanlaxmi Bank Ltd., Solapur prepare the Profit and Loss Account for the year ended 31 st March 2021 and the Balance Sheet as on that date.

Particulars	Rs.
Share Capital (Authorised and Issued)	6,00,000
20,000 shares of Rs. 50 each, Rs. 30 paid	
Reserve Fund	2,00,000
Money at call and Short Notice	3,00,000
Investment at cost	20,00,000
Interest paid on Deposits and Borrowings	1,40,000
Law Charges	6,000
Postage and telegrams	4,000
Salaries (including remuneration to Managing Director	90,000
Rs. 20,000 and Directors Fees Rs. 12,000)	
Rent, Taxes and Insurance	8,000
General Expenses (Including Stationery Rs. 6,000, Auditor's fees Rs. 10,000 and other expenditure Rs. 4,000)	20,000
Deposits : a) Fixed	10,00,000
b) Saving	4,00,000
c) Current	46,00,000
Premises (after Depreciation upto 31-3-2020 Rs. 50,000)	3,50,000
Furniture (after Depreciation upto 31-3-2020 Rs. 10,000)	30,000
Cash in Hand	70,000
Cash with RBI	4,00,000
Cash with SBI	6,00,000
Borrowings from other Banks	7,50,000
Interest and Discount	2,23,250
Profit and Loss Account (Credit Balance on 1-4-2020)	1,00,000

Dividend for the year 2019-20	60,000
Loans, Cash Credit and Overdrafts	32,28,250
Bills Payable	50,000
Bills discounted and Purchased	7,50,000
Rebate on Bills Discounted (on 31-3-2021)	10,000
Branch Adjustment (Cr.)	25,000
Commission, Exchange received	45,000
Library- Books	12,000
Repairs to Bank Property	8,000
Gold Bullion	1,50,000

Adjustments :

1. Provide depreciation at 5% on Premises and at 10% on Furniture. (On original cost of the assets)
2. Provide Rs. 58,000 for Bad and Doubtful Debts.
3. Rebate on Bills Discounted as on 31-3-2021 amounted to Rs. 16,500 for unexpired period.
4. Loans advanced by bank included a sum of Rs. 1,00,000 due from a customer against the mortgage of his machinery. As the client is unable to pay the amount, the bank takes over the machinery at the market value of Rs. 70,000 in full satisfaction of its claim on the date of Trial Balance.

❑❑❑

Unit-2

a) Farm Accounting

Structure of the Unit

2.0 Objective

After studying this unit you will be able to understand –

- The objectives of farm accounting.
- The book keeping and preparation of financial statements for farm transactions.
- The special features of depreciation on fixed assets.

2.1 Introduction

Agriculture activity is a predominant activity in India. In the recent years, Commercial farming has been assuming great importance, particularly in States like Punjab, Tamil Nadu, Andhra Pradesh and Haryana. Farming activities now comprises not only of growing crops but also include animal husbandry (rearing of livestock), poultry farming, sericulture (silkworm breeding), pisciculture (rearing of fish), floriculture (growing flowers) etc. As a result of this development, 'farm accounting' has attracted great attention.

2.2 Presentation of Subject Matter

2.2.1 Meaning of farm accounting

In the recent years, commercial farming has been assuming great importance. Agriculture activity is a predominant activity in India. Farming activity includes animal husbandry, poultry farming, sericulture, pisciculture etc. Corporate entities are entering in the farming business in a big way. Therefore, the Institute of Cost and Works Accountant of India issued a booklet, explaining how the farm books should be kept and how the profit or loss arising from the farming operations should be ascertained.

2.2.2 Features of farm Accounting :

While preparing the farm accounts, one should be guarded about the peculiar features of farm accounting. Some of the features of farm transactions are given below:

1. The farm business is family type. It is confined to the family. The farmer keeps a single bank account for business and for his private purposes.
2. Part of the produce and products of the farm are consumed by the family.
3. The farmer and his family members may work on the farm without receiving any specified wages.
4. Farming activities are not confined to raising crops alone. Besides raising crops, the farmers, engage themselves in other farming activities like poultry, dairying, pig production, rearing fish, growing flowers etc.

5. Inventory valuation of standing crops, cattle, poultry, etc., is the most difficult one.
6. Agriculture operations on a farm are subject to natural calamities such as pests, diseases, floods, weather conditions etc. and variations in Governments policies, market prices of inputs, like, fertilizers, seeds, chemicals.
7. Most of the small farmers are illiterate and they cannot afford the expense of employing someone to maintain the accounts.
8. Even big farmers are not aware of accounting techniques which can prove useful for managerial decisions.
9. The collection of statistical data is done in a conventional manner.
10. Agriculture sector in India is unorganized and dominated by small farmers. The average size of holding land is very small etc.

2.2.3 Objectives of Farm Accounting

Following are the objectives of maintaining farm accounts;

1. To ascertain the financial position of the farming operations at any time.
2. To provide acceptable accounting records which can form the basis for securing finance from financial institutions.
3. To understand the Crop-wise performance so that the profitable and unprofitable activities can be segregated.
4. To provide reliable and useful information for assessment of agriculture income tax.
5. To have better control over farming activities.
6. To provide useful information for claiming compensation from government or insurance companies in case of loss suffered due to natural calamities etc.

2.2.4 Accounting for farms :

There are four types of transactions relating to farm activities i.e. Cash, Credit, exchange and national. The cash and credit transactions are recorded as usual. The exchange transactions, in the nature of barter, are normally recorded at opportunity cost that is the price in the open market. Notional transactions means the transactions which take place between the members of owner's family and the farm.

The performance of each crop shall be found out separately to understand the profitability of crops. The direct cost clearly identifiable with a crop shall be charged accordingly. The common cost should be suitable allocated on some accepted basis.

Books of Accounts :

Following books of accounts are maintained under farm accounting :

1. Cash Book for recording cash transactions. Analytical column cash book is prepared.
2. Debtors and Creditors Register to record credit transactions.
3. Stock Register is prepared for recording opening, purchase, sale and stock remained at the end.
4. Fixed Assets Register which contains the details of cost of asset, depreciation on it and closing balance.
5. Loan Register is prepared for recording loan amount and interest on it.
6. Register for National Transactions is prepared to record the transactions between farm and farm household.
7. Cost analysis Register for keeping record of each farming activity to know the profit of each activity etc.

Cost and Revenues:

Expenses and incomes associated with farming activities, other than agriculture activities are given below.

Farming Activities	Cost/Expenses	Revenues/Incomes
Poultry	Chicken feed, hay, packing, boxes, cost of shed, medicines, salaries and wages.	Sale of eggs, chickens, broilers, hens, sale of manures.
Dairy	Cattle feed, hay, cost of cultivation of feed crop, insecticides, salaries and wages,	Sale of milk, milk products, calves, dairy cattle and slaughtered

	cost of maintaining milk processing facilities	cattle
Fisheries	Cost of seed and water, fish feed, cost of tanks, catching expenses depreciation on assets, salaries and wages	Sale of fish

2.2.5 Preparation of Final Accounts :

Farm final accounts can be prepared according to any of the two methods i.e. Single entry method and Double entry method.

Single Entry Method : Under this method two statements are prepared one in the beginning of the year and another at the end of the accounting year. The excess of assets over liabilities is considered as a net worth of the business and the profit or loss made by business during a period can be ascertained by comparing the net worth of the business on two dates after making the adjusting entries of drawings, introduction of additional capital etc.

Double Entry method : Under this method farm account is prepared by following the principles of double entry system. This accounts is debited with opening stock and the relevant expenses incurred and credited with the sale proceeds and closing stock. The difference between debit and credit is show profit or loss. For every farm activity a separate columns are provided. The profit or loss of each activity is transferred to Balance Sheet.

2.2.6 Illustrative example of farm Accounting

Illustration 1 :

From the information given below prepare a 'Crop Account' to ascertain the gross profit made by this section of the farm :

Opening Stocks:	Rs.
Grains	8,000
Seeds	600
Fertilizers	3,000

Purchases :

Seeds 8,200

Fertilizers 32,000

Sale of grain

Grain distributed as wages 3,000

Wages paid in cash 3,700

Grains used by the proprietor 4,300

Grains consumed by the live stock section 2,700

Solution :

Dr. Crop Account Cr.

Particulars		Rs.	Particulars		Rs.
To Opening Stock			By Sales of Grain		32,000
Grains	8,000		Wages		3,300
Seeds	600		(Grains distributed)		
Fertilizers	3,000		Drawings		4,300
		11,600	Grains used by the Proprietor)		2,700
			Live stock section (grains consumed)		
To Purchases :			Closing Stock :		
Seeds	1,800		Grains	3,700	
Fertilizers	8,200		Seeds	300	
		10,000	Fertilizers	400	
					4,400
To Wages :					
Cash	3,700				
Grains	3,300				
		7,000			
To Repairs and Maintenance		1,900			
To Depreciation Farm Machinery		2,500			
To Crop Insurance		600			
To Profit from Crops		13,100			
		46,700			46,700

Illustration 2 :

From the following information, prepare "Crop Account" to find out the profit made by the crop section of the farm.

	Rs.	Rs.
Opening Stocks :		
Grain	2,600	
Seeds	600	
Fertilizers	400	
		3,600
Purchases :		
Seeds	400	
Fertilizers	600	
		1,000
Wages paid in cash		3,500
Wages paid in kind by given grain		2,500
Sale of grain		25,400
Grain consumed by the proprietor		600
Grain consumed by the live stock section		2,400
Depreciation on farm machinery		1,000
Repairs and maintenance of farm machinery		2,000
Closing Stock		
Grain	2,000	
Seeds	400	
Fertilizers	600	
		3,000

Solution :

Dr. Crop Account Cr.

Particulars		Rs.	Particulars		Rs.
To Opening Stock			By Sales of Grain		25,000
Grains	2,600		By Wages in kind (contra)		2,500
Seeds	600		By Grain consumed by		
Fertilizers	400		live stock section		2,400
		3,600	By Grain consumed by the		
To Purchases :			proprietor (Drawings)		600
Seeds	400		By Closing Stocks:		
Fertilizers	600		Grain	2,000	
		1,000	Seeds	400	
			Fertilizers	600	3,000
To Wages :					
In Cash	3,500				
In Kind	2,500				
		6,000			
To Depreciation		1,000			
To Repairs and Maintenance		2,000			
To Crop profit transferred					
to Profit and Loss A/c		20,300			
		33,900			33,900

Illustration 3 :

From the following information prepare Cattle Account to ascertain the profit made by the cattle division.

	No.	Value Rs.
Opening Stock of live stock	100	2,00,000
Closing stock of live stock	118	2,42,000

Opening stock of cattle food		4,000
Closing stock of cattle food		5,000
Purchases of cattle during the year	180	3,70,000
Sales of cattle during the year	175	4,38,000
Sales of carcasses	5	1,000
Purchases of cattle food		40,000
Wages of rearing cattle		10,000

Crop worth Rs. 11,000 grown in the farm was used for feeding the cattle. Out of the calves born 4 died and their carcasses realised Rs. 100.

Solution :

Dr. Cattle Account Cr.

Particulars	**No**	**Amount Rs.**	**Particulars**	**No.**	**Amount Rs.**
To Opening Stock			By Sale of Cattle	175	4,38,000
of live stock	100	2,00,000	By Sales of carcasses	5	1,000
To Purchase of cattle	180	3,70,000	By Sales of carcasses of		
To Calves born (Bal. fig.)	22	---	calves	4	100
To Cattle food :			By Closing stock of		
Opening Stock 4,000			live stock	118	2,42,000
Purchases 40,000					
44,000					
Less Closing stock 5,000					
		39,000			
To Wages for rearing cattle		10,000			
To Crop Account-Crop grown in the farm used for feeding cattle		11,000			
To Net profit transferred to General profit and Loss Account		51,000			
	302	6,81,100		302	6,81,100

Illustration 4 :

From the information given below, prepare a "Crop Account" to ascertain the gross margin made by this division of the farm.

Opening Stock	Rs.
Grain	3,000
Seeds and fertilizers	2,000
Purchases :	
Seeds	500
Fertilizers	1,500
Sale of grain	15,000
Grain distributed as wages	2,000
Wages paid in cash	3,000
Grain consumed by the proprietor	2,000
Grain consumed by the live stock section	1,500
Repairs and maintenance of farm machinery	1,200
Depreciation on farm machinery	300
Crop insurance	500
Closing Stock :	
Grain	6,000
Seeds and fertilizers	3,000

Solution :

Dr. Crop Account Cr.

Particulars		Rs.	Particulars	Rs.
To Opening Stock			By Sale of grain	15,000
Grain	3,000		By Wages (contra)	2,000
Seeds and fertilizers	2,000		By Drawings – grain consumed	
		5,000	by proprietor	2,000
To Purchases :			By Live stock section-grain	
Seeds	500		consumed by animals	1,500
Fertilizers	1,500			

		2,000	By Closing Stock		
To Wages			Grain	6,000	
Cash	3,000		Seeds and fertilizers	3,000	
Grain	2,000				9,000
		5,000			
To Crop insurance		500			
To Repairs and maintenance		1,200			
To Depreciation		300			
To Profit transferred to general profit and loss account		15,500			
		29,500			29,500

Illustration 5 :

From the following Trial Balance extracted from the books of Suraj Farms draw up the final accounts for the year ended 31st March, 2021 and the Balance Sheet as on the date :

Debit Balances		Rs.	Credit Balances		Rs.
Stock on 1-4-2020			Sales		
Live stock	1,50,000		Live Stock	48,000	
Paddy	60,000		Paddy	2,12,000	
Cattle feed	11,000		Milk	1,57,000	4,17,000
Fertilizers	5,000		Sundry Creditors		26,000
Seeds	3,000	2,29,000	Outstanding expenses		4,000
Purchases :			Capital Account		4,41,800
Live Stock	30,000				
Cattle feed	60,000				
Fertilizers	16,000				
Seeds	5,800	1,11,800			
Sundry Debtors		21,000			
Repairs and Maintenance of Farm equipments		12,000			

Farm equipments	1,50,000		
Crop expenses	50,400		
Live stock expenses	12,500		
General expenses	11,700		
Cash in hand	7,300		
Cash at Bank	8,500		
Land	2,75,000		
	8,89,200		8,89,200

Additional Information :

1. Closing stock as on 31-03-2021

   Live stock Rs. 1,32,000; Paddy Rs. 30,000; Cattle feed Rs. 6,000; Fertilizers Rs. 3,500; Seeds Rs. 2,700.

2. The consumption of the farm output by the proprietor:

   Milk etc., Rs. 6,000

   Paddy Rs. 9,500

3. Provide 10% depreciation on Farm Equipments and 2% on Land and Buildings.

Solution :

Trading and Profit and Loss Account

Dr. for the year ended 31-03-2021 Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock			By Sale of Cattle		
Live stock	1,50,000		Live stock	48,000	
Paddy	60,000		Paddy	2,12,000	
Cattle feed	11,000		Milk	1,57,000	4,17,000
Fertilizers	5,000				
Seeds	3,000	2,29,000	By Produce consumed		
			by proprietary		
To Purchase			Milk	6,000	

Live stock	30,000		Paddy	9,500	15,500
Cattle feed	60,000				
Fertilizers	16,000		By Closing Stock :		
Seeds	5,800	1,11,800	Live stock	1,32,000	
			Paddy	30,000	
To Crop expenses		50,400	Cattle feed	6,000	
To Live stock expenses		12,500	Fertilizers	3,500	
To Gross Profit		2,03,000	Seeds	2,700	1,74,200
		6,06,700			6,06,700
To General expenses		11,700	By Gross Profit		2,03,000
Repairs and Main.		12,000			
Depreciation					
From Equipments	15,000				
Land & Buildings	5,500	20,500			
To Net Profit		1,58,800			
		2,03,000			2,03,000

Balance Sheet
as on 31-03-2021

Particulars	Rs.	Amt.	Particulars	Rs.	Amt.
Sundry Creditors		26,000	Cash in hand		7,300
Outstanding exp.		4,400	Cash in Bank		8,500
Capital A/c	4,41,800		Sundry Debtors		21,000
Less : Produce consumed	15,500		Closing Stocks :		
	4,26,300		Live Stock	1,32,000	
Add : Net Profit	1,58,800	5,85,100	Paddy	30,000	
			Cattle feed	6,000	
			Fertilizers	3,500	
			Seeds	2,700	1,74,200
			Farm equipments	1,50,000	
			Less : Depreciation	15,000	1,35,000
			Land & Buildings	2,75,000	

			Less : Depreciation	5,500	2,69,500
		6,15,500			6,15,500

Illustration 6 :

Mr. Gopal has a five acres farm land. He grows rice on four acres. The balance area has mango trees. Other particulars about his activities, during 2020-21 are :

	Amount Rs.
Opening stock of fertilizers	30,000
Rice saplings purchases	50,000
Water Charges	12,000
Sprinkler system	60,000
Pump	30,000
Fertilizer purchases	90,000
Insecticide spraying charges`	9,000
Wooden boxes purchased during the year	6,000
Jute bags purchased during the year	48,000
Agriculture labour wages	60,000
Orchard labour wages	24,000
Threshing Machine	10,000
Dead trees sold	5,000
Salary to Manager	6,000

During the year, he obtained 90,000 mangoes from his trees, which he disposed off at Rs. 10 per dozen. All the boxes were used for packing.

He also obtained 100 quintals rice per acre, half of which fetched him Rs. 7 per kilo and the rest Rs. 5 per kilo. One-tenth quantity of the bags purchased, remained unutilized. Fertilizers, worth Rs. 20,000 remained in stock at the end of the year. Depreciation is to be provided at 10 per cent. Rural development authority of his region monitors his performance and he needs to provide product wise Profit and Loss Account to them. He apportions common expenses in proportion of the area under each product. Insecticide is required to be sprayed once in every three years on mango trees to keep them free from harmful insects.

Prepare product wise Profit and Loss Accounts.

Solution :

In the Books of Mr. Gopal

Profit and Loss Account

Dr. for the year ended 31-03-2021 Cr

Particulars	Rice	Mango	Particulars	Rice	Mango
To Purchases			By Sales	2,40,000	75,000
Rice Saplings	50,000	--	By Scrap sale		
To Fertilizers consumed	80,000	20,000	Sale of dead trees	---	5,000
To Jute Bags consumed	43,200	---			
To Wooden Boxes	---	6,000			
To Labour Wages	60,000	24,000			
To Salary to Manager	4,800	1,200			
To Water Charges	9,600	2,400			
To Depreciation on					
Sprinkler					
system @ 10%	4,800	1,200			
To Water Charges	9,600	2,400			
To Depreciation on					
Sprinkler					
system @ 10%	4,800	1,200			
Pump @ 10%	2,400	600			
Thresher @ 10%	1,000	---			
To Insecticide					
Spraying		3,000			
To Profit c/d		21,600	By Loss c/d	15,800	
	2,55,800	80,000		2,55,800	80,000

2.3 Summary :

Farming is similar to any other business, occupation etc. However, it has some special peculiar features. These features deserve special attention while designing farm accounting or accounting practices. Agriculture sector in India is most unorganized. Even big farmers are not fully aware of accounting techniques of farm accounting. However, efforts should be made to make farm accounting more popular so that advantages of farm accounting may be obtained by Indian farmers.

2.4 Check your Progress

A) Fill in the gaps.

1. .... Activity is a predominant activity in India.
2. .... is the application of accounting practices in agriculture operations.
3. Land development expenses is included in the cost of ....
4. .... is usually not depreciated because its monetary value tends to increase with the passage of time.
5. .... transactions are those that take place between the members of the owner's family and the farm.

B) State the following statements are true or false.

1. Farming sector in India is by and large, unorganized.
2. Only big farmers in India are aware of accounting techniques related to farm accounting.
3. When farm products are consumed by farm workers it is debited to wages accounting.
4. Farm accounting is still in its infant stage of development in India.
5. The collection of data of farm accounting is done in a conventional manner.

2.5 Key Terms

- **Land development expenses :** A business may purchase land for cultivation. When virgin land is to be cultivated, a big sum has to be spent for clearing the land, leveling, bunding and providing irrigation and drainage facilities. All these expenses are termed as 'land development expenses' and should preferable be added to the cost of land.

- **Depreciation on assets :** Depreciation must be provided on farm assets but not depreciation is provided on land because its monetary value tends to increase with the passage of time.
- **Drawings :** The treatment of drawings in kind (i.e. dairy products and crop products consumed by the family) is done by making the following entry;

Drawing A/c Dr.

To Milk/Crops A/c

The wages paid in kind of labours :

Wages A/c

To Milk/Crops A/c

2.6 Answer to check your progress

A) 1. Farm 2. Farm accounting 3. Land 4. Land 5. National

B) 1. True 2. False 3. True 4. True 5. True

2.7 Exercise :

(Theory and Practical Problems)

a) Broad Questions

1. What is mean by Farm Accounting? Explain its features.
2. Define 'Farm Accounting' explain its objectives.

b) Write short notes

a) Features of farm Accounting

b) Objectives of farm Accounting

c) Crop Accounts

d) Accounting for farms

Exercise-1

From the following Trial Balance, extracted from the books of Raj Farms, draw up the final accounts for the year ending 30th March, 2021.

Debit Balances		Rs.	Credit Balances		Rs.
Stock on 1-4-2020		26,000	Sundry Creditors		2,600
Live Stock	15,000		Outstanding expenses		400
Paddy	6,000		Sales :		
Cattle feed	1,000		Live stock	4,800	
Fertilizers	500		Paddy	42,500	
Seeds	500	23,000	Milk	25,700	73,000
Purchases :			Capital Account		50,300
Live stock	3,000				
Cattle feed	10,800				
Fertilizers	1,600				
Seeds	500	15,900			
Sundry Debtors		2,100			
Repairs and maintenance of farm machinery		2,200			
Farm Machinery		15,000			
Crop expenses		5,400			
Live stock expenses		3,800			
General expenses		3,900			
Cash in hand		1,500			
Cash at bank		8,500			
Land		45,000			
		1,26,300			1,26,300

Additional Information :

1. Closing stocks : Live stock, Rs. 10,000; Paddy Rs. 5,000; Cattle feed Rs. 600; Fertilizers Rs. 400.
2. Mr. Raj has consumed the following items out of his farm output :

Milk	Rs. 3,000
Paddy	Rs. 500

Provide 10% depreciation on farm machinery.

Exercise-2

From the following Trial Balance of Viraj, prepare trading and profit and loss account for the year ending 31st March, 2021 and a balance sheet as on that date.

Debit Balances		Rs.	Credit Balances	Rs.
Opening Stock			Sales :	
Paddy	500		Paddy	3,000
Potatoes	800		Potatoes	2,000
Cattle	1,000		Sugar cane	3,000
Sheep	700	3,000	Cattle	10,000
			Milk etc.	2,000
Purchases :			Sheep	3,000
Cattle	8,000		Loan from Land	
Sheep	1,000		Development Bank	8,700
Seeds	500		Capital Balance	20,000
Manures	1,000		Creditors for supplies	2,000
Cattle feed	1,000	11,500		
Crop expenses :				
Labour	400			
Other expenses	300	700		
Live stock expenses :				
Veterinary and medicines	500			
Labour	200			
Dairy expenses	300	1,000		
Expenses of machinery				
Repairs	300			
Diesel and oil	500			
Electricity	200	1,000		
General overheads :				
Rent and rates	1,000			
Insurance	200			
Wages for permanent	800			

labour				
Bank interest	500	2,500		
Farm Machinery		10,000		
Cash in hand		1,000		
Cash at Bank		3,000		
Land		20,000		
		53,700		53,700

Additional Information :

1. Closing stock : Rs.

	Rs.
Paddy	1,000
Potatoes	600
Cattle	1,500
Sheep	1,000

2. 50% of rent and rates may be taken as the share of Mr. Viraj for his residence.
3. Mr. Viraj has consumed the following from out of farm output:

Milk etc.	200
Potatoes	100
Paddy	700

4. Provide 10% depreciation on machinery.

Exercise-3 :

From the following trial balance of Sandhya Farm, prepare Corp Account, Live-stock Account, Profit & Loss Account for the year ended 31st March, 2021, and Balance Sheet as on that date.

Trial Balance

Debit Balance	**Rs.**	**Credit Balance**	**Rs.**
Opening Stock :		Sundry Creditors	7,500
Growing Crops	5,000	Bank Overdraft	1,500
Wheat	2,500	Managers Personal Account	1,000

Fertilizer	2,500	**Sales :**	
Live-stock	12,500	Wheat	17,500
Feeding Materials	3,000	Live-stock	37,500
Crop Expenses	5,000	Loan	30,000
Live-stock Expenses	14,150	Provision for Depreciation	15,000
Farm House Expenses	600	Profit & Loss A/c	5,000
Interest on Loan (Crop)	2,000	Capital	1,35,000
Salaries & Wages :			
Manager's Salary	3,000		
Farm Labour	2,500		
Staff Meals	250		
Loan & Building	1,05,000		
Farm Machinery	54,000		
Sundry Debtors	15,000		
Cash in Hand	13,000		
Repairs to Machinery	500		
Tools & Implements	1,250		
Office Expenses	2,000		
Live-stock Purchases	6,250		
	2,50,000		2,50,000

Additional Information :

(a) Stock on 31st March, 2021 Growing crops Rs. 2,000; Wheat Rs. 2,000; Fertilizer Rs. 1,000; Live-stock Rs. 20,000; Feeding materials Rs. 500; Tools and Implements Rs. 1,000.

(b) Depreciation on Tools & Implements is to be allocated between Crop and Live-stock equally.

(c) Manager's salary and staff meals are charged 30% to the Live-stock Account and 80% to the Crop Account.

(d) Farm product worth Rs. 500 is consumed by cattles.

(e) Farm house expenses and Farm Labour distributed between Crop and Live-stock in the ratio of 3 : 2.

Exercise-4 :

From the following prepare : (i) Crop A/c, (ii) Live-stock A/c, (iii) Profit & Loss A/c for the year ended 31-3-2021 and (iv) Balance Sheet as on that date.

Particulars	Debit Rs.	Credit Rs.
Stocks (1-4-2020)		
Live-stock	6,000	--
Crops	4,000	--
Feed	200	--
Farm House Expenses	240	--
Crop Expenses	2,000	--
Live-stock Expenses	5,500	--
Live-stock Purchases	2,500	--
Salaries & Wages		
Farm Labour (Crop)	1,000	--
Manager's Salary	1,200	--
Legal Fees	600	--
Office Expenses	200	--
Staff Meals	100	--
Sundry expenses (Live-stock)	160	--
Repairs to Machinery	400	--
Repairs & Maintenance (Live-stock)	100	--
Interest on Loan (Crop)	600	--
Cash in Hand	2,800	--
Sundry Debtors	8,000	--
Tools & Implements	300	--
Sheds (Live-stock)	100	--
Farm Machinery	22,000	--
Land & Building	40,000	--
Sales :		
Live-stock	--	15,000
Corn & Strand	--	7,000
Provision for Depreciation	--	8,000

Manager's Personal Account	--	100
Sundry Creditors	--	1,000
Bank Overdraft	--	900
Loan	--	10,000
Capital	--	56,000
	98,000	98,000

Adjustments :

1. Depreciate machinery by Rs. 100 and charge it to Crop A/c only.
2. Crop worth Rs. 400 was used for feeding Live-stock.
3. Office expenses and legal fees are purely of Administrative nature.
4. Charge 10% of salaries and staff meals to Live-stock A/c.
5. Depreciation on tools and implements is to be apportioned between Crop and Live-stock in the ratio of 3 : 1.
6. The manager of the farm resides in the Farm House as Free Residence but chargeable only 1/3 of the Farm House Expenses and is also entitled to a commission of 5% on profit made by Live-stock A/c before his commission.
7. Closing Stocks on 31-3-2021 were :

Growing Crops	Rs.	2,000
Tools & Implements	Rs.	100
Live-stock	Rs.	8,000
Feed	Rs.	400

2.8 Further Readings

1) Advanced Accountancy – Shukla & Grewal
ii) Advanced Accountancy – Chakrab horthy
iii) Advanced Accountancy – R. R. Gupta
iv) Advanced Accountancy – R. L. Gupta
v) Advanced Accountancy – Tulsian
vi) Steps in Advanced Accounting – Maheshwari

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Unit - 2

b) Hire Purchase System

Excluding Hire Purchase Trading Account

Structure of Unit :

2.0 Objectives

2.1 Introduction and Legal Position

2.2 Presentation of Subject Matter

2.2.1 Meaning of Purchase Agreement

2.2.2 Distinction between Hire Purchase and Installment

2.2.3 Terms used in Hire purchase

2.2.4 Accounting Entries in the books of Hire Purchaser and Vendor

2.2.5 Methods of calculation of interest.

2.2.6 Default and Repossession

2.3 Summary

2.4 Check your progress

2.5 Key words

2.6 Answer to check your progress

2.7 Exercise

2.0 Objectives :

After studying this unit students should be able to understand :

- Meaning and nature of Hire Purchase System.
- Difference between Hire purchase and Installment.
- Different Methods of calculation of Interest.
- Accounting entries to record hire purchase transactions.
- Accounting treatment after default in payment of installments.

2.1 Introduction & Legal Position :

Hire purchase means a transaction where goods are purchased or sold with the stipulation that (a) payment will be made by installments; (b) each installment will be treated as hire so that if default is made in the payment of even the last installment, the seller will be entitled to take away the goods without compensating the hire purchaser in any way; and (c) in case all instalments are paid, the goods will be treated as sold and property will pass to the purchaser. The property in the goods does not pass to the purchaser or hirer till the final instalment is paid.

He is free to return the goods without having to pay the instalment falling due after the return. In case of the instalment system, the property in the goods passes to the purchaser immediately the contract is signed and, if default is made in the payment of any instalment, the remedy open to the seller is to sue the purchaser for payment of the instalments due and not to take possession of the goods. This is the legal position but the intention of both the parties is, in both cases, to buy and sell, the payment being made in instalments.

The total payment made in case of hire purchase or instalment is more than the case price-naturally because in addition to case price, interest is also payable. It is necessary to calculate the interest so that the amount paid for interest is charged to revenue and the asset is capitalized only at the case price.

2.2 Presentation of Subject Matter

2.2.1 Meaning of Hire Purchase Agreement :

Hire purchase agreement means an agreement under which goods are let on hire and under which the hirer has on option to purchase them in accordance with the terms of the agreement and includes the agreement under which :

i) Possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodical instalments.

ii) The property in the goods (i.e. ownership of goods) is to pass to such a person on the payment of the last instalment; and

iii) Such a person has a right to terminate the agreement at any time before the property so pass.

2.2.2 Distinction between Hire purchase system and Instalments system :

Basis of Distinction	Hire Purchase System	Instalment System
1) Act Governing	It is governed by Hire Purchase Act 1972	It is governed by the Sale of Goods Act 1930
2) Nature of contact	It is an agreement of hiring.	It is an agreement of sale.
3) Passing of Title (ownership)	The title of goods passes on last payment.	The title of goods passes immediately.
4) Right to reposses	The seller may take possession of the goods if hirer is in default.	The seller can sue for price if the buyer is in default. He cannot take possession of the goods.
5) Right to Dispose off	Hirer can not hire out, sell, pledge or assign entitling transferee the goods till the payment of last instalment.	The buyer may dispose off the goods and give good title to bonafied purchaser.
6) Accounting	Asset account is debited step by step as and when instalments are paid.	The asset account is debited with full cash value immediately upon the agreement.

2.2.3 Terms used in Higher purchase Agreement :

a) **Hirer / Hire Purchaser :** A 'Hirer' means a person obtains possession of the goods from an owner under a hire purchase agreement.

b) **Hire vendor :** Hire Vendor means a person who delivers the possession of goods to the hirer under a hire purchase agreement.

c) **Cash Price :** Cash price means the price at which the goods may be purchased by the hirer for cash.

d) **Down Payment :** Down payment means an initial payment payable by the hirer on signing the hire purchase agreement.

e) **Hire Purchase Price :** Hire purchase price means the total sum payable by the hirer to the hire vendor. The hire purchase price includes cash price of the goods plus interest on outstanding balances.

Hire purchase price = Cash price + Interest on outstanding Balances.

2.2.4 (I) Accounting Entries in the Books of Hire Purchaser :

Following are the two methods of recording the hire purchase transactions the books of hire purchase.

a) Part cash price method.

b) Full cash price method.

Part cash price method is generally used to record hire purchase transaction but if there is repossession of goods for non-payment of instalment by the hire vendor the full cash price method is suitable.

a) Part cash price method :

Performa Journal Entries :

Sr.No.	Nature of transaction	Journal Entry	
1.	For cash down (On signing the agreement) Payment becomes due	Asset A/c To vendor's Ac/ (with cash down payment)	Dr.
2.	For payment of cash down	Vendor's A/c To Cash / Bank A/c	Dr.
3.	When subsequent instalments Falls due	Asset A/c (with cash price) Interest A/c (with interest) To vendor's A/c (with amount of instalents)	Dr. Dr.
4.	When instalment is paid	Vendor's A/c To Cash / Bank A/c.	Dr.

(Conted. on next page)

5.	For charging depreciation At the end of the year	Depreciation A/c Dr. To asset A/c (At the given rate on full cash price)
6.	For closing of depreciation and interest A/c	Profit & Loss A/c Dr. To Depreciation A/c To Interest A/c

Notes :

i) The first entries are made only if cash down / advance payment is made at the time of singing the agreement.

ii) The entries 3 to 6 are to be repeated every year till the last year.

b) Full Cash price Method :

Under this method, the asset A/c is debited with full cash price on signing the agreement as if asset is purchased on credit Performa Journal Entries.

Sr.No.	Nature of transaction	Journal Entry
1.	On signing the agreement	Asset A/c Dr. To Vendor's A/c (with full cash price of asset)
2.	For payment of cash down amount	Vendor's A/c Dr. To cash / Bank A/c (with cash down amount)
3.	For instalments becomes Due	Interest A/c Dr. To vendor's A/c (with interest amount in instalment)
4.	For payment of instalments	Vendors A/c Dr. To Cash / Bank (with amount of instalments)

(Conted. on next page)

5.	For charging depreciation Of the end of the year	Depreciation A/c Dr. To Asset A/c. (with amount of depreciation)
6.	For transfer in interest and Depreciation to P & L A/c	Profit & Loss A/c Dr. To Interest A/c. To Depreciation A/c

Note : Entries 3 to 6 are to be repeated every year.

2.2.4 (II) Accounting Entries in the books of Vendor :

Sr.No.	Nature of transaction	Journal Entry
1.	On singing the agreement	Hire purchaser's A/c Dr. To sales A/c (with Full cash price)
2.	For receipt of cash down Payment	Cash / Bank A/c Dr. To Hire purchaser's A/c (with cash down amount)
3.	When instalments becomes due	Hire purchaser's A/c Dr. To Interest A/c (with interest included in instalments)
4.	For receipt of instalment	Cash / Bank A/c Dr. To Hire purchaser's A/c (with the amount of instalments)
5.	For transfer of interest to P & L. A/c.	Interest A/c Dr. To profit & Loss A/c.

2.2.5 Methods of Calculation of Interest :

I) When Cash price, Hire Purchase Price and Rate of Interest are given :

When cash price, hire purchase price and rate of interest are given in the problem it is simple method. Interest at a given rate is calculated on the outstanding balance of cash price at the being of each year. Following are the illustrations.

Illustration – 1

On 1st April 2015, Sandeep purchased a machine for Ashok on hire purchase basis. The particulars are as follows :

i) Cash price of machne Rs. 20,000/-

ii) Cash down payment Rs. 8,000/-

iii) Balance in three annual instalment of Rs. 4,000/- plus interest.

iv) Interest to be charged on outstanding balance at 5% p.a.

v) Depreciation at 10% on reducing balance method.

For the above particulars pass journal entries in the books of both the parties and given necessary ledger accounts.

Solution :

In this problem cash price is given Rs. 20,000/- and total instalments is given also Rs. 20,000/- The rate of interest is 5% p.a. therefore we have to calculate the interest amount at the end of each year.

Installments Analysis Table :

Date	Outstanding Balance Cash price	Date of Payment	Instalment Advance	Interest	Portion of cash price	Depreciation of 10% on WDV
1-4-2015	20,000	1-4-2004	8,000	—	8,000	—
1-4-2015	12,000	31-3-2005	4600	600	4000	2000
1-4-2016	8,000	31-3-2006	4400	400	4000	1800
1-4-2017	4000	31-3-2007	4200	200	4000	1620

In the books of Sandeep (Hire Purchaser)

Journal Entries (Part Cash Method)

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
1-4-2015	Machine A/c Dr.		8,000	
	To Ashok A/c			8,000
	(Amount payable to Ashok on signing the agreement)			
1-4-2015	Ashok A/c. Dr.		8,000	
	To Aash			8,000
	(Cash down payment made to Ashok)			
31-3-2016	Machine A/c Dr.		4,000	
	Interest A/c Dr.		600	
	To Ashok A/c			4,600
	(Instalment including interest payable to Ashok)			
31-3-2016	Ashok A/c Dr		4,600	
	To Cash			4,600
	(Payment of instalment to Ashok)			
31-3-2016	Depreciation A/c Dr.		2,000	
	To Machine A/c			2,000
	(Charging depreciation @ 10% on WDV basis)			
31-3-2016	P & L A/c Dr.		2,600	
	To Depreciation A/c			2,000
	To Interest A/c			600
	(Balance on Depreciation & interest is Transferred to Profit & Loss A/c)			

31-3-2017	Machine A/c Dr.		4,000	
	Interest A/c Dr.		400	
	To Ashok A/c			4,400
	(Instalment including interest is payable)			
31-3-2017	Ashok A/c Dr.		4,400	
	To Cash			4,400
	(Payment of instalment)			
31-3-2017	Depreciation A/c Dr.		1,800	
	To Machine A/c			1,800
	(Charging depreciation at 10% on WDV basis)			
31-3-2017	Profit & Loss A/c Dr.		2,200	
	To Depreciation			1,800
	To Interest			400
	(Balance of depreciation and interest transfer to P & L A/c.)			
31-3-2018	Machine A/c Dr.		4,000	
	Interest A/c Dr.		200	
	To Ashok A/c			4,200
	(Instalment including interest is payable)			
31-3-2018	Ashok A/c Dr.		4,200	
	To cash			4,200
	(Payment of Instalment)			
31-3-2018	Depreciation A/c Dr.		1,620	
	To machine A/c			1,620
	(charging depreciation at 10% on WDV basis)			
31-3-2018	Profit & Loss A/c Dr.		1,820/-	
	To Depreciation A/c			1,620
	To Interest A/c			200
	(Balance of depreciation & interest is transfer)			

Ledger Account :

Dr. **Machine A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Ashok	8,000	31-3-2016	By Depreciation	2,000
1-4-2016	To Asho	4,000	31-3-2016	By Balance c/d	10,000
		12,000			**12,000**
1-4-2016	To balance b/d	10,000	31-3-2017	By Depreciation	1,800
31-3-2017	To Ashok	4,000	31-3-2017	By Balance c/d	12,200
		14,000			**14,000**
1-4-2017	To balance b/d	12,200	31-3-2018	By Depreciation	1,620
31-3-2018	To Ashok	4,000	31-3-2018	By Balance c/d	14,580
		16,200			**16,200**
1-4-2018	To balance b/d	14,580			

Dr. **Ashok A/c (Vendor)** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Cash	8,000	1-4-2016	By Machine A/c	8,000
31-3-2016	To Cash	4,600	31-3-2016	By Machine A/c	4,000
			31-3-2016	By Interest	600
		12,600			**12,600**
1-3-2017	To Cash	4,400	31-3-2017	By Machine	4,000
			31-3-2017	By Interest	400
		4,400			**4,400**
31-3-2018	To Cash	4,200	31-3-2018	By Machine	4,000
			31-3-2018	By Interest	200
		4,200			**4,200**

Dr. **Depreciation A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
31-3-2016	To Machine	2,000	31-3-2016	By Profit & Loss A/c	20,000
31-3-2017	To Machine	1,800	31-3-2017	By Profit & Loss A/c	1,800
31-3-2018	To Machine	1,620	31-3-2018	By Profit & Loss A/c	1,620

Dr. **Interest A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
31-3-2016	To Ashok	600	31-3-2016	By Profit & Loss A/c	600
31-3-2017	To Ashok	400	31-3-2017	By Profit & Loss A/c	400
31-3-2018	To Ashok	200	31-3-2018	By Profit & Loss A/c	200

Journal Entries in the books of Ashok (Vendor)

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
1-4-2015	Sandeep A/c Dr.		20,000	
	To Sales			20,000
	(Sale of machine to Sandeep HP basis)			
1-4-2015	Cash A/c Dr.		8,000	
	To Sandeep A/c			8,000
	(receipt of cash down payment from Sandeep)			
31-3-2016	Sandeep A/c Dr.		600	
	To Interest A/c			600
	(interest receivable from Sandeep)			
31-3-2016	Cash A/c Dr.		4,600	
	To Sandeep A/c			4,600
	(receipt of Instalment including interest)			

(Conted. on next page)

31-3-2016	Interest A/c Dr.		600	
	To Profit & Loss A/c			
	(transfer to balance interest to P & L A/c)			
31-3-2017	Sandeep A/c Dr.		400	
	To Interest A/c			400
	(interest receivable from Sandeep)			
31-3-2017	Cash A/c Dr.		4,400	
	To Sandeep A/c			4,400
	(transfer of balance to P & L A/c)			
31-3-2018	Sandeep A/c Dr.		200	
	To Interest A/c			200
	(interest receivable from Sandeep)			
31-3-2018	Cash A/c Dr.		2,200	
	To Sandeep A/c			2,200
	(receipt of instalment including interest)			
31-3-2018	Interest A/c Dr.		200	
	To Profit & Loss A/c			200
	(transfer of balance to P & L A/c)			

Ledger Accounts :

Dr. **Sandeep A/c (Hire Purchaser's)** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Sales	20,000	1-4-2015	By Cash	80,000
31-3-2016	To Interest	600	31-3-2016	By Cash	4,600
			31-3-2016	By Balance c/d	8,000
		20,600			**20,600**

(Conted. on next page)

1-4-2016	To balance b/d	8,000	31-3-2017	By Cash	4,400
31-3-2017	To Interest	400	31-3-2017	By Balance c/d	4,000
		8,400			**8,400**
1-4-2017	To Balance	4,000	31-3-2018	By Cash	4,200
31-3-2018	To Interest	200			
		4,200			**4,200**

Dr. **Interest A/c** Cr.

Date	**Paticulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
3-1-2016	To Profit & Loss A/c	600	31-3-2016	By Sandeep	600
31-3-2017	To Profit & Loss A/c	400	31-3-2017	By Sandeep	400
31-3-2018	To Profit & Loss A/c	200	31-3-2018	By Sandeep	200

Illustration – 2 :

On 1st Apri 2015, Asian Ltd., purchased a machine on hire purchase system from Sunshine Ltd., The Cash price of the machine was Rs. 74,500/- and the payment was to be made as follows :

Rs. 20,000/- was to be made on signing to agreement and the balance in three annual instalments of Rs. 20,000/- each at the end of each year. 5% interest is charged by Sunshine Ltd., per annum. Asian Ltd., was decided to write off 10% depreciation per annum on reducing value of the machine. Prepare necessary ledger accounts in the books of Asian Ltd.,

Solution :

Calculation of Interest Chart

Date	Advance Instalment	Interest @ 5% on outstanding Cash price	Cash price included in Instalment	Cash price unpaid	Depreciation @ on WDV
1-4-2015	—	—	—	74,500	74,500
1-4-2015	20,000	—	20,000	54,500	—
31-3-2016	20,000	5% on 54,500 = 2725	17,275	37,225	74,500 – 7,450 = 67,050
31-3-2017	20,000	5% on 37,225 = 1,861	18,139	19,086	67,050 – 6,705 = 60,345
31-3-2017	20,000	Bal figure = 914	19,086	—	60,345 – 6,035 = 54,310

Note :

In the above problem cash price of the machine is given Rs. 74,500/- and hire purchase price is also given Rs. 80,000/- (i.e. 20,000/- Adv. + instalments of Rs. 20,000 each). Therefore the difference of Rs. 5,500/- (80,000 – 74,500) is interest payable.

Ledger Accounts in the books of Asian Ltd.,

Dr. **Interest A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
31-3-2016	To Sunshine Ltd.	2,725	31-3-2016	By Profit & Loss A/c	2,725
31-3-2017	To Sunshine Ltd.	1,861	31-3-2017	By Profit & Loss A/c	1,861
31-3-2018	To Sunshine Ltd.,	914	31-3-2018	By Profit & Loss A/c	914

Dr. **Machine Account** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Sunshine Ltd.,	20,000	1-4-2015	By Depreciation	7,450
31-3-2016	To Sunshine Ltd.,	17,275	31-3-2016	By balance C/d	29,825
		37,275			**37,275**
1-4-2016	To balance b/d	29,825	31-3-2017	By Depreciation	6,705
31-3-2017	To Sunshine Ltd.	18,139	31-3-2017	By Balance A/c	41,259
		47,964			**47,964**
1-4-2017	To balance Ltd.	41,259	31-3-2018	By Depreciation	6,035
31-3-2018	To Sunshine	19,086	31-3-2018	By Balance c/d	54,310
		60,345			**60,345**

Dr. **Sunshine Ltd., (Vendor) A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To cash	20,000	1-4-2015	By Machine	20,000
31-3-2016	To Cash	20,000	31-3-2016	By Machine	17,275
			31-3-2016	By Interest	2,725
		40,000			**40,000**
31-3-2017	To Cash	20,000	31-3-2017	By Machine	18,139
			31-3-2017	By Interest	1,861
		20,000			**20,000**
31-3-2018	To Cash	20,000	31-3-2018	By Machine	19,086
			1-3-2018	By Interest	914
		20,000			**20,000**

II) When Hire purchase price and rate of interest are given but cash price is not given :

In this method though the rate of interest is given the total interest payable can not be calculated, as the cash price of asset is not given. Therefore at the start cash price of the asset should be ascertained. To do this calculation the analysis of instalment will start from the last instalment. Hence this method is called 'Reverse Method'

Illustration – 3 :

Aniket purchased a motor car on hire purchase system from Sahyadri Motors on 1-4-2014 on paying Rs. 12,000 down. The balance amount (including 10% p.a.) was paid at the end of each year as under. 31-3-2015 Rs. 25,600/- 31-3-2016 Rs. 19,600/- 31-3-2017 Rs. 14,000/-, 31-3-2018 Rs. 8,800/-.

Depreciation was charged by Aniket @ 10% under fixed instalment syste system. Show calculation of interest in each instalment and ledger accounts in the books of Aniket and Sahyadri Motors.

End of the year	Amount Due	Interest = 10 $\frac{10}{110}$ = 1/11	Cash at the beginning (100)	Beginning of the year
31-3-2018	8800	8800 x 1/11 = 800	8,000	1-4-2007
31-3-2017	8000 + 14000	22000 x 1/11 = 22000	20,000 = 2,000	1-4-2006
31-3-2016	20,000 + 19,600	39,600 x 1/11 = 39,600	36000 = 36,600	1-4-2005
31-3-2015	36,000 + 25,600	61,600 x 1/11 = 61,600	56,000 = 5,600	1-4-2004
1-4-2014	56,000 + 12,000 = 68,000	68,000 x Nil = --	68,000	1-4-2004
		12,000	68,000	

Thus the cash price of motor at the beginning is Rs. 67,000/- and total interest payable is Rs. 12,000/- Advance payment is made on the day of signing the agreement, hence it does not includes interest.

Dr. **Motor Car A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2014	To Sahyadri Motor	68,000	31-3-2015	By Depreciation	6,800
			31-3-2015	By balance c/d	61,200
		68,000			**69,000**
1-4-2015	To balance b/d	61,200	31-3-2016	By Depreciation	6,500
			31-3-2016	By balance c.d	54,400
		61,200			**61,200**
1-4-2016	To balance b/d	54,400	31-3-2017	By Depreciation	6,800
			31-3-2017	By Balance c/d	47,600
		54,400			**54,400**
1-4-2017	To balance b/d	47,600	31-3-2018	By Depreciation	6,800
			31-3-2018	By Balance c/d	40,800
		47,600			**47,600**

Dr. **Sahyadri Motors A/c.** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2014	To Cash	12,000	1-4-2014	By Motor Car	68,000
31-3-2015	To Cash	25,600	31-3-2015	By Interest	5,600
31-3-2015	To Balance c/d	36,000			
		73,600			**73,600**
31-3-2016	To Cash	19,600	1-4-2015	By Balance B/d	36,000
31-3-2016	To Balance c/d	20,000	31-3-2016	By Interest	3,600
		39,600			**39,600**

31-3-2016	To Cash	14,000	1-4-2016	By balance b/d	20,000
31-3-2017	To balance c/d	8,000	31-3-2017	By Interest	2,000
		22,000			**22,000**
31-3-2018	To Cash	8,800	1-4-2017	By Balance	8,000
			31-3-2018	By Interest	800
		8,800			**8,800**

In the Books of Sahyadri Motors

Dr. **Sunshine Ltd., (Vendor) A/c** Cr.

Date	**Paticulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
1-4-2014	To Sales	68,000	1-4-2004	By Cash	12,000
31-3-2015	To Interest	5,600	31-3-2005	By Cash	25,600
			31-3-2005	By Balance c/d	36,000
		73,600			**73,600**
1-4-2015	To Balance b/d	36,000	31-3-2016	By Cash	19,600
31-3-2016	To Interest	3,600	31-3-2016	By Balance c/d	20,000
		39,600			**39,600**
1-4-2016	To Balance b/d	20,000	31-3-2017	By Cash	14,000
31-3-2017	To Interest	2,000	31-3-2017	By Balance b/d	8,000
		22,000			**22,000**
1-4-2017	To Balance b/d	8,000	31-3-2018	By Cash	8,800
31-3-2018	To Interest	800			
		8,800			**8,800**

Dr. **Interest A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
31-3-2015	To Profit & Loss A/c	5,600	31-3-2015		5,600
31-3-2016	To Profit & Loss A/c	3,600	31-3-2016		3,600
31-3-2017	To Profit & Loss A/c	2,000	31-3-2017		2,000
31-3-2018	To Profit & Loss A/c	800	31-3-2018		800

Illustration - 4

On 1st April, 2015 the Unique transports Ltd., purchased a Mini Truck from Hindusthan Motors Ltd., on hire purchase basis. The payment was made as under -

Rs. 50,000 on signinging the agreemal Rs. 65,000 on 31-3-2016

Rs. 60,000 on 31-3-2017 Rs. 55,000 on 31-3-2018

Interest includes in cash price @10% p.a. Unique depreciates the truck at 20% on WDV. Given hedger Accounts in the books of Unique Ltd.,

Solution :

The hire purchase price is given Rs. 2,30,000 and rate of interest is 10% but cash price is not given. Suppose cash price is Rs. 100 the interest is 10, then the total amount due is Rs. 110 (100 + 10).

Therefore when the total amount due is Rs. 110, the interest is Rs. 1-. So, when the total amount due is Re. 1 interest is 10/110 = 1/11

End of the year	Amount Due	Interest = 10 $\frac{10}{110}$ = 1/11	Cash price at the beginning	Beginning of the year
31-3-2018	55000	55,000 x 1/11 = 5,000	50,000	1-4-2017
31-3-2017	50,000 + 60,000 = 1,10,000	1,10,000 x 1/11 10,000	1,00,000	1-4-2017
31-3-2016	1,00,000+1,65,000 = 1,65,000	1,65,000 x 1/11 = 15,000	1,50,000	1-4-2016
1-4-20015	1,50,000 + 50,000 = 2,00,000	2,00,000 x -- = 30,000	2,00,000 2,00,000	1-4-2015
		30,000	2,00,000	

Thus the total purchase price is Rs. 2,30,000 the total interest included in instalment is Rs. 2,00,000 and cash price is Rs. 2,00,000/-

In the books of Unique Transports Ltd.,

Dr. **Mini Truck A/c (Part Cash Method)** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Hindustan Motors	50,000	31-3-2016	By Depreciation	40,000
31-3-2016	To Hindustan Motors	50,000	31-3-2016	By Balance c/d	60,000
		1,00,000			**1,00,000**
1-4-2016	To Balance b/d	60,000	31-3-2017	By Depreciation	32,000
31-3-2017	To Hindustan Motors	50,000	31-3-2017	By Balance c/d	78,000
		1,10,000			**1,10,000**
1-4-2017	To Balance b/d	78,000	31-3-2018	By Depreciation	25,600
31-3-2018	To Hindustan Motors	50,000	31-3-2018	By Balance c/d	1,02,400
		1,28,000			**1,28,000**
1-4-2018	To Balance b/d	1,02,400			

Dr. **Hindustan Motors A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Cash	50,000	1-4-2015	By Mini Truck	50,000
31-3-2016	To Cash	65,000	31-3-2016	By Mini Truck	50,000
			31-3-2016	By Interest	15,000
		1,15,000			**1,15,000**
31-3-2017	To Cash	60,000	31-3-2017	By Mini Truck	50,000
			31-3-2017	By Interest	10,000
		60,000			**60,000**
31-3-2018	To Cash	55,000	31-3-2018	By Mini Truck	50,000
			31-3-2018	By Interest	5,000
		55,000			**55,000**

III) Ratio Method :

Sometimes Cash price of the asset and hire purchase price of the asset are given but rate of interest is not mentioned. In such cases the total interest (H. P. Price – Cash price) is apportioned in the ratio of outstanding balances of H.P. price at the beginning of each period.

Illustration – 5 :

Mr. Ravishankar purchased a machine on hire purchase basis from the Telco Machines Ltd. On 1st April 2015. The cash price of the machine was Rs. 1,00,000/-. Mr. Ravishnakar paid Rs. 20,000/- on signing the agreement and took the delivery of the machine. The balance amount was paid in four equal Installments of Rs.24,000/- each at the end of the each year.

Depreciation is charged @10% p.a. on the WDV basis.

Prepare Machine A/c and Telco Machine A/c in the books of Revishankar.

Solution :

In this hire purchase price of the machine is given Rs. 16,000/- (20,000 + 16,000)

Instalment Analysis Table

Date	Advance Installment paid	Instalment outstanding	Ratio of Instalment	Interest included Instalment instalment	Cash price included in WDV basis	Depreciation at 10% on
1-4-2015	20,000	--	--	--	20,000	Cash price 100000
31-3-2016	24,000	96,000	4	16000 x 4/10 = 64,000	176600	100000-100000 = 90000
31-3-2017	24,000	72,000	2	16000 x 3/10 = 4800	19200	90000 – 9000 = 81000
31-3-2018	24,000	48,000	3	16000 x 2/10 = 3200	20800	81000 - 8100 = 72900
31-3-2019	24000	24000	1	16000 x 1/10 = 16000	22400	72900 - 7290 =65,610
			10	16000	100000	

In the books of Ravishankar (Part Cash Method)

Dr. **Machine A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Telco Machnes	20,000	31-3-2016	By Depreciation	10,000
31-3-2016	To Telco Machine	17,600	31-3-2016	By Balance c/d	27,600
		37,600			**37,600**
1-4-2016	To Balance b/d	27,600	31-3-2017	By Depreciation	9,000
31-3-2017	To Telco Machines	19,200	31-3-2017	By Balnace c/d	37,800
		46,800			**36,800**
1-4-2017	To Balance b/d	37,800	31-3-2018	By Depreciation	8,100
31-3-2018	To Telco Machine	22,400	31-3-2019	By Balance b/d	65,610
		72,900			**72,900**

Dr. **Telco Machine A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Bank	20,000	1-4-2015	By Machine	20,000
31-3-2016	To Bank	24,000	31-3-2016	By Machine	17,600
			31-3-2016	Interest	6,400
		44,000			**44,000**
31-3-2017	To Bank	24,000	31-3-2017	By Machine	19,200
			31-3-2017	By Interest	4,800
		24,000			**24,000**
31-3-2018	To Bank	24,000	31-3-2018	By Machine	20,800
			31-3-2018	By Interest	3,200
		24,000			**24,000**
31-3-2018	To Bank	24,000	31-3-2019	By Machine	22,400
			31-3-2019	By Interest	1,600
		24,000			**24,000**

2.2.6 Default and Repossession :

If a hire purchaser fails to pay an installment on the stipulated date, the hire purchaser is said to be at default. In such case, the hire vendor may reposes the goods. Repossession means taking back the possession of goods by the hire vendor. Subject to agreement, the repossession may be complete or partial.

2.2.6.1 Complete Repossession :

In case of complete or full repossession the hire vendor take back the possession of all the goods and forfeit the installments already paid by the hire purchaser.

Accounting treatment :

In the books of hire purchaser

i) All entries till the date of default are passed in the usual manner.

ii) On the date of default for transfer of Vendor A/c balance.

a. Hire Vendor A/c Dr. (with entire balance in
To Asset A/c (vendor A/c)

b. For transfer of balance on asset A/c to Profit & Loss A/c
Profit & Loss A/c Or (with entire balance requiring
To Asset A/c in Asset A/c

In the books of Hire Vendor

i) All entries the date of default are passed in the usual manner.

ii) On the date of default

a. For repossession of goods :
Goods repossessed A/c Dr. (with balance in hire
To Hire Purchaser's A/c Purchaser's A/c)

b. For amount spent for repairs of goods repossessed.
Goods repossessed A/c Dr. (with amount spent on repairs
To Cash / Bank

c. For sale of goods reposed
Cash / Bank A/c Dr. (With sale proceeds of
To goods repossessed A/c goods repossessed)

d) For transfer to profit on sale of goods repossessed

Goods repossessed A/c Dr.

To Profit and Loss A/c

(In case of loss on sale, reverse entry will be passed)

Illustration : 6

On 1-4-2015 Shahu Traders acquired two Motor Cycle each costing Rs. 37,300/- for M/s. Hind Motors Ltd. On hire purchase. Payment to be made Rs. 20,000 down and the balance in three equal instalments of Rs. 20,000 each at the end of each year. The interest is charged at 5% p.a. Depreciation to be provided is at 10% p.a. on reducing balance method.

M/s. Shahu Traders after having paid the advance and the first instalment at the end of first year failed to pay the second instalment because of financial difficulties. Hind Motors took the possession of both the Motor cycle and sold them for Rs. 46,500/- after spending Rs. 2800/- for repairs

Write up necessary ledger accounts in the books of both the parties.

Solution :

In the method cash price of the motor cycle is given Rs. 74,600/- (37300 x 2) Hire purchase price is given Rs. 80,000 (20000 adv + 20000 x 3) and the rate of interest is given at 5%. Therefore we have to calculate the interest included in each instalment by simple method.

Instalment Analysis Table

Date	Advocate Instalment	Interest included In instalment	Cash price included in Instalment	Unpaid Cash price	Depreciation of 10% on WDV
1-4-2015	--	--	--	74,600	74,600
1-4-2015	20000	--	20,000	54,600	--
31-3-2016	20,000	5% on 54,600 =2,730	17,270	38,330	74,600-7,460 =67,140
31-3-2017	20,000	5% on 37,330 =1,867	18133	19,197	67,140-6,714 =60,426
31-3-2018	20,000	Bal. figure = 803	19,197	--	60,426-6,043 =54,383
	80,000	5,400	74,600		

Dr. **Motor Cycle Account (Full Cash price Method)** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Hind Motors	74,600	31-3-2016	By Depreciation	7,460
			31-3-2016	By Balance c/d	67,140
		74,600			**74,600**
1-4-2016	To Balance b/d	67,140	31-3-2017	By Depreciation	6,714
			31-3-2017	By Hind Motors (traveller)	39,197
			31-3-2017	By P. & L. A/c	21,229
		67,140			**67,140**

Dr. **Hind Motors Ltd., A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Bank	20,000	1-4-2015	By Motor cycle	74,600
31-3-2016	To Bank	20,000	31-3-2016	By Interest	2,730
31-3-2016	To Balance c/d	37,330			
		77,330			**77,330**
31-3-2017	To Motor cycle	39,197	1-4-2016	By Balance b/d	37,330
			31-3-2017	By Interest	1,867
		39,197			**39,197**

In the Books of Hind Motors

Dr. **Hind Motors Ltd., A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Sales	74,600	1-4-2015	By Bank	20,000
31-3-2016	To Interest	2,730	31-3-2016	By Bank	20,000
			31-3-2016	By Balance c/d	37,330
		77,330			**77,330**

1-4-2016	To Balance b/d	37,330	31-3-2017	By Goods	
31-3-2017	To Interest	1867		Respossed	39,197
		39197			**39197**

Dr. **Goods Repossessed A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
31-3-2017	To Shahu Traders	39,197	31-3-2017	By Bank (Sales)	46,500
31-3-2017	To Bank (Repairs	2,800			
31-3-2017	To P & L A/c	4,503			
		46,500			**46,500**

Alternative Method :

In the books of Shahu Traders (Part Cash Method)

Dr. **Motor Cycle A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Hind Motors	20,000	31-3-2016	By Depreciation	7,460
31-3-2016	To Hind Motors	17,270	31-3-2016	By Balance c/d	29,810
		37,270			**37,270**
1-4-2016	To Balance b/d	29,810	31-3-2017	By Depreciation	6,714
31-3-2017	To Hind Motors	18,133	31-3-2017	By Hind Motors	20,000
			31-3-2017	P & L A/c	21,229
		47,943			**47,943**

Dr.			Hind Motors A/c		Cr.
Date	**Paticulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
1-4-2015	To Bank	20,000	1-4-2015	By Motor Cycle	20,000
31-3-2016	To Bank	20,000	31-3-2016	By Motor Cycles	17,270
			31-3-2016	Interest	2,730
		40,000			**40,000**
31-3-2017	To Motor Cyccle	20,000	31-3-2017	By Motor Cycle	18,133
	A/c (Transfer)		31-3-2017	By Interest	1,867
		20,000			**20,000**

Illustration - 7 :

Mr. Kankadas purchased a machine on hire purchase system on 1-4-2016 from Mr. Narayandas for Rs. 11,175 and payment was to be made as Rs. 3,000 on signing the agreement and the balance in three annual instalments to Rs. 3,000/- each at the end of each year. Interest charged of 5% p.a. Kankadas depreciation the machine at 10% p.a. on reducing balance method.

Mr. Kankdas after having paid down payment and first instalment of the end of first year could not pay second instalment due to financial difficulties and Mr. Narayandas took possession of the machine.

Mr. Narayandas sold the machine for Rs. 7,500 after spending Rs. 800 for repairs of machine. Shown necessary ledger accounts assuming accounts are closed on 31st March every year.

Solution :

The cash price of the machine is given Rs. 11,175 and hire purchase pria is given Rs. 12,000. Hence told interest included in instalment is Rs. 825/-. The rate of interest is given 5%.

Interest Calculation Table

Date	Advocate Instalment	Interest included In instalment	Cash price included in Instalment	Unpaid Cash price	Depreciation of 10% on WDV
1-4-2016	--	--	--	11,175	11,175
31-3-2016	3,000	--	3,000	8,175	--
31-3-2017	3,000	8,775 x 5%	22,591	5,584	11,175 - 1,118
		= 409			= 10,057
31-3-2018	3,000	5,584 x 5%	2,720	2,864	1,005 - 1,006
		= 280			= 9,051
31-3-2019	3,000	Bal figure =	2,864	--	9,051 - 905
		= 136			= 8,146
	1,200	825	11,175		

In the books of Mr. Kankadas

(Full cash price method)

Dr. **Machine A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2016	To Narayandas	11,175	31-3-2017	By Depreciation	1,118
			31-3-2017	By Balance c/d	10,057
		11,175			**11,175**
1-4-2017	To Balance b/d	10,057	31-3-2018	By Depreciation	1,006
			31-3-2018	By Narayandas (Transfer)	5,864
			31-3-2018	By Profit & Loss A/c	3,187
		10,057			**10,057**

Dr. **Mr. Narayandas A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2016	To Bank	3,000	1-4-2016	By Machine	11,175
31-3-2017	To Bank	3,000	31-3-2017	By Interest	409
31-3-2017	To Balance c/d	5,584			
		11,584			**11,584**
31-3-2018	To Machine A/c	5,864	1-4-2017	By Balance b/d	5,584
	(Transfer)		31,3,2018	By Interest	280
		5,864			**5,864**

In the Books of Mr. Narayandas

Dr. **Kankadas A/c.** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2016	To Sales	11,175	1-4-2016	By Bank	3,000
31-3-2017	To Interest	409	31-3-2017	By Bank	3,000
			31-3-2017	By Balance c/d	5,584
		11,584			**11,584**
1-4-2017	To Balance b/d	5,584	31-3-2018	By Goods	5,864
31-3-2018	To Interest	280		Repossessed A/c	
		5,864			**5,864**

Dr. **Goods Repossessed A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
31-3-2018	To Kankdas	5,864	31-3-2018	By CAsh (Sales)	7,500
31-3-2018	To Cash (Repairs)	800			
31-3-2018	To Profit & Loss A/c	1,964			
		7,500			**7,500**

2.2.6 Partial Repossession :

In case of partial repossession the hire vendor takes back the possession of a part of the goods.

Accounting treatment :

In the books of Hire Purchaser

i) All entries till the date of for future are passed in usual manner.

ii) On a date of default following entries are passed.

a. For transfer of agreed value of goods repossessed.

Hire vendor's A/c	Dr.	(with agreed value of
To Asset A/c		goods repossessed)

b. For transfer on default

Profit & Loss A/c	Dr.	(with difference in book value
To asset A/c		and agreed value)

(In case of profit on default reverse entry will be passed)

In the books of Hire Vendor

i) All entries till the date of default are passed in usual manner.

ii) On the date of default following entries are passed.

a. On repossession of goods at agreed values.

Goods Repossessed A/c	Dr.	(with agreed value of goods
To Hire purchaser's A/c		repossessed)

b. For amount spent on repairs of goods repossessed.

Goods Repossessed A/c	Dr.
To cash	

c. For sale of goods repossessed

Cash / Bank A/c	Dr.
To Goods Repossessed A/c	

d. For transfer of Profit on sale of goods reposed

Goods repossessed A/c Dr.

To Profit & Loss A/c

(In case of loss on sale, reverse entry will be passed)

Illustration – 8 :

X Transport Ltd., purchased from Delhi Motors 3 Tempos costing Rs. 50,000/- each on hire purchase system on 1-4-2016. Payment was to be made Rs. 30,000 down and the remainder in 3 equal instalments payable on 31-3-2017, 31-3-2018 and 31-3-2019 together with interest at 9% p.a. X Transport Ltd. Writes of depreciation at the rate of 20% p.a. on the diminishing balance. X Ltd. Paid the instalments due all the end of first year i.e. 31-3-2017 but could not pay the next on 31-3-2018. Delhi Motors agreed to leave tempo with purchaser on 1-4-2018 adjusting the value of the other 2 Tempos against the amount due on 1-4-2018. The Tempos are valued on the basis of 30% depreciation annually on WDV.

Delhi Motors after spending Rs. 2,000 on repairs sold all the 2 Tempos for Rs. 60,000.

Show ledger accounts in the books of X Transport Ltd. & Delhi Motors.

Interest Analysis Table

Date	Advocate Instalment	Interest of 9% on unpaid cash price	Cash Price included in Instalment	Unpaid Cash price	Depreciation of 20% on WDV
1-4-2016	–	–	–	1,50,000	1,50,000
1-3-2016	30,000	–	30,000	1,50,000-30,000 = 1,20,000	–
31-3-2017	50,800	9% on 1,20,000 = 10,800	40,000	1,20,000-40,000 = 80,000	1,50,000-30,000 1,20,000
31-3-2018	47,200	9% on 80,000 =7,200	40,000	80,000-40,000 =40,000	1,20,000-24,000 96,000
31-3-2019	43,600	9% on 40,0000 = 3,600	40,000	30,000-40,000 = Nil	96,000-19,200 = 76,800
	1,71,600	21,600	1,50,000		

In the Books of X Transports Ltd.,

Dr. **Tempos Account** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Delhi Motors	1,50,000	31-3-2017	By Depreciation	30,000
			31-3-2017	By Balance c/d	1,20,000
		1,50,000			**1,50,000**
1-4-2017	To Balance b/d	1,20,000	31-3-2018	By Depreciation	24,000
				By Balance c/d	96,000
		1,20,000			**1,20,000**
1-4-2018	To Balance b/d	96,000	1-4-2018	ByDelhi Motors (Vaue of 2 tempos takon away WN-1)	49,000
			31-3-2019	By P & L. A/c (Loss on Default WN-3)	15,000
			31-3-2019	By Depreciation A/c	6,400
			31-3-2019	By Balance c/d (Tempo retailed W.N.-2)	25,600
		96,000			**96,000**

Dr. **Sunshine Ltd., (Vendor) A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2016	To Bank	30,000	1-4-2016	By Tempos	1,50,000
31-3-2017	To Bank	50,800	31-3-2017	By Interest	10,800
31-3-2017	To Balance c/d	80,000			
		1,60,800			**1,60,000**

(Conted. on next page)

31-3-2018	To Balance c/d	87,200	1-4-2017	By Balance b/d	80,000
			31-3-2018	By Interest	7,200
		87,200			**87,200**
1-4-2018	To Tempos	49,000	1-4-2018	By Balance	87,200
1-4-2018	To Balance c/d	38,200			
		87,200			**87,200**

In the books of Delhi Motors

Dr. **X Transports Ltd., A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2016	To Sales	1,50,000	1-4-2016	By Bank	30,000
31-3-2017	To Interest	10,800	31-3-2017	By Bank	50,800
			31-3-2017	By Balance c/d	80,000
		1,60,000			**1,60,000**
1-4-2017	To Balance b/d	80,000	31-3-2018	By Balance c/d	87,200
31-3-2018	To Interest	7,200			
		87,200			**87,200**
1-4-2018	To Balance b/d	87,200	1-4-2018	By Goods repossessed	49,000
			1-4-2018	By Balance c/d	38,200
		87,200			**87,200**

Dr. **Goods repossessed A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2018	To X Transports	49,000	1-4-2018	By Bank (Sale)	60,000
1-4-2018	To Bank (Reports)	2,000			
1-4-2018	To P & L A/c	9,000			
		60,000			**60,000**

Working Note :

1) Agreed Value of 2 Tempos repossessed

Cash price of Tempos	1,00,000
Less : Dep. At agreed 30% for 1st year	30,000
	70,000
Less : Dep. Of agreed 30% for 2nd year	21,000
Value of reposed temp	49,000

2) Value of One tempo with Hire purchaser

Cash price of one tempo	50,000
Less : Deperciation at 20% for 1st year	10,000
	40,000
Less : Depreciation at 20% for 2nd year	8,000
	32,000
Less : Depreciation at 20% for 3rd year	6,400
Value of one Tempo	25,600

3) Loss of Default

Cost of 2 tempos	1,00,000
Less : Depreciation at 20% for 1st year on WDV	20,000
	80,000
Less : Depreciation at 20% for 2nd year on WDV	16,000
Book value of 2 tempos on date of default	64,000
Less : Agreed value as per WN 1	49,000
Loss on default	15,000

Illustration : 9

Prashant purchased 4 motor cycles of Rs. 56,000 each on hire purchase system on 1-4-2015. The hire purchase price for all 4 motor cycle was Rs. 2,40,000 to be paid Rs. 60,000 down and three instalments of Rs. 60,000 each at the end of each year.

Interest is charged at 5% p.a. Buyer depreciation motor cycle at 10% p.a. on straight line method. After having paid down payment and 1st Instalmant, buyer could not pay 2nd instalment and seller took possession of 3 motor cycles at an agreed value to be calculated after depreciating cars of 20% p.a. on written down value method. One motor cycle was left with the buyer.

Seller after spending Rs. 4,500 on repairs, sold away all the three motor-cycle to Mahesh for Rs. 1,40,000.

Give ledger accounts in the books of both the parties.

Solution :

The cash price of 4 motor cycle is given Rs. 2,24,00 and hire purchase price is given Rs. 2,40,000. Therefore the interest included in instalment is Rs. 16,000. The interest included in 1st instalment Rs. 82,000 (5% on Rs. 1,64,000) 2nd instalment Rs. 5,619 (5% on Rs. 1,12,200), 3rd instalment Rs. 2,190 (balancing figure).

In the books of Prashant

Dr. **Motor Cycle A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Vendor's A/c	2,24,000	31-3-2016	By Depreciation	22,400
			31-3-2016	By Balance c/d	2,01,600
		2,24,000			**2,24,000**
1-4-2016	To Balance b/d/	2,01,600	31-3-2017	By Depreciation	22,400
			31-3-2017	By Vendor A/c (Value of 3 motor cycles taken over)	1,07,520
			31-3-2017	By Profit & Loss A/c (Loss on default)	26,880
			31-3-2017	By Balance c/d Valued one motor cycle)	44,800
		2,01,600			**2,01,600**

Dr. **Vendor's A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To Bank	60,000	1-4-2015	By Motor Cycle	2,24,000
31-3-2016	To Bank	60,000	31-3-2016	By Interest	8,200
31-3-2016	To Balance	1,12,200			
		2,32,200			**2,32,200**
31-3-2017	To Motor cycle A/c	1,07,520	1-4-2016	By Balance b/d	1,12,200
31-3-2017	To Balance c/d	10,290	31-3-2017	By Interest	5,610
		1,17,810			**1,17,810**

In the books of Vendor

Dr. **Prashant A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2015	To sales	2,24,000	1-4-2015	By Bank	60,000
31-3-2016	To Interest	8,200	31-3-2016	By Bank	60,000
			31-3-2016	By Balance c/d	1,12,200
		2,32,200			**2,32,200**
1-4-2016	To Balance b/d	1,12,200	31-3-2017	By Goods repossessed	1,07,520
31-3-2017	To Interest	5,610			
			31-3-2017	By Balance b/d	5,610
		1,17,810			**1,17,810**

Dr. **Goods repossessed A/c** Cr.

Date	Paticulars	Rs.	Date	Particulars	Rs.
1-4-2017	To Prashant A/c	1,07,520	31-3-2017	By Bank (Sale)	1,40,000
31-3-2017	To each (repairs)	4,800			
31-3-2017	To Profit & Loss A/c	27,680			
		1,40,000			**1,40,000**

Working Notes :

1) Agreed Value of 3 motor cycle taken over

Cost of 3 motorcycle	1,68,000
Less : Depreciation at 20% on WDV for 1st Year	33,600
	1,34,400
Less : Depreciation of 20% on WDV for 2nd year	26,880
Value date of default	1,07,520

2) Value of one motor cycle with the buyer

Cost of 1 motorcycle	56,000
Less : Depreciation at 10% on straight line	
Method for 1st year	5,600
	50,400
Less : Depreciation of 10% on straight line method	
For 2nd year value of 1 motor cycle	5,600
	44,800

3) Less on date of default

Cost of 3 motor cycle	1,68,000
Less : Depreciation at 10% on straights line	
For 1st year	16,800
	1,51,200
Loss : Depreciation 10% on straight line	
For 2nd year	16,800
	1,34,400
Less : Agreed value as per WN-1	1,07,520
Less : on default	26,880

2.3 Summary :

Hire purchase system is a midway between cash sale system and credit sale system. Cash sale system is the most common method of selling delivering goods only against the prompt payment. In credit sale system goods are sold and delivered immediately but the price is collected on some future date without interest.

In Hire purchase system goods are delivered immediately and price is collected in easy instalments with regular intervals. The instalments so collected are inclusive of interest and unpaid balance of the cash value of goods delivered. Though the goods are delivered immediately to the buyer, the ownership in goods does not pass to the buyer unless all the instalments are paid. Even if only last instalment is not paid, the buyer loses the possession of the goods because seller is thereof owner having right to take away the goods.

2.4 Check your progress

✢ **Objective Type**

State True or False.

A) From the accounting point of view, there is no difference between sale and Hire purchase sale.

ii) In hire purchase transaction the property in the goods passes to the hire purchaser at the payment of the cash down.

iii) The difference between the hire purchase price and cash price is known as interest.

iv) Interest is calculated on the hire purchase price of the given rate.

v) Depreciation an asset is calculated on the cash price of the asset.

vi) In the books of hire purchaser, the asset account is always debited of full cash price of the asset.

vii) The payment of cash down does not offect the amount to be debited to the asset account.

B) Choose correct alternative :

i) Cash paid down at the time of hire of hire purchase transaction is debited by the hire purchaser to –

a) Asset Account, b) Purchase Account,
c) Hire Vendor Account.

ii) The amount of interest is credited by the buyer to –

a) Interest Account, b) Vendor Account,
c) Asset Account.

iii) When to goods are re-possessed by the vendor, the balance in asset account is transferred to –

a) Hire Vendor Account, b) Goods repossessed Account,
c) Profit and Loss Account.

iv) The depreciation in the books of buyer is charged on

a) The hire purchase price, b) The cash price,
c) whichever is higher out of H.P. Price and Cash price.

v) In hire purchase ownership of goods is transferred only on –

a) Signing the agreement b) Payment of last instalment
c) Payment of first instalment.

2.5 Key Words :

i) Hire purchaser : A person obtains possession of the goods from an owner under hire purchase agreement.

ii) Hire Vendor : A person who delivers the possession of goods to the hire purchaser under hire purchase agreement.

iii) Cash Price : Means the at which the goods may be purchased by the hire purchaser for cash.

iv) Hire Purchase price : The total sum payable by the Hire Purchaser to the Hire vendor.

H.P. Price = Cash Price + Interest.

v) Down Payment / Advance : An initial payment payable by the hire purchaser on signing the agreement.

2.6 Answer to Check Your Progress

A) [**Ans. :** i) False, ii) False, iii) True, iv) True, v) True, vi) False, vii) True]

B) [**Ans.:** i) a, i) b, iii) b, iv) b, v) b]

2.7 Exercise

Therotical Questions :

a) Broad Questions

1. Distinguish between Hire purchase and Instalment System.
2. What is mean by Hire Purchases System? Explain its features.

b) Short Notes

1. Hire Purchases agreement
2. Hire Purchases system Sales, Normal Sales
3. Repossission of Goods

Practical Problems :

A) Simple Method (when instalment amount is not given)

1) M/s. Asian Ltd., purchased a machne for Rs. 2,40,000 agreeing to pay Rs. 40,000/ down and four annual instalments of Rs. 50,000 each with 5% interest payable of the end of each year.

M/s Asia Ltd. Depreciates the machine at 5% p.a. on the diminishing method. Show necessary ledger accounts in the books of purchaser and vendor A/c.

b) Simple Method (When cash price, Hire purchase price and instalments are given)

2) Sandwik Ltd., purchased a Motor Truck on Hire purchase system Rs. 90,000 was payable on delivery on 1-4-2010 and the balance by four annual instalments of Rs. 90,000 each on 31 st March. The vendor charged 5% interest on the unpaid balance. The cash price of the truck is Rs. 4,09,500. Depreciation of 10% of straight line was writing off each year.

c) Reverse Method : (When cash price is not given)

3) India Ltd. Purchased a motor car on hire purchase system from Sahyadri Motor on 1-4-2014 and agreed to pay interest 20% p.a. on the unpaid balance of Cash price. India Ltd. Decided to depreciate the car by 20% on reducing balance method. India Ltd. Paid Rs. 55,000 on signing the agreement and the balance in four annual instalments as follows :-

31-3-2015	Rs. 99,000	31-3-2016	Rs. 88,000
313-2017	Rs. 77,000	31-3-2018	Rs. 66,000

Show Motor Car A/c and Vendor A/c in the books of India Ltd.,

4) Small Industries Ltd. Purchased a machinery on hire purchase system on 1-4-2012 from HMT Ltd. With an agreement to pay in five instalments and agreed to pay interest at 10% on the unpaid balance of cash price.

Small Industries decided to depreciate the machinery by 10% on straight line method.

The Instalments paid were as follows.

31-3-2013	Rs. 22,500	31-3-2016	Rs. 18,000
31-3-2014	Rs. 21,000	31-3-2017	Rs. 16,500
31-3-2015	Rs. 19,500		

Prepare machinery A/c and vendor A/c in the books of small Industries.

D) Ratio Method : (When Rate of interest is not given)

5)

i)	Purchase		Mr. Bhima
ii)	Assets Purchased		Tractor
iii)	Cash price		Rs. 2,50,000
iv)	Seller		M/s. Balwant Agency
v)	Date of Transaction		1-4-2013
vi)	Payment on the date of signing		Rs. 50,000
vii)	Instalments		
	On 31-3-2014	Rs.	60,000
	On 31-3-2015	Rs.	60,000
	On 31-3-2016	Rs.	60,000
	On 31-3-2017	Rs.	60,000
viii)	Depreciation at 20% on diminishing balance method.		

You are required to prepare Tractor A/c and Vendor A/c in the books of Mr. Bhima.

6) Sagar Hotel Ltd. Purchased a refrigerator from M/s Poonawala under Hire Purchase system. The Hotel cash price of the Refirigerator is Rs. 34,000. Cash paid to

the hire vendor is as under.

Date	Rs.	
1-4-2014	10,000	(Against Delivery)
31-3-2015	10,000	
31-3-2016	10,000	
31-4-2017	10,000	

The Sagar Hotel Ltd. Charged depreciation @ 20% under Diminishing Balance Method.

You are required to give Hire Vendor's Account and Refrigerator A/c in the books of Hire Purchaser.

(Oct. 2008)

Default & Repossession :

A) Complete Repossession :

7) On 1st April, 2015 Power Fabrication works purchased a lathe machine on hire purchase. The cash price of the machine was Rs. 5,00,000 and the same was to be paid, commencing from 1-4-2015 in five six monthly instalments together with interest at 10% p.a. The books of accounts are closed on 31st March every year. The rate of depreciation is at 10% p.a. of WDV method.

All the instalments were duly paid upon 1-4-2016 but due to financial difficulty Hire Purchaser could not pay the instalment on 30-9-2016. The vendor repossessed the machine. Show ledger account in the books of Hire purchaser.

8) Bombay Transports Ltd., purchased from Kolkatta Motors. Three Mini Trucks costing Rs. 2,00,000 each on hire purchase system. Payment was to be made in three equal instalments together with interest at 5%. Bombay Transports write of depreciation @ 20% p.a. on the diminishing balance. If paid the instalment due at the end of the first year but could not pay the next instalment.

Hire vendor took the possession of all the three trucks and sold them for Rs. 3,50,000 after spending Rs. 20,000/- for its repairs.

Give necessary ledger accounts in the books of both the parties.

B) Partial Repossession.

9) M/s Radhika Trading Co. purchased two motor cycle from Bajaj Auto Ltd. Costing Rs. 40,000/- each on 1st April 2016 on hire purchase system. The terms of agreement were.

Cash down payment Rs. 10,000/- for each motor cycle, Remaindor in 3 equal instalments together with interest at 10% p.a. to be paid at the end of each year.

Radhika Trading co writes off 25% depreciation each year on diminishing balance method. Radhika Trading Co. paid the installments due on 31st March 2018 but could not pay the final instalment.

Bajaj Auto Ltd. Repossessed one motor cycle adusting its value against the amount due. The repossession was done on the basis of 30% depreciation on diminishing balance method. The vendor spent Rs. 4,280/- for the repairs of the motor cycle and sold it for Rs. 20,000/-

Hire purchaser close its books on 31st March every year.

Write up necessary ledger accounts in the books of both the parties.

10) Adinath Engineering works purchased 5 lathe machine from Ruchi Machines Ltd., on hie purchase system. The cash price of each machine was Rs.1,00,000/-. It was agreed that Rs. 1,25,000 should be paid immediately and the balance in three equal instalments of Rs. 1,50,000 each of the end of each year. The Ruchi machines charges interest at 10% p.a. The buyer depreciates machines at 20% p.a. on the diminishing balance method.

Adinath Engineering works paid cash down and two instalments but failed to pay the last instalment. Ruchi Machines repossessed three machnes, leaving two machines with the buyer and adjusting the value of 3 machines against the amount due. The Repossessed machines were valued on the basis of 30% depreciation p.a. on the written down value. The machines repossessed were sold by the vendor for Rs. 1,50,000 after necessary repairs amounting to Rs. 25,000/-

Show necessary accounts in the books of both the parties.

- **Further Readings :**

    1) Advance Accountancy : R. R. Gupata

    2) Steps in Advanced Accountancy – S. N. Maheshwari

    3) Advance Accountincy – V. A. Patil Dr.P. M. Herekar.

❑❑❑

Unit-3

Insurance Claim

Loss of Stock and Loss of Profit Policy

Structure of the Unit

3.3.2.4 Deduct the amount of sa ving in the insured standing charges during the period of Idemnity.

3.3.2.5 Apply the Test of Average Clause to the sum ascertained as under

3.3.2.6 Problems on ascertaing five claim under Loss of Profit Policy

3.4 Summary

3.5 Check your progress

3.6 Answer to check your progress

3.7 Exercise

3.8 References

3.0 Objectives :

The study of this unit will help students to –

- identity the major risks to which a business is exposed.
- compute the amount of loss recoverable from the insurance company against a policy for loss of stock, or consequential loss.
- compute the amount of loss recoverable from the insurance company against a policy for loss of profit.
- make necessary accounting entries.
- explain the meaning of certain key terms.

3.1 Introduction :

A fire in a business place destroys a number of assets such as building, furniture, machinery, stock etc. A businessman needs insurance cover to insure against possible loss of assets in the event of occurrence of fire. In the interest of business unit, it is necessary to take fire insurance policy to indemnify itself against such losses resulting from the fire. A fire insurance claim is lodged with insurance company in regard to the following.

1. To cover the loss of stock destroyed by fire.

2. To cover loss of profit during the period of dislocation of normal business operations.

However, the businessman will have to exercise due care and caution in insuring adequately for the loss and stock and loss of profit. In the absence of insurance cover, normal business operations cannot be restored. Insurance cover would enable him to carry on business without any risk.

In the present unit we are mainly concerned with estimating the amount of claim under loss of stock and loss of profit as a result of fire.

3.2 Presentation of Subject Matter

Computation of Insurance claim under Loss of Stock Policy :

A fire insurance policy can be taken for indemnification against loss of fixed assts and loss of stock on account of fire claims in relation with fixed assets are based on the value of these fixed assets if the same are insured against fire or any other hazards. But difficulty arises particularly in case of stock for which no account appears in the books. If proper stock book is maintained for the purpose, claims can be ascertained easily for loss of stock. On the other hand if the stock book is not maintained, the value of stock destroyed by fire will be estimated on the basis of quantity and price of the same as shown by different documents, papers and certain other information. These are two situations in which claims can be ascertained.

3.2.1 When proper records are available and the information of stock lying with the business on the date of fire is known :

Under this situation following would be the steps for lodging claim with insurance company.

i) Ascertain the value of stock lying with business unit on the date of fire.

ii) Ascertain the value of stock salvaged from fire.

iii) Find out stock destroyed by fire by deducting the stock salvaged from the stock value on the date of fire.

iv) The amount of claim would be equal to the stock destroyed by fire. (Provided there is no application of average clause).

3.2.2 When proper records are not available :

The following steps involved for lodging claim with insurance company.

Step – 1 :

Calculate the rate of gross profit on the basis of last accounting year, or on the basis of last few years after adjusting abnormal items if any. This is done by preparing trading account of previous year, which gives the figure of gross profit. The proforma of Trading A/c. is as under:

Dr. **Trading Account for the year ended ....** Cr.

Particular	Rs.	Rs.	Particular	Rs.	Rs.
To Opening stock		xxx	By Sales	xxx	
To Purchases ...	xxx		- Return Inward	xxx	
- Return outward	xxx				xxx
		xxx	By Closing stock		xxx
To wages		xxx			
To Carriage inward		xxx			
To Freight		xxx			
To Gross Profit c/d (Balancing figure)		xxx			
		xxx			xxx

Step - 2

Calculate the gross profit rate from the above.

$$\text{Gross profit rate} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100.$$

Step – 3

Prepare Memorandum Trading Account for the period from the opening date of the year to the date of fire.

In the memorandum Trading A/c. all the figures of opening stock, purchases, wages and sales during the above period are available and given in the problem. The figure of gross profit is ascertained by applying the gross profit percentage of last year as calculated in step no.2 to the sales for the current period. Having obtained the figure of gross profit, the memorandum Trading A/c. is balanced and balancing figure would represent the figure of stock lying with the business unit on the date of fire. The proforma of Memorandum Trading Account is as under :

Memorandum Trading Account.

(for the period from the first day of the year of accounting to the date of fire)

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening stock		xxx	By Sales	xxx	
To Purchases	xxx		+ Unrecorded sales	xxx	
+ Unrecorded purchases	xxx			xxx	
	xxx		- Return Inwards	xxx	
- Return outward	xxx	xxx	By closing stock		xxx
To wages		xxx	(i.e. stock destroyed		
To Carriage & freight		xxx	by fire)		
To Gross profit		xxx	(Balancing figure)		xxx
(…% on…sales)					
		xxx			xxx

Step – 4 : Prepare a statement of fire claim lodged with insurance company.

Company – For calculating the amount of claim for loss of stock, salvaged stock, if any should be deducted from the value of stock destroyed by fire.

Amount of claim for loss of stock	Rs.
Value of closing stock on the date of fire…… (as per memorandum Trading Account)	xxx
Less – value of stock salvaged	xxx
Amount of claim :	xxx

Step – 5 : Application of Average Clause :

Average clause applies if actual loss exceeds the amount of the insured value; the amount of claim is to be limited after applying the average clause. Average clause means the claim for the loss of stock is proportionately reduced having regard to the under-insurance of stock. Under-insurance means the business unit has not been adequately covered the stock values for the purpose of insurance, i.e. the policy amount taken by the business unit is less as compared to the normal stock holding. Therefore, the amount of claim is proportionately reduced by keeping in view the extent of under insurance. The following equation is used for calculating the claim by applying Average clause.

$$\text{Claim} = \frac{\text{Amount of Policy}}{\text{Value of stock on the date of fire}} \times \text{Loss of stock destroyed by fire.}$$

Notes :

1) It must be remembered that the amount of actual loss is less than the insured value of actual goods (i.e. policy amount), then the amount of claim would be equal to the stock, destroyed by fire.

2) If the gross profit rate remains constant from year to year provided it is not disturbed by abnormal happenings. Normally there is reasonably consistency in the gross profit rate, the gross profit percentage is taken as the basis for further calculation. If it is fluctuating, it is better to make an estimated rate of gross profit based on the available information.

3) Existence of Abnormal items of purchase and sales disturb the gross profit rate. Abnormal item means items, which do not carry normal price tag due to reasons that they are defective or poor quality or slow moving items etc. Such items therefore, required to be separated from other normal items so as to reflect the correct gross profit percentage. While preparing Trading A/c., the existence if such abnormal items are separated with two purposes. One to ascertain the profit or loss on such items and stock such items on the date of fire. Second is to render the normal gross profit rate undisturbed or undiluted.

3.2.3 Problems on Loss of Stock Policy :

Illustration – 1 : A fire occurred in the business premises of Calcutta Traders on 15 May 2015 destroying a great part of his stock. On 1st January 2014 it appeared in the books as Rs.30,000/-. The value of stock salvaged was Rs.18,000/- the Gross Profit on the sales was 30% and sales amounted to Rs.1,50,000/- from January 2014 to the date of fire, while for the same period the purchases amounted to Rs.1,47,000/-.

Prepare statement of claim for submission to Insurance Co.

Solution : Given rate of Gross profit – 30%.

I. Preparation of Memorandum Trading A/c. to find out closing stock on the date of fire.

Memorandum Trading A/c.

(for the period from 1st Jan 2015 to 15th May, 2015)

To Opening stock	30,000	By Sales	1,50,000
To Purchases	1,47,000	By Closing stock	
To Gross Profit c/d.	45,000	(on 15th May, 2015)	72,000
(30% on sales Rs.150000)		(Balancing figure)	
	2,22,000		2,22,000

II. Preparation of statement of fire insurance claim.

Statement of fire claim.	**Rs.**
Value of closing stock at the date of fire.............. (as per memorandum trading A/c.)	72,000
Less : Stock of goods salvaged	18,000
Value of goods destroyed by fire, i.e. fire claim	54,000

Illustration – 2 : A merchant's godown caught by fire on Nov. 3, 2012 at night causing serious damage to stock. The following information is obtained from the books and record salvaged :

		Rs.
Stock at cost on 31.12.2010	....	45,000
Stock at cost on 31.12.2011	....	50,000

Purchases during the year 2011 ……………….. 4,75,000

Sales during the year 2011 ……………………. 5,87,500

Purchases from 15^{th} Jan. to Nov. 3, 2012 …….. 4,40,000

Sales from 1^{st} Jan. to Nov. 3, 2012 ………….. 4,00,000

In June 2012, shop soiled goods of the cost price of Rs.2,000 were thrown away as valueless.

Assuming that the rate of Gross Profit has been the same in 2012 as in 2011, estimate the value of the stock in the godown at the time of fire and a statement of claim for submission to the Insurance Company.

Solution :

I. Preparation of Trading Account for the year ending 31^{st} Dec. 2011 to find out Gross Profit and Rate of Gross Profit Rate.

Trading Account for the year ended 31.12.2011

To Opening stock	45,000	By Sales	5,87,500
To Purchases	4,75,000	By Closing stock	50,000
To Gross Profit c/d (Balancing figure)	1,17,500		
	6,37,500		6,37,500

II. Calculation of Rate of Gross Profit for 2011.

$$\text{Rate of Gross Profit} = \frac{\text{Gross profit}}{\text{Sales}} \times 100$$

$$= \frac{1,17,500}{5,87,500} \times \frac{100}{1}$$

$$= 20\%$$

III. Preparation of Memorandum Trading Account for the period January 2012 to Nov. 3, 2012.

Memorandum Trading Account
(for the period 1st Jan. 2012 to Nov. 3, 2012.)

To Opening stock	50,000	By Sales	4,00,000
To Purchases	4,40,000	By Closing stock	
To Gross Profit	80,000	burnt by fire	1,70,000
(20% on sales)		(Balancing figure)	
	5,70,000		**5,70,000**

IV. Calculation of Amount of Claim to be submitted.

Value of closing stock at the date of fire	1,70,000
Less- shop-solid goods thrown away	2,000
Amount of claim	1,68,000

Illustration – 3 : Fire occurred in the premises of Alpha & Beta Co. on 1st Sept. 2012 and stock of the value of Rs.1,01,000 was salvaged and business books and records were saved.

The following information was obtained.

Purchases for the year ended 3.3.2012	7,00,000
Sales for the year ended 3.3.2012	11,00,000
Purchases from 1.4.2012 to 1.09.2012	2,40,000
Sales from 1.4.2012 to 1.09.2012	3,60,000
Stock on 3.3.2011	3,00,000
Stock on 3.3.2012	3,40,000

It is also given that the stock on 31.3.2012 was overvalued by Rs.20,000.

Calculate the amount of the claim to be processed to the Insurance Company irrespective of losses. Rate of Gross profit is to be based on the year ended 31.3.2012.

Solution :

I. Calculation of Gross Profit for the year ended 31.3.2011.

Trading Account for the year ended 31.3.2011.

To Opening stock	3,00,000	By sales		11,00,000
To Purchases	7,00,000	By Closing stock	3,40,000	
To Gross Profit c/d	4,20,000	- Over valuation		
(Bal. Fig.)		of stock.	20,000	3,20,000
	14,20,000			14,20,000

II. Calculation of Rate of Gross Profit for the year 2012.

$$\text{Rate of Gross Profit} = \frac{\text{G.P.}}{\text{Sales}} \times 100$$

$$= \frac{4,20,000}{11,00,000} \times \frac{100}{1}$$

$$= 38.18\%$$

III. Preparation of Memorandum Trading A/c. to find out loss of stock on the date of fire.

Memorandum Trading Account
(for the period from 1.4.2012 to 1.9.2012)

To Opening stock	3,20,000	By	3,60,000
To Purchases	2,40,000	By Closing stock	
To Gross Profit c/d.		lost in fire	3,37,448
(38.18% of Sales Rs.3,60,000)	1,37,448		
	6,97,448		**6,97,448**

IV. Calculation of statement of claim.

Value of stock on the date of fire (i.e. 1.09.2012)	3,37,448
Less – Value of stock salvaged	1,01,000
Claim for Loss of Stock	2,36,448

Illustration – 4 : A fire occurred on 15th April 2020 and destroyed the business premises of Delhi Electronics Ltd. The books of accounts and stock amounting to Rs.18,000 were saved and the following information was available from the books.

Year	Sales Rs.	Gross Profit Rs.
Year ending Dec. 31, 2015	8,60,000	2,15,000
Year ending Dec. 31, 2016	7,10,000	2,13,000
Year ending Dec. 31, 2017	6,00,000	2,00,000
Year ending Dec. 31, 2018	5,50,000	1,87,000
Year ending Dec. 31, 2019	4,80,000	1,60,000

The stock on Dec. 31, 2019 was valued at Rs.97,000. The purchases, sales and production wages from Jan. 1, 2020 to 14th April 2020 were ascertained at Rs.75,000, 1,59,000/- and Rs.30,000 respectively.

You are to prepare a statement in support of claim against the Insurance Company.

Solution :

I. Calculation of rate of gross profit of past years.

$$\text{Rate of Gross Profit} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100.$$

Years	**Calculation**	**Rate of Gross Profit**
2015	215000 / 860000 x 100	25%
2016	213000 / 710000 x 100	30%
2017	200000 / 600000 x 100	33.33%
2018	187000 / 550000 x 100	34%
2019	160000 / 480000 x 100	33.33%

Note : The rte of gross profit has been constant over last 3 years hence we expect the rate of gross profit 33.33% during 2020.

II. Preparation of Memorandum Trading Account.

Memorandum Trading Account.
(for the period from 1 Jan. 2020 to 15th April 2020)

	Rs.		Rs.
To opening stock	97,000	By Sales	1,59,000
To purchases	75,000	By Closing stock	96,000
To production wages	30,000	(on 15.4.2020)	
To gross profit (33.33% on sales Rs.1,59,000)	53,000		
	2,55,000		2,55,000

III. Calculation of statement of fix claim.

Value of stock on the date of fire (i.e. 15.4.2020)	96,000
Less : Value of stock salvaged ………………..	18,000
Amount of claim ………..Rs.	78,000

Illustration – 5 : A fire broke out in the warehouse of Mercantile Traders Ltd. on 30th Sept. 2018. The company desires to file a claim with insurance company for loss of stock and give you the following information to enable you to prepare a statement showing the amount to be claimed.

		Rs.
1.	The lost accounts of the Company were prepared on 31st Dec. 2017	--
2.	Sundry Debtors on 31.12.2017	40,000
3.	Sundry Creditors on 30.09.2018	30,000

4.	Cash received from Debtors	1,44,000
5.	Stock on 31.12.2017	15,000
6.	Purchases from 1-1-2018 to 30-9-2018	1,25,000
7.	Rate of Gross Profit	25%

Solution :

In this problem figure of sales is missing. To find this missing item the total debtors A/c. is prepared.

I. Preparation of Memorandum Trading Account.

Memorandum Trading Account

(for the period from 1.1.2018 to 30.9.2018)

	Rs.		**Rs.**
To Opening stock	15,000	By Sales	1,34,000
To Purchases	1,25,000	By Closing stock	39,500
To Gross Profit	33,500	(on 30.9.2018)	
(25% on sales- 134,000)			
	1,73,500		**1,73,500**

II. Preparation of statement of fire claim. Rs.

	Rs.
Value of stock on the date of fire (i.e.30.9.2018)	39,500
Less : Value of stock salvaged ………………………	Nil
Amount of claim Rs. …………	39,500

Working Note : 1) Rate of Gross Profit of last year is given.

2) To find out credit sales, a total debtors A/c. is prepared.

Total Debtors Account.

To Opening balance	40,000	By Cash	1,44,000
To Sales (Bal. Figure)	1,34,000	(Cash collected from Drs)	
		By Closing Balance c/d.	30,000
	1,74,000		1,74,000

Illustration – 6 : A fire occurred in the business of Patil Traders on 20.10.2019. From the following particular ascertain the loss of stock and prepare a claim for Insurance applying average clause.

Stock on 1.1.2017	30,600
Purchases from 1.1.2018 to 31.12.2018	1,22,000
Sales from 1.1.2018 to 31.12.2018	1,80,000
Stock on 31.12.2018	27,000
Purchases from 1.1.2019 to 19.10.2019	1,47,000
Sales from 1.1.2019 to 19.10.2019	1,50,000

The stock were always valued at 90% of cost. The stock saved was worth Rs.18,000. The amount of policy was Rs.63,000.

Solution :

I. Preparation of Trading A/c. to find out Gross Profit.

Trading Account.

(for the year ended 31.12.2018.)

	Rs.		**Rs.**
To Opening stock $\left[\frac{30600}{90} \times 100\right]$	34,000	By Sales	1,80,000
To Purchases	1,22,000	By Closing stock $\left[\frac{27000}{90} \times 100\right]$	30,000
To Gross Profit c/d. (Balancing figure)	54,000		
	2,10,000		**2,10,000**

II. Calculation of Rate of Gross Profit.

$$\text{Rate of Gross Profit} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

$$= \frac{54,000}{180000} \times 100$$

$$= 30\%$$

III. Preparation of Memorandum Trading A/c. to find out closing stock on the date of fire.

Memorandum Trading Account

(for the period from 1.1.2019 to 19.10.2019)

To Opening stock	30,000	By Sales	1,50,000
To Purchases	1,47,000	By Closing stock	72,000
To Gross profit c/d	45,000	(i.e. on the date of fire)	
(30% of sales Rs.150000)			
	2,22,000		2,22,000

IV. Statement of fire claim.

Value of stock on the date of fire	72,000
Less : Value of stock salvaged	18,000
Value of stock destroyed by fire	54,000

V. Calculation of claim by applying Average Clause.

Application of Average Clause.

$$\text{Claim} = \frac{\text{Insurance Policy}}{\text{Stock on the date of fire}} \times \text{Actual loss by fire.}$$

$$= \frac{63,000}{72,000} \times 54,000$$

$$= 47,250$$

Note : If policy amount is given the average clause is applied for calculation of fire claim.

Illustration – 7 : Find out the amount of claim to be lodged with Insurance Company from the following information.

Particulars	2015 Rs.	2016 Rs.	2017 Rs.	2018 Rs. (up to date of fire i.e.20.6.2018)
Opening stock	30000	—	—	—
Purchases	150000	150000	180000	120000
Sales	120000	160000	260000	168000
Wages	6000	10000	12000	8000
Closing stock	40000	80000	100000	—

During the year 2017, the closing stock included goods purchased but not recorded Rs.10000. The salvaged stock was valued at Rs.18000. The amount of Policy was Rs.68000. There was an average clause in the policy. The firm closes its books on 31st Dec. every year.

Solution :

I. Preparation of Trading Account for 3 years to ascertain Gross profit for last three years.

Trading Account

(for the year ended 31st Dec. 2015, 2016, & 2017)

	2015 Rs.	**2016 Rs.**	**2017 Rs.**		**2015 Rs.**	**2016 Rs.**	**2017 Rs.**
To Opening stock	30000	40000	80000	By Sales	120000	160000	260000
To Purchases Add Unrecorded Purchases	100000	150000	190000	By closing Stock	40000	80000	100000
To Wages	6000	10000	12000				
To Gross Profit c/d (Bal.figure)	24000	40000	78000				
	160000	**240000**	**360000**		**160000**	**240000**	**360000**

Note : In the year 2017 there was unrecorded purchases amounted to Rs.10000, therefore the total purchases for 2017 were (180000 + 10000) Rs. 190000.

II. Calculation of Gross Profit Rate.

Gross Profit Rate = Gross Profit / Sales.

1. 2015 ………….. $\dfrac{24000}{120000} \times 100 = 20\%$

2. 2016 ………… $\dfrac{40000}{160000} \times 100 = 25\%$

3. 2017 ………… $\dfrac{78000}{260000} \times 100 = 30\%$

Hence, average percentage of Gross profit to sale will be :

$$= \frac{20 + 25 + 30}{3} = \frac{75}{3} = 25\%$$

III. Preparation of Memorandum Trading Account for ascertainment of value of closing stock on the date of fire.

Memorandum Trading Account

(for the period 1.1.2018 to 20.6.2018)

	Rs.		**Rs.**
To Opening stock	1,00,000	By Sales	1,68,000
To Purchases	1,20,000	By Closing stock	1,02,000
To Wages	8,000	(Balancing figure	
To Gross Profit c/d.	42,000	i.e. stock on the date of fire)	
	2,70,000		2,70,000

IV. Calculation of Loss of stock destroyed by fire.

Value of stock on the date of fire …………..	1,02,000
Less : Value of stock salvaged …………….	18,000
Loss of stock by fire …	84,000

V. Calculation of fire claim by applying Average Clause.

Claim by application of the Average Clause.

$$\text{Amount of Claim} = \frac{\text{Insurance Policy}}{\text{Value of stock on the date of fire}} \times \text{Loss of stock destroyed by fire.}$$

$$= \frac{68,000}{102000} \times 84,000$$

$$= 56,000/-$$

Illustration – 8

On 20th Sept. 2018, the premises of Hindustan Lever Ltd. destroyed by fire and a stock of Rs.6000 was salvaged and retained by the insured. The business books and records were saved from which the following information is obtained.

	Rs.
Stock on 1.1.2017	50,000
Stock on 31.12.2017	70,000
Purchases for the year ended 31.12.2017	4,74,000
Sales for the year ended 31.12.2017	6,00,000
Purchases from 1.1.2018 to 20.9.2018	1,50,000
Sales from 1.1.2018 to 20.09.2018	2,05,000

In valuing the stock on 31.12.2017, Rs. 4,000 had been written off, certain stock having cost of Rs.9,000/-.

Half of these goods were sold in July 2018 for Rs.5,000. The balance is estimated to be worth the original cost. Subject to above exception the gross profit had remained at the uniform rate.

On 19th Sept. 2018, goods worth Rs.4,000 had been received by the godown keeper but had not been entered in the purchase A/c. Show the statement of claim for loss of stock.

Solution :

I. Preparation of Trading A/c. for 2017 to find out gross profit.

Trading Account for the year ended 31.12.2017.

	Rs.			Rs.
To Opening stock	50,000	By Sales		6,00,000
To Purchases	4,74,000	By Closing stock	70,000	
		Add:amount written off		
To Gross Profit c/d.	1,50,000	previously	4000	
(Bal figure)				74,000
	6,74,000			6,74,000

II. Calculation of Gross profit rate for 2007.

$$\text{Gross profit rate} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

$$= \frac{1,50,000}{6,00,000} \times 100$$

$$= 25\%.$$

III. Preparation of memorandum Trading A/c. up-to-date of fire to find out stock burnt by fire.

Memorandum Trading Account.

(for the period from 1.1.2018 to 20.9.2018)

To Opening stock 74,000		By Sales	2,05,000
Less Abnormal item at original 9,000	65,000	Less- Sale proceeds abnormal items. 5,000	2,00,000
To Purchases	1,50,000	By closing stock	69,000
+ Unrecorded purchases at cost 4,000	1,54,000	(on the date of fire)	
To Gross profit c/d. (25% on sales i.e. Rs.400000)	50,000		
	2,69,000		2,69,000

IV. Ascertainment of stock destroyed by fire i.e. fire claim.

Statement of fire insurance claim.

	Rs.
Normal stock	69,000
Add : abnormal item at original Cost (1/2 of Rs.9000)	4,500
	73,500
Less : Value of stock salvaged	6,000
Value of stock destroyed by fire	67,500

Note : Fire Insurance claim will be equal to Rs.67,500 in the absence of any average clause.

Fix claim Rs. 67,500

Illustration – 9

On 15th May 2020 the premises of Pune Ltd. were destroyed by fire but sufficient records were saved from which the following information was obtained.

	Rs.
Stock on 1.1.2019	76,800
Purchases during the year 2019	3,20,000
Sales during the year 2019	4,05,200
Stock on 31.12.2019	63,600
Purchases from 1.1.2020 to 15.5.2020	1,08,000
Sales from 1.1.2020 to 15.5.2020	1,22,800

An item of stock purchased in 2018 at cost Rs.20,000 was valued at Rs.12,000 on 31.12.2018. Half of this stock was sold in 2011 for Rs.5,200, the remaining was valued at Rs.4,800 on 31.12.2019. One fourth of the original stock was sold on 15.3.2020 for Rs.2,800 and remaining stock was considered to be worth 60% of the original cost. The salvaged stock was worth Rs.24,000. The amount of policy was Rs.60,000 and there was an average clause in the policy. Find the amount of claim.

Solution :

I. Preparation of Trading A/c. for the year 2019 to find out Gross profit.

Trading Account for the year ended 31.12.2019.

	Rs.	Rs.		Rs.	Rs.
To Opening stock	76800		By Sales	405200	
Less: Value of			Less: Sale of half		
abnormal Item	12,000	64,000	of abnormal item	5200	4,00,000
To Purchases		3,20,000	By Closing Stock	63,600	
To Gross Profit c/d		74,000	Less : Value of	48,000	
(Balancing figure)			remaining amnormal		
			item	4,800	58,800
		4,58,800			**4,58,800**

II. Calculation of Gross Profit Rate.

$$\text{Gross profit rate} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

$$= \frac{74{,}000}{4{,}00{,}000} \times 100$$

$$= 18.5\%$$

III. Preparation of Memorandum Trading Account to find out stock burnt on the date of fire.

Memorandum of Trading Account.

(for the period from 1.1.2020 to 15.5.2020, i.e. the date of fire)

	Rs.		**Rs.**
To Opening stock	58,800	By Sales	1,22,800
To Purchases	1,08,000	Less: Sale of abnormal	
To Gross Profit c/d.	22,200	item(remaininghalf)	2,800
(18.5% on sales			1,20,000
i.e.Rs.120000)		By Closing stock on the	
		date of fire. (balancing figure)	69,000
	1,89,000		**1,89,000**

IV. Ascertainment of Loss of stock by fire.

	Rs.
Normal stock on the date of fire	69,000
(as per memorandum Trading A/c.)	
Add : Abnormal items (60% of Rs.5000)	3,000
	72,000
Less : Stock salvaged	24,000
Value of stock destroyed by fire, i.e. loss	48,000

V. Application of Average clause to find out net fire claim.

$$\text{Claim} = \frac{\text{Insurance Policy}}{\text{Actual value of stock}} \times \text{Amount of loss.}$$

$$= \frac{60{,}000}{72{,}000} \times 48{,}000$$

$$= 40{,}000$$

Working Note on Abnormal items :

		Rs.
1.	Total Abnormal item of stock	20,000
2.	Half of the stock was sold in 2011	5,200
3.	Half of the remaining half (i.e.1/4 was sold in March 2012 Rs.5,000)	2,800
4.	Remaining ¼ was considered to be valued for claim at 60% of the original cost, i.e. 60% of Rs.5000)	3,000

3.3 Computation of Insurance Claim Under Loss of Profit Policy :

When a fire occurs, the business is dislocated for a certain period of time and the normal business cannot be achieved. During this period of dislocation, the sales are comparatively less than what they are supposed to be under normal working conditions. When sales are reduced, the corresponding profits are also reduced. Consequential loss insurance indemnifies the insured any loss of profit suffered by him, consequent on the destruction of business by fire. An ordinary fire insurance policy does not cover loss of profit due to reduction in sales on account of fire. So a separate policy known as consequential loss policy is taken to cover the following losses due to fire.

1. Loss of profit due to reduction in turnover / output.
2. Payment of standing charges.

3. Increased cost of working (which is necessary to avoid or diminish reduced turnover)

3.3.1 Important Terms :

3.3.1.1 Indemnity Period :

Indemnity period means the period for which the policy is taken. It is the expected period during which the business is likely to be dislocated resulting reduction in sales. The loss of profit on account of reduced sales during the indemnity period only, would be compensated by the insurance company.

3.3.1.2 Short Sales :

The term short sales refer to the loss of sales on account of fire resulting in dislocation of business. This is the difference between the standard sales and actual sales during the period of fire.

3.3.1.3 Standard Sales :

The term standard sales refers to the sales for the period corresponding with the indemnity period during the preceding accounting year adjusted in view of trends noticed during the accounting year in which fire occurred.

3.3.1.4 Gross Profit :

The term Gross profit for loss of profit has got a different meaning than that of what is commonly understood. It refers to the ratio of net profit and insured standing charges to the sales during the preceding financial year.

$$\text{Gross Profit Ratio} = \frac{\text{Net profit + Insured standing charges of last year}}{\text{Sales of the previous year}} \times 100$$

In case of net loss, the rate of gross profit will be determined as under :

$$\text{Gross Profit Rate} = \frac{\text{Insured standing charges - Net loss}}{\text{Sales of the previous year.}} \times 100$$

3.3.1.5 Standing Charges :

It means fixed charges, which continue irrespective of reduction in sales. It is just opposite of variable charges which fluctuate with the sales, e.g. wages and salaries of permanent staff, rent, rate tax and insurance, directors fees and auditors fee etc.

3.3.1.6 Increased Cost of Working :

The insured may have to incur certain additional expenses to keep the business running during the indemnity period. Such increased working expenses will be allowed subject to a limit, which is the least of two figures resulting from the following.

a) $$\frac{\text{Net Profit + Insured standing charges}}{\text{Net profit + All standing charges.}} \times \text{Increased cost of working}$$

b) Short sales avoided through increased cost of working + Rate of Gross profit.

3.3.1.7 Saving in Expenses :

Any saving in expenses will have to be deducted from the amount of loss of profit to arrive the Gross claim under Loss of Profit Policy.

3.3.1.8 Average Clause :

The amount of Gross fire claim will be proportionately reduced if the sum insured under the Policy is less than the amount for which the policy should have been taken. The amount for which policy should have been taken is determined by applying the rate of gross profit to turnover for 12 months immediately preceding the date of fire. Such turnover may have to be adjusted keeping in view the trend of sales in the accounting year in which the fire occurs.

3.3.2 Procedure for Calculating the Fire Claim under Loss of Profit :

Following procedure is followed for ascertaining fire claim –

3.3.2.1 : **Ascertain the amount of short sales, i.e. excess of standard sales over actual sales during dislocation of business.**

Sales in the previous year for a period corresponding to the indemnity period	xxx
Add : Expected increase in the current year, if any.	xxx
	xxx
Less: Actual sales during indemnity period	xxx
Short sales	xxx

3.3.2.2 : Calculate the Gross Profit Rate :

The gross profit rate is found out by applying the following formula-

$$\text{Gross Profit Rate} = \frac{\text{Net Profit of Previous year + Insured standing charges}}{\text{Sales during the previous year.}} \times 100$$

3.3.2.3 : Ascertain the increased cost of working and add it.

If all the standing charges are not insured, the claim in respect of increased cost of working must be reduced proportionately with the help of following formula-

$$\text{Claim} = \frac{\text{Net profit + Insured standing charges}}{\text{Net profit + All standing charges}} \times \text{Increased cost of working.}$$

But the claim in respect of increased cost of working must not exceed the sum produced by applying the rate of Gross profit, the amount of reduction in sales.

3.3.2.4 : Deduct the amount of saving in the insured standing charges during the period of indemnity.

3.3.2.5: Apply the test of Average Clause to the sum ascertained as under:

$$\text{Net Claim} = \frac{\text{Amount of policy}}{\text{Gross profit on annual sales.}} \times \text{Loss of profit.}$$

Note : When the amount of policy is less than the gross profit, it applied average clause.

Alternatively, lower of two following percentages may be applied to short sales in order to ascertain loss of profit due to fire.

1) $$\text{Gross profit Ratio} = \frac{\text{Net profit + Insured standing charges of last accounting year.}}{\text{Sales for the last accounting year.}} \times 100$$

2) $$\text{Indemnity Ratio} = \frac{\text{Policy value.}}{\text{Sales of 12 months immediately preceding fire as adjusted for trend.}} \times 100$$

3.3.2.6 Problems on ascertaining fire claim under Loss of Profit Policy:

Illustration – 1 :

Mr.Shashtri had taken a loss of profit policy for Rs.1,20,000. The period of indemnity being 6 months after the fire. On 16th May 2018 his office premises were destroyed by fire. The following information is available from his books.

	Rs.
Net profit for the year ended 2017	72,000
Standing charges for the year ended 2017	24,000
Sales for the year ended 2017	14,40,000
Sales from the year ending on 15 May 2018	15,00,000
Sales from 16th May to 15th Nov. 2017	9,00,000
Sales from 16th May 2018 to 15th Nov. 2018	3,00,000

Calculate the amount of fire claim.

Solution :

I. Calculation of Short sales :

	Rs.
Sales in the previous year, i.e. from 16 May to 15 Nov. 2017	9,00,000
Actual sales, i.e. from 16 May 2018 to 15th Nov.2018	3,00,000
Short sales	6,00,000

II. Calculation of Gross profit Rate or Earning Ratio :

$$\text{Gross Profit Rate} = \frac{\text{Net Profit + Standing charges}}{\text{Sales for the previous year}} \times 100$$

$$= \frac{72,000 + 24,000}{14,40,000} \times 100$$

$$= \frac{96,000}{14,40,000} \times 100$$

$$= 6.67\%$$

III. Calculation of Indemnity Ratio.

$$\text{Indemnity Ratio} = \frac{\text{Policy Amount}}{\text{Sales of 12 months immediately preceding the date of fire.}} \times 100$$

$$= \frac{1,20,000}{15,00,000} \times \frac{100}{1}$$

$$= 8\%.$$

IV. Calculation of Loss Profit :

Loss Profit = Short Sales x Lower of the two ratios.

= 6,00,000 x 6.67%

= 40,200

Claim for Loss of Profit = Rs. 40,020/-

Illustration – 2 :

A businessman took out a Loss of Profit Policy for Rs.90,000 with an indemnity period of Six months. His net profit for the last financial year was Rs.56,000 after deducting standing charges of Rs.14,000, and the sales for that period was Rs.2,80,000.

A fire occurred on 31 March 2019. His turnover for six months immediately following the fire was Rs.1,80,000. As compared with the turnover of corresponding months in the previous year, it was short by Rs.3,20,000. His turnover for 12 months immediately preceding fire was Rs.4,50,000.

Calculate the amount of claim lodged with Insurance Company.

Solution :

I. Calculation of Short Sales.

Short sales given in the problem = Rs. 3,20,000

II. Calculation of Gross Profit Rate.

$$\text{Gross Profit Rate} = \frac{\text{Net Profit + Standing charges}}{\text{Sales of the previous year}} \times 100$$

$$= \frac{56{,}000 \times 14{,}000}{2{,}80{,}000} \times 100$$

$$= \frac{70{,}000 \times 100}{2{,}80{,}000} \times 100$$

$$= 25\%.$$

III. Calculation of Indemnity Ratio.

$$\text{Indemnity Ratio} = \frac{\text{Amount of Policy}}{\text{Sales for 12 months immediately preceding the date of fire.}} \times 100$$

$$= \frac{90{,}000}{4{,}50{,}000} \times 100$$

$$= 20\%.$$

IV. Calculation of Amount of claim under Loss of Profit.

Loss of Profit = Short sales x Lower of the two ratios.

= 3,20,000 x 20%

= 3,20,000 x 20 / 100

= 64,000

∴ Amount of claim lodged with Insurance Company Rs.64,000.

Illustration – 3 :

On 1.7.2018 Modern Furniture Dealers Ltd. Took out a profit Insurance Policy for Rs.1,50,000 with a period of indemnity of six months. Net profit of the company for the year ended 30.6.2018 was Rs.1,20,000 and the turnover for the period was Rs.4,80,000. Standing charges for that period amounted to Rs.24,000 and those were fully insured.

On 30.9.2018 a fire broke out and the normal turnover could not be restored before the end of six months. As a result the reduction in turnover during the period of indemnity was Rs.48,000 when compared with the corresponding period in the previous year. In an effort to maintain the turnover the increased cost of working was ascertained at Rs.7,200 although these had been a saving of Rs.800 in insured standing charges over the same period. Moreover, the turnover for the twelve months ended 30.9.2018 amounted to Rs.4,90,000 indicating an increase in turnover for the 2017-18 financial year. Calculate the claim under loss of profit policy.

Solution :

I. Calculation of short sales during the period of Indemnity.

Short sales given in the problem Rs.48,000.

II. Calculation of Gross Profit Rate.

$$\text{Gross Profit Rate} = \frac{\text{Net Profit + Insured standing charges}}{\text{Turnover for the last year}} \times 100$$

$$= \frac{1,20,000 + 24,000}{4,80,000} \times 100$$

$$= 30\%$$

III. Calculation of amount of Gross Claim.

Gross Profit on short sales. (30% on Rs.48,000)	=	14,400
+ Increased cost of working	=	7,200
		21600
- Saving in insured standing charges	=	800
Amount of Gross Claim	=	20,800

IV. Application of Average Clause.

Turnover for 12 month ending preceding the date of fire	Rs.4,90,000
Gross profit – 30% on sales (30% of Rs.49,000)	Rs.1,47,000
Policy Value	Rs.1,50,000
It is fully covered by the policy hence amount of	Rs. 20,800

Note : There is no application of average clause, since the amount of policy is more than the Gross profit.

Illustration – 4 :

From the following information, calculate the amount of claim under loss of profit policy.

1. Date of fire 1 April 2020.
2. Period of indemnity : 4 months.
3. Policy amount Rs.3,00,000.
4. Sales from 1.1.2019 to 31.12.2019, Rs.18,00,000.
5. Sales from 1.4.2019 to 31.3.2020, Rs.20,00,000.
6. Net profit for the year ended 31.12.2019 – Rs.2,00,000 and standing charges Rs.2,00,000 (out of which Rs.40,000 were uninsured)
7. Sales during the dislocation period Rs.2,00,000 and during the corresponding period in the last year Rs.6,00,000.

Solution :

I. Calculation of short sales during the period of Indemnity.

Sales in previous year i.e. 1-4-2019 to 31-7-2019	Rs. 6,00,000
Less : Actual sales during indemnity period	
(1-4-2020 to 31-7-2020)	Rs. 2,00,000
Short Sales	Rs. 4,00,000

II. Calculation of Gross Profit Rate.

$$\text{Gross Profit Rate} = \frac{\text{Net profit + Insured standing charges}}{\text{Sales of the previous year}} \times 100$$

$$= \frac{2,00,000 + 1,60,000\ (200000\text{-}40000)}{18,00,000} \times 100$$

$$= \frac{3,60,000}{18,00,000} \times 100$$

$$= 20\%.$$

III. Calculation of Loss of Profit on Sale.

Loss of Profit = Short sales x Gross profit Rate.

= 4,00,000 x 20%.

Gross Claim = 80,000.

IV. Calculation of Net claim by applying Average clause.

a) Insurance cover required = 20% on sales for 12 months ending on the date of fire.

= 20% on sales Rs. 20,00,000

= Rs. 4,00,000

b) Net claim. $= \dfrac{\text{Policy Amount}}{\text{Insurance cover required}} \times$ Gross claim i.e. loss of profit.

$$= \frac{3,00,000}{4,00,000} \times 80,000$$

= Rs.60,000

Note : No need to calculate Indemnity ratio when average clause is applied for calculating average clause.

Illustration – 5 :

Mr. Sanjay holds a loss of profit policy. From the following information calculate the amount of claim under loss of profit policy.

1. The accounts are prepared annually on 31st December.
2. The net profit plus insured standing charges for the year ended 31st Dec. 2020 amounted to Rs.50,000.
3. A fire occurred on 30th April 2021, the period of Indemnity is 6 months.
4. The sales for the year ended 30th April 2021 were Rs.1,40,000 and For the year ended 31st Dec. were Rs.1,25,000.
5. The sales during the period of dislocation were Rs.20,000 and fro the corresponding period in the preceding year were Rs.45,000.
6. The expenses incurred to mitigate loss was Rs.2,000.
7. The saving in insured standing charges due to fire amounted to Rs.500.
8. The amount of policy was Rs.40,000.

Solution :

I. Calculation of short sales during the period of Indemnity.

	Rs.
Sales of previous period, i.e. 1.5.2020 to 31.10.2020	45,000
Less : Actual sales i.e. 1.5.2021 to 31.10.2021	20,000
Short Sales	25,000

II. Calculation of Gross Profit Rate.

$$\text{Gross Profit Rate} = \frac{\text{Net profit + Insured standing charges}}{\text{Sales of the previous year}} \times 100$$

$$= \frac{50{,}000}{1{,}25{,}000} \times 100$$

$$= 40\%.$$

III. Calculation of Loss of profit on sales.

Loss of Profit = Short sales x Gross profit Rate

= 25,000 x 40 / 100

= 10,000.

IV. Calculation of Amount of Gross Claim.

	Rs.
Loss of Profit calculated as above	10,000
Add – Increase in expenses	2,000
	12,000
Less – Saving in insured standing charges	500
Gross Claim	11,500

V. Calculation of Net claim by application of Average clause.

a) Insurance cover required = Gross profit at 40% on the sales for 12 months ending on date of fix

Rs.140000.

= 40% on Rs.140000.

= 56000.

b) Net claim = $\frac{\text{Amount of policy}}{\text{Insurance cover required.}}$ x Gross loss i.e. loss of profit.

$$= \frac{40,000}{56,000} \times 11,500$$

Net claim = Rs.8,214.

Illustration – 6 :

M/s.Patil Traders are insured under loss of profit policy for Rs.1,26,000. Their books of accounts are closed on 31st Dec. each year. The fire occurred in the premises of the business on 1.7.2018. The record saved disclosed the following information.

	Rs.
Sales during the year ended 30.6.2018	14,40,000
Sales during the year ended 31.12.2017	12,00,000
Sales from 1.7.2018 to 30.9.2018	60,000
Sales in the corresponding period from 1.07.2017 to 31.12.2017	3,60,000
Standing charges for the year ending 31.12.17	72,000
Net profit for the year ending 31.12.2017	48,000
Period of Indemnity	3 months.

In has been ascertained that the business has consistently an increase of 25% in sales in the month preceding the fire over corresponding period of the previous year. Calculate the amount of claim.

Solution :

I. Calculation of short sales during the period of Indemnity:

	Rs.
Sales of Previous period Expected (from 1.7.2017 to 30.9.17)	3,60,000
Add- 25% increase anticipated	90,000
	4,50,000
Less : Actual sales during Indemnity period	
(for 1.7.2018 to 30.09.2018)	60,000
Short sales	3,90,000

II. Calculation of Gross Profit Rate :

$$\text{Gross Profit Rate} = \frac{\text{Net Profit + Insured standing charges}}{\text{Sales in the last accounting year.}} \times 100$$

$$= \frac{48,000 + 72,000}{12,00,000} \times 100$$

$$= 10\%.$$

III. Calculation of Loss of Profit :

Loss of Profit = Short sales x Gross profit Rate.

= 3,90,000 x 10/100

Gross claim = 39,000.

IV. Application of Average Clause.

a) Insurance cover required = 10% of Sales for 12 months ending on the date of fire + 25% increase.

= 10% of Rs.14,40,000 + 3,60,000.

= 10% of Rs.18,00,000

= 1,80,000.

$$\text{b) Net claim} = \frac{\text{Policy Amount.}}{\text{Insurance cover require.}} \times \text{Gross claim i.e. Loss of profit.}$$

$$= \frac{1,26,000}{1,80,000} \times 39,000$$

$$= 27,300.$$

Claim for Los of Profit is Rs. 27,300.

3.4 Summary

Hire Purchase Agreement is an agreement in writing between hire vendor and hire purchaser which includes the terms and conditions of hire purchase deal. Down payment is the initial payment by the hire purchaser at the time of entering into a hire purchase agreement. Cash is the amount to be paid for purchase of Assets. It is the original price of the assets, which includes cost and profit of the hire vendor. Interest means interest payable by hire purchaser to hire vendor. Calculated on outstanding Balance of each instalment. Hire purchase price is the total amount payable by the hire purchaser to the hire vendor. It includes cash price and interest.

3.5 Check your progress

A) Select the most appropriate answer.

1. The main object of average clause is to ……………

   a) encourage full insurance. b) encourage under insurance,
   c) discourage full insurance.

2. In case of average clause the loss is suffered by both the insurer and the insured ……

   a) in the ratio of risk covered. b) in equal ratio
   c) only by insurer.

3. A plant worth Rs.40,000 has been insured for Rs.30,00, the loss on account of fire is Rs.25,000. The insurance company will bear loss to the extent of …………

   a) Rs.30,000 b) Rs.25,000 c) Rs.18,750

4. In case the net profit is Rs.10,000 insured standing charges Rs.5,000 and sales Rs.1,00,000, the rate of gross profit will be … …………

   a) 10% b) 15% c) 5%

5. Cost of goods sold is calculated by deducting gross profit from ……………

   a) Purchase b) Closing stock c) Sales.

6. In case of Loss of Profit Policy, Gross Profit is equal to net profit ………… changes.

   a) Insured standing charges b) Un-insured standing charges
   c) Increased cost of working.

B) State whether each of the following statement is True or False.

1. The loss of profit policy covers loss of profit due to loss of sales as well as loss of standing charges due to their non-recovery.

2. The insertion of average clause in an insurance policy results in bearing a part of loss by the insured himself.

3. It is not necessary to make any adjustment in the standard sales of the preceding period in the light of any change in future prospects.

4. The term gross profit in case of a Loss of Profit Policy is different from the term gross profit as used in loss of stock policy.

5. Any saving in expenses is to be deducted for determining the final claim.

6. Actual loss of stock is equal to total stock on the date of fire less stock salvaged.

7. Loss of Profit is calculated on short sales multiplied by rate of gross profit when under insurance.

3.6 Answers to Check your progress

A) 1) a 2) a 3) c 4) b 5) c 6) a

B) 1) True 2) True 3) False 4) False

5) True 6) True 7) True

3.7 Exercises

3.7.1 Questions for Self Study.

1. Explain the necessity of Loss of Stock Policy.
2. How to calculate claims under Loss of Stock Policy?
3. Explain the steps involved in calculation of claims under Loss of Profit Policy.
4. **Write Short Notes on –**
   1. Loss of Profit Policy.
   2. Indemnity Ratio.
   3. Loss of Stock Policy.
   4. Standard Sales.
   5. Average Clause.

3.7.2 Practical Problems for Self Study.

3.7.2.1 Problems on Loss of Stock Policy.

1. The godown of Purple Ltd. caught fire on 15th June 2020. Records saved fromfire showed the following particulars.

	Rs.
Stock at cost on 1st January 2019	60,000
Stock at cost on 31st December 2019	88,000
Purchases Less Returns for the year 2019	5,68,000
Sales Less Return for the year 2019	7,20,000
Purchases Less Returns from 1st Jan to 15th Jan. 2020.	1,80,000
Sales Less Returns from 1st Jan to 15th June 2020.	2,46,000

Gross profit had remained at uniform rate. The stock salvaged were worth Rs.7,200 and they were retained by Purple Ltd. The godown was insured. Show the amount of claim.

2. A fire occurred in the godown of X Ltd. on 9th March 2020, destroying the entire stock. The books and records were salvaged from which the following particulars were ascertained.

Sales for the year 2019	10,01,000
Sales for the period 1.1.2020 to 8.3.2020	3,00,000
Purchases for the year 2019	8,00,000
Purchases for the period 1.1.2020 to 8.3.2020.	1,25,000
Stock on 1.1.2019	3,31,100
Stock on 31.12.2019	3,85,000

The company has been following the practice of valuing the stock of good at actual cost plus 10%. Included in the stock on 1.1.2019 were some shop-sold goods, which originally cost Rs.2000 but were valued at Rs.1100. These goods were sold during the year 2019 for Rs.1000. Subject to these the rate of gross profit and basis of valuation of stock were uniform.

You are required to ascertain the value of stock destroyed.

3. A fire occurred on 15.9.2019 in the premises of Godrej Ltd. From the following figures calculate the amount of claim to be lodged with the insurance company for Loss of Stock.

	Rs.
Stock on 1.1.2018 (at cost)	20,000
Stock on 1.1.2019 (at cost)	30,000
Purchases for the year ended 2018	40,000
Purchases from 1.1.2019 to 15.9.2019	88,000
Sales for the year ended 2018	60,000
Sales from 1.1.2019 to 15.9.2019	1,05,000

During the current year cost of purchases have increased by 10% above last years level. Selling price has gone up by 5%. Salvaged stock amounted to Rs.6000.

4. Fire occurred in the premises of Badluck Ltd. on 10.4.2007. From the following particulars ascertain the claim for loss of stock.

	Rs.
Stock on 1.1.2016	72,000
Stock on 31.12.2016	45,000
Purchases during the year 2016	2,90,000
Sales during the year 2016	4,00,000
Purchases from 1.1.2017 to 9.4.2017	2,92,000
Sales from 1.1.2017 to 9.4.2017	3,78,000
Salvaged stock	14,000

The company follows the practice of stocks at cost less 10%.

3.7.2.2. Practical Problems on Loss of Profit Policy.

1. From the following particulars find out the amount of claim of Loss of Profit Policy.

		Rs.
1.	Date of fire 30.6.2020	
2.	Period of Indemnity – 6 months.	
3.	Sum Insured	40,000
4.	Net profit for the accounting year ending 31.3.2020	12,500
5.	Sales for the year ended 30.6.2020	2,00,000
6.	Standing charges for the accounting year ending 31.3.2020	28,500
7.	Sales for the year ending 31.3.2020 1,98,000	
8.	Sales for the indemnity period for 1.7.2020 to 31.12.2020	56,000
9.	Sales for the period 1.7.2019 to 31.12.2019	1,10,000

The sales of the year 2020–21 had shown tendency of increase of 10% over the turnover of preceding year.

2. From the following data calculate the claim under Loss of Profit Policy.

   1. Financial year ends on 31st December.
   2. Turnover Rs.2,00,000
   3. Indemnity period 6 months.
   4. Period of interruption – 1st July to 31st October.
   5. Net profit Rs.18000.
   6. Standing charges Rs.42,000 out of which Rs.10,000 have not been insured.
   7. Sum Assured – Rs.50,000.
   8. Standard Turnover Rs.65,000.
   9. Turnover in the period of Interruption Rs.25000 out of which 6000 was from a rented place at Rs.600 per month.
   10. Annual Turnover Rs.240000.

11. Saving in standing charges Rs.4725 per annum.

12. Date of fire – Night of 30th June.

13. It was agreed between the insurer and the insured that the business trends would lead to an increase of 10% in the turnover.

3. A fire occurred on 1st July 2020 in the premises of Silver Ltd. and business was practically dis-organized up to 30th Nov. 2020. From the books of account, following information was extracted.

		Rs.
1.	Actual turnover from 1.7.2020 to 30 Nov. 2020	60,000
2.	Turnover from 1st July to 30th Nov. 2019	2,00,000
3.	Net profit for the financial year	90,000
4.	Insured standing charges for the last financial year	60,000
5.	Turnover for the last financial year	5,00,000
6.	Turnover for the year ending 30th June 2019	5,50,000
7.	Total standing charges for the year	72,000

The company incurred additional expenses amounted to Rs.9000 which reduced the loss in turnover. There was also a savings during the indemnity period of Rs.2486.

The company holds a loss of profit policy for Rs.1,65,000 having an indemnity period for 6 months. There has been a considerable increase in trade and it has been agreed that an adjustment of 20% be made in respect of upward trend in Turnover.

Compute the claim under Loss of Profit Policy.

3.8 References for Additional Reading :

1. B.Com. Accountancy, Volume-III; by P.V. Rathnam, Himalaya Publishing House.
2. Advanced Accountancy; by S.P. Jain and K.L. Narang, Kalyani Publishers.
3. Advanced Accountancy, Vol. II; by S.K.R. Paul, Central Publication.
4. Advanced Accountancy; by Maheshwari & Maheshwari Sultanchand Publication.

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Unit 4

GST Accounting with Practical's using Tally Part-I

Structure

Theory

4.0 Objectives:

After studying this unit we will be able to understand

1. GST Taxation System
2. Dual GST
3. Structure of GST
4. GSTIN Structure
5. Tax Invoice
6. Input Tax Credit Set Off
7. GST Payment
8. GST Reports & Returns

4.1 Introduction:

GST is known as the Goods and Services Tax. It is an indirect tax which has replaced many indirect taxes in India such as the excise duty, VAT, services tax, etc. The Goods and Services Tax Act was passed in the Parliament on 29th March 2017 and came into effect on 1st July, 2017.

In other words, Goods and Service Tax (GST) is levied on the supply of goods and services. Goods Services Tax Law in India is a comprehensive, multi-stage, destination-based tax that is levied on every value addition. GST is a single domestic indirect tax law for the entire country.

4.2 Presentation of Subject Matter

4.2.1 Indirect Taxes prior GST

In India, a consumer earlier paid several indirect taxes including sales tax, services tax, central excise duty, additional customs duty, state-level value added tax and octroi tax, among others. With the implementation of the Goods and Services Tax (GST) from 1st July 2017, almost all the indirect taxes, have been subsumed under GST. Now, all these taxes are paid as one tax called the GST.

However, there are some indirect taxes which have not been brought under the radar of GST. Customs duty, security transaction tax, building and welfare cess and electricity duty levied by local authorities and state governments are some of them.

Below is a list of indirect taxes that are levied on the supply of good and services in India, which now is taxed under the common name of GST

1. EXCISE DUTY

Excise duty is levied on goods and services that are produced in India. This is a tax on manufacturing which is paid by the manufacturer to the government. The manufacturer distributes and passes this tax on the end consumers.

2. VALUE-ADDED TAX

It is a tax on the consumption of a product and it is levied on its value when additional or margin value is added to the product during the subsequent stages of production, starting from the point of production to the point of sale. The tax goes on adding at every stage of production as per the value addition.

3. SERVICE TAX

Service tax is a tax levied on the service providers. It is levied on services like air-conditioned restaurants, accommodation provided by the hotel, inns, services provided by travel agents, cab services, cable services, etc. The idea behind service tax is similar to that of excise duty. The incidence of this tax applies to the disbursement of services.

4.2.2 GST Implementation in India

The year 2017 will forever be etched in Indian history as the year that saw the implementation of the biggest and most important economic reform since Independence - the Goods and Services Tax (GST). The reform that took more than a decade of intense debate was finally implemented with effect from 1 July 2017, subsuming almost all indirect taxes at the Central and State levels.

GST, which was publicized as ‘One nation, One tax’ by the government, aims to provide a simplified, single tax regime in line with the tax framework applicable in several major economies across the Globe. This single tax has helped streamline various indirect taxes and brought in more efficiency in business. GST law in India is a comprehensive, multi-stage, destination-based tax that is levied on every value addition.

4.2.3Why GST was introduced in India?

One of the main reasons for GST being introduced in India is the tax burden that falls both on companies and consumers. With the current tax system, there are multiple taxes added at each stage of the supply chain, without taking credit for taxes paid at previous stages. As a result, the end cost of the product does not clearly show the actual cost of the product and how much tax was applied. This cascading structure is too complex and inefficient.

GST will integrate most taxes into a single one that will be applied to the sale and purchase of goods and services, with deductions for taxes paid at previous supply chain stages. This structure is predicted to be easier to track both for the government and business owners

4.2.4 Understanding GST Taxation System

The goods and services tax (GST) is an indirect federal sales and tax that is applied to the cost of certain goods and services. The business adds the GST to the price of the product, and a customer who buys the product pays the sales price plus the GST. The GST portion is collected by the business or seller and forwarded to the Government. It is also referred to as value added tax (VAT) in some countries.

4.2.5 Dual GST

Many countries in the world have a single unified GST system i.e. a single tax applicable throughout the country. However, in federal countries like Brazil and Canada, a dual GST system is prevalent whereby GST is levied by both the federal and state or provincial governments. In India, a dual GST is proposed whereby a Central Goods and Services Tax (CGST) and a State Goods and Services Tax (SGST) will be levied on the taxable value of every transaction of supply of goods and services

4.2.6 Structure of GST

<u>SGST</u>

1. State GST
2. Collected by the State government

<u>CGST</u>

1. Central GST
2. Collected by the Central government

<u>IGST</u>

1. Integrated GST
2. Collected by the Central government on interstate supply of goods and Services.

4.2.7 Determination of Tax

GST is destination based tax i.e. consumption tax, which means tax will be levied where goods and services are consumed and will accrue to that state.

Under GST, there are three levels of Tax, IGST, CGST & SGST and based on the 'place of supply' so determined, the respective tax will be levied. IGST is levied where transaction is inter-state and CGST & SGST are levied where the transaction is intra-state. For understanding Place of Supply for Services the following two concepts are very important namely:

1. Location of the recipient of services
2. Location of the supplier of services

4.2.8 Registration

Registration Procedure under GST (u/s 25 of CGST):

Every person who is liable to be registered shall for registration within 30 days from the date on date on which he become liable to registration, before applying for registration declare

1. Legal name of business
2. PAN
3. Mobile number
4. Email address
5. State or union territory

In part A of from GST REG -01 on common portal, on successful verification of these numbers, a reference number will be generated application shall submit part B of from GST REG-01 duly signed, along with documents specified in the said from at the common portal from GST REG -02: acknowledgement of application if these documents are found to be in order the proper office shall approve the registration within 3 working days from the date of submission.

4.2.9 GSTIN Structure:

Every taxpayer under the GST regime is provided with a State + PAN-based 15-digit Goods and Services Taxpayer Identification Number (GSTIN). Here is the breakdown of the GSTIN format:

1. The first 2 digits of the 15 digit GSTIN represent the state code.
2. The next 10 digits are the PAN Number of the person or the business entity.
3. The thirteenth digit is based on the number of registrations done by the firm within a state under the same PAN.
4. The fourteenth digit will be the alphabet "Z" by default
5. The last digit is called the check code to detect errors and can be denoted by either a number of an alphabet

4.2.10 Business liable to register under GST:

The whole system of GST depends on the people who are supposed to get registered under GST. I would rather say, registered people are the backbone of any taxation system. Our government has broadly specified two categories of people who are required to register under GST,they are:

1. Normal Category
2. Mandatory Category

1. Normal Category:

Following businesses are required to get registration under GST:

1. Supplier whose aggregate turnover exceeds 20 lakh in a financial year (Rs. 10 lakh for North East states)
2. Person holding registration under any Indirect tax law (VAT, Service tax, Excise duty etc.)
3. Successor, in case of demerger aggregate turnover means the aggregate value of all taxable supplies (excluding the value of inward supplies on which tax is payable by a person on reverse charge basis) exempt supplies, export of goods or services or both and interstate supplies of persons having the same Permanent Account Number, to be computed on all India basis but excludes Central tax, State tax, Union territory tax, Integrated tax and Cess.

2. Mandatory Category:

For the following persons, GST registration is mandatory:

1. A person making an inter-state (one state to another state) taxable supply of a good. Inter-state supplier of services has been excluded by notification no 10/2017 IGST.
2. Casual taxable persons making taxable supply
3. Persons who are required to pay tax under reverse charge.
4. Every electronic commerce operator like Amazon.
5. Goods supplier on electronic commerce platform.
6. Non-resident taxable person making taxable supply.
7. Any person who is required to deduct TDS under GST
8. Person making taxable supply on behalf of other taxable people
9. Input service distributor.
10. Every person supplying online information and database access or retrival services from a place outside India to a person in India, other than a registered person.
11. Any other person or class of persons as may be notified by the Government on the recommendation of the council.

4.2.11 Tax Invoice:

The tax invoice issued must clearly mention information under the following 16 headings:

1. Name, address and GSTIN of the supplier
2. Tax invoice number (it must be generated consecutively and each tax invoice will have a unique number for that financial year)
3. Date of issue
4. If the buyer (recipient) is registered then the name, address and GSTIN of the recipient
5. If the recipient is not registered AND the value is more than Rs. 50,000 then the invoice should carry:
    i. name and address of the recipient
    ii. address of delivery

    iii. state name and state code

6. HSN code of goods or accounting code of services**
7. Description of the goods/services
8. Quantity of goods (number) and unit (meter, kg etc.)
9. Total value of supply of goods/services
10. Taxable value of supply after adjusting any discount
11. Applicable rate of GST(Rates of CGST, SGST, IGST, UTGST and Cess Clearly mentioned)
12. Amount of tax(With breakup of amounts of CGST, SGST, IGST, UTGST and Cess)
13. Place of supply and name of destination state for inter-state sales
14. Delivery address if it is different from the place of supply
15. Whether GST is payable on reverse charge basis
16. Signature of the supplier

4.2.12 Bill of Supply:

A business registered under GST issues a tax invoice to the buyer. Such an invoice mentions the GST rate charged on the goods and services sold.

However, some businesses registered under GST cannot charge any tax on the invoice issued by them. Such dealers have to issue a Bill of Supply.

A Bill of Supply is issued when GST is not applicable on a transaction or when GST is not to be recovered from the customers.

4.2.13 Supplementary Invoice:

Supplementary tax invoice is a type of invoice that is issued by a taxable person in case where any deficiency is found in a tax invoice already issued by a taxable person. It can be in form of a debit note or a credit note.

4.2.14 Input Tax Credit Set Off:

As per CGST (Amendment) Act 2018, the priority of set-off of ITC is as below:

1. For CGST Output- First set off thru ITC of IGST, then CGST

2. For SGST Output – First set off thru ITC of IGST, then SGST

3. For IGST Output – First set off thru ITC of IGST, then CGST & then SGST

Following new sections have been inserted thru CGST (Amendment) Act 2018:

As per Section 49A,

Notwithstanding anything contained in section 49, the input tax credit on account of central tax, State tax or Union territory tax shall be utilized towards payment of integrated tax, central tax, State tax or Union territory tax, as the case may be, only after the input tax credit available on account of integrated tax has first been utilized fully towards such payment.

As per Section 49B,

Notwithstanding anything contained in this Chapter and subject to the provisions of clause (e) and clause (f) of sub-section (5) of section 49, the Government may, on the recommendations of the Council, prescribe the order and manner of utilization of the input tax credit on account of integrated tax, central tax, State tax or Union territory tax, as the case may be, towards payment of any such tax.

Let us understand the same with help of an example:

Head	Output Liability	Input Tax Credit available (ITC)	As per old Set-off rules		As per revised Set-off rules (applicable from 1st Feb 2019)	
			Paid thru ITC	Paid thru Cash	Paid thru ITC	Paid thru Cash
CGST	800	500	CGST-500 IGST-300	0	IGST- 800	0
SGST	400	200	SGST-200 IGST-200	0	SGST- 200	200
IGST	0	800	–	0	–	

4.2.15 Accounting for Goods:

Practical

In this practical we will learn following terms in Tally

1. Company set up
2. Enabling GST
3. Ledger Creation
4. Stock Item Creation
5. Voucher Entry
    a. Purchase
    b. Sales
6. GST Reports
    a. Tax Payment
    b. GSTR1
    c. GSRT2
    d. GSTR3B

4.3 Summary:

Actually, in Tally, We do not need to create a GST return. It is automatically created if we create the sales and purchase bills correctly in a proper way.

The best thing is we can start entering Purchase and Sales bills in Tally while we are in our shop, since the interface is similar to creating a sales bill and anyone can do it once we know how to do it.

There is a very low learning curve. It doesn't feel that we are creating a GST return, but just feels that we are creating a sales bill. It feels easy and simple.

Illustration

1. Purchased following material from Vaibhav Traders (RD from Karnataka) on credit, @ 2% Discount, Invoice No. 136, GST @ 18%
    a. 18.5" Monitor - 50 Qty. - 3800/- each
    b. 19.5" Monitor - 50 Qty. - 4100/- each

2. Sold following material to Maruti Traders (RD from Maharashtra) on credit, @ 2% Discount, Invoice No. 613, GST @18%

a. 18.5" Monitor - 50 Qty. - 4350/- each

b. 19.5" Monitor - 50 Qty. - 4650/- each

Working Notes& Entries

1. In above transaction No. 1 Material purchased from Vaibhav Traders who is from Karnataka i.e. purchase made from interstate therefore IGST is applicable and 2% discount on assessable value which is to be deducted.

Purchase 1. 18.5" Monitor 50 X 3800 = 1,90,000.00 2. 19.5" Monitor 50 X 4100 = 2,05,000.00	3,95,000.00
Less – Discount Received (2% on 3,95,000.00)	7,900.00
Add – IGST (18% on 3,95,000.00)	71,100.00
Vaibhav Traders	4,58,200.00

Entry

Purchase A/c	Dr.	3,95,000.00	
IGST A/c	Dr.	71,100.00	
To Vaibhav Traders A/c			4,58,200.00
To Discount Received A/c			7,900.00

2. In above transaction No. 2 Material sold to Maruti Traders who is from Maharashtra i.e. sale made in intrastate therefore CGST & SGST are applicable and 2% discount on assessable value which is to be deducted.

Sales 1. 18.5" Monitor 48 X 4350 = 2,08,800.00 2. 19.5" Monitor 48 X 4650 = 2,23,200.00	4,32,000.00
Less – Discount Received (2% on 4,32,000.00)	8,640.00
Add – CGST (9% on 4,32,000.00) Add – SGST (9% on 4,32,000.00)	38,880.00 38,880.00
Maruti Traders	5,01,120.00

Entry

Maruti Traders A/c	Dr.	5,01,120.00	
Discount Allowed A/c	Dr.	8,640.00	
To Sales A/c			4,32,000.00
To CGST A/c			38,880.00
To SGST A/c			38,880.00

Tax Payment

Particulars	Amount	Amount	Amount
Tax Collection			
Tax on Sales		77,760.00	
1. IGST	00.00		
2. CGST	38,880.00		
3. SGST	38,880.00		77,760.00
Less – Tax on Sales Return			
1. IGST	00.00		
2. CGST	00.00		
3. SGST	00.00		
Input Tax Credit			
Tax on Purchase		71,100.00	
4. IGST	71,100.00		
5. CGST	00.00		
6. SGST	00.00		71,100.00
Less - Tax on Purchase Return			
1. IGST	00.00		
2. CGST	00.00		
3. SGST	00.00		
Tax Payment			**6,660.00**

Following is the procedure to solve above given illustration in tally

1. Create a company
2. Set GST features to 'Yes'

a. Goods & Services Tax – Yes

b. Set/Alter GST options –Yes

3. Create Ledgers

a. Purchase	– Purchase Account
b. Sales	– Sales Account
c. Discount Received	– Indirect Incomes
d. Discount Allowed	– Indirect Expenses
e. Vaibhav Traders	– Sundry Creditors
f. Maruti Traders	– Sundry Debtors
g. IGST	– Duties & Taxes
h. CGST	– Duties & Taxes
i. SGST	– Duties & Taxes

4. Create Stock Item

a. 18.5" Monitor

b. 19.5" Monitor

(Note – before creating stock item we should create 'Units of Measure')

5. Voucher Entry

a. Purchase Voucher	– F9
b. Sales Voucher	– F8

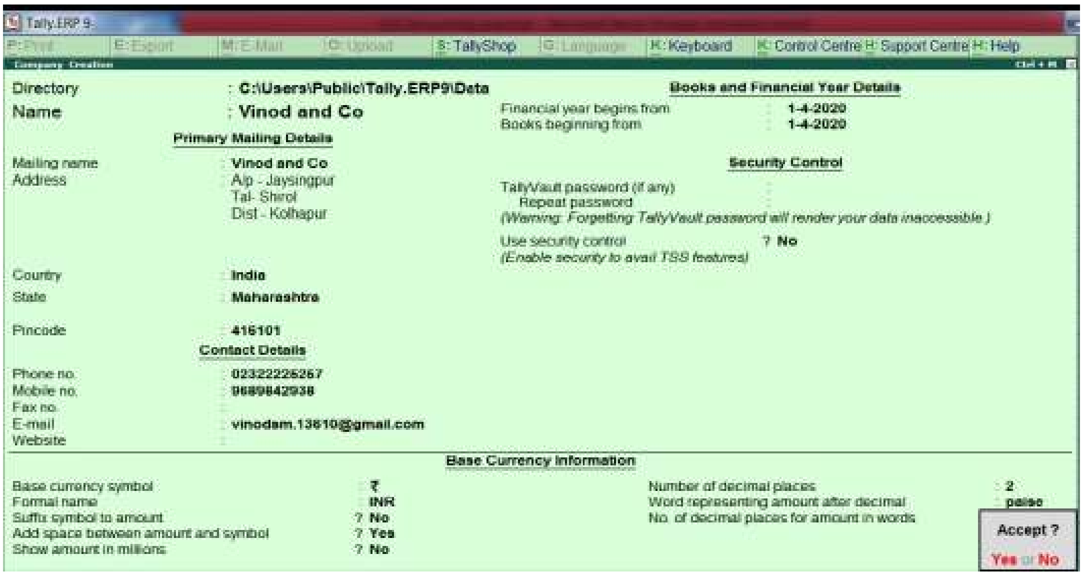
6. Reports

a. Tax Payment (As per above calculation)

b. GST Reports

Company Creation

Go to Gateway of Tally screen → Press Alt+F1 → Select Create option



Fill up all required detail and save this

GST features

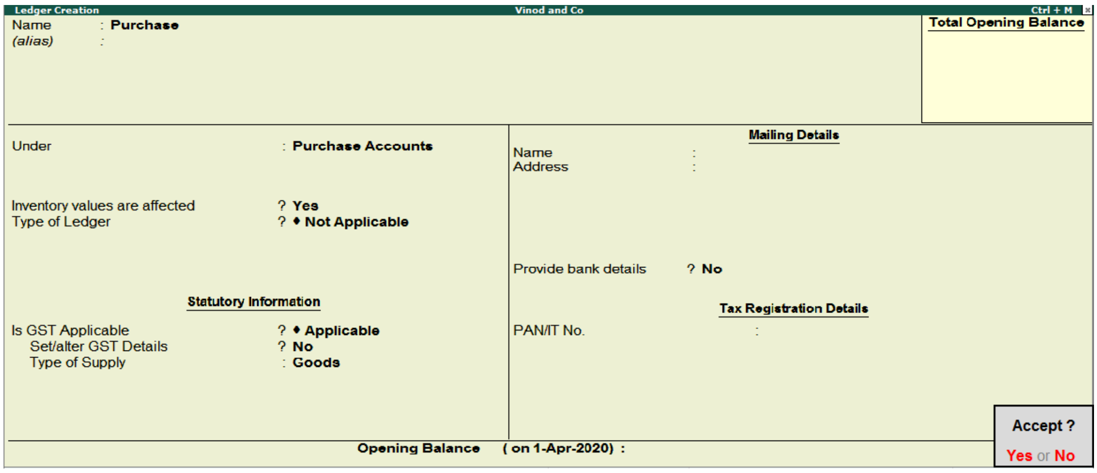
To activate GST Go to Gateway of Tally screen → Press F11 → Select Statutory & Taxation → Set GST options to Yes which is shown as below

Fill all required information and save this

Ledger Creation

To create ledger Go to Gateway of Tally screen → Enter into Accounts Info option → select Ledger → Select Create option to create new ledgers

Purchase ledger



Name – Purchase

Under – Purchase Account

Inventory values are affected – Yes

Type of ledger – Not Applicable

Statutory Information

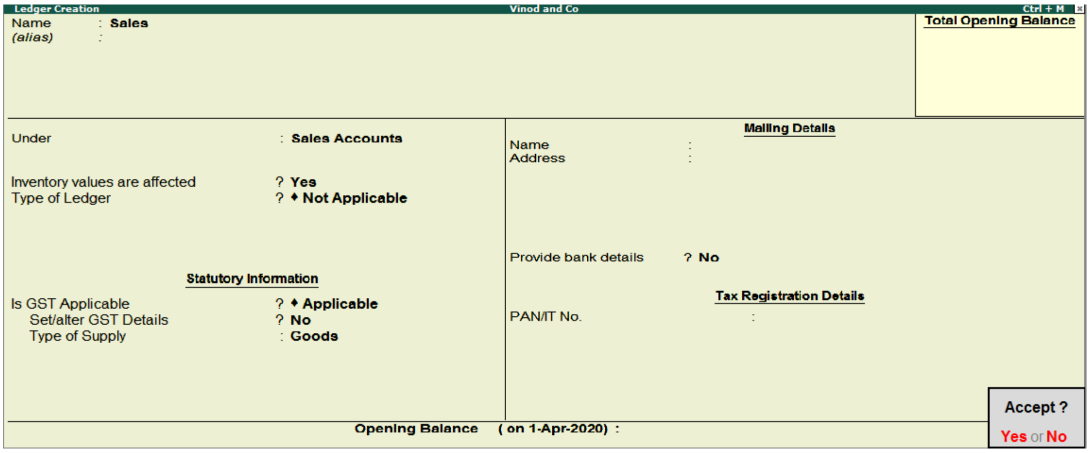
Is GST Applicable – Applicable

Set/Alter GST Details – No

Type of supply – Goods

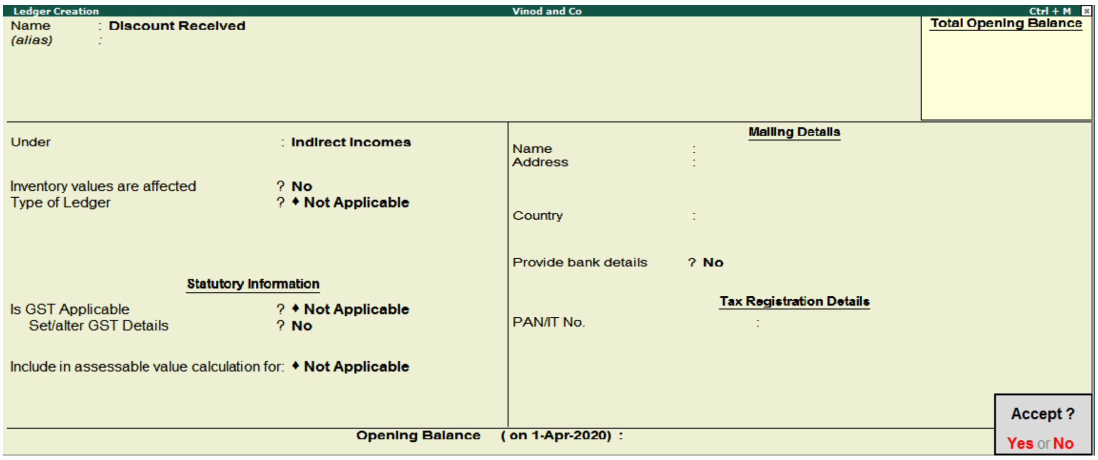
After filling above all information we have to save this

<u>Sales ledger</u>



Fill all information as per Purchase ledger just we have to change Group i.e. Sales Account which is shown in above image.

Discount Received



Name – Discount Received

Under – Indirect Incomes

Inventory values are affected – No

Type of ledger – Not Applicable

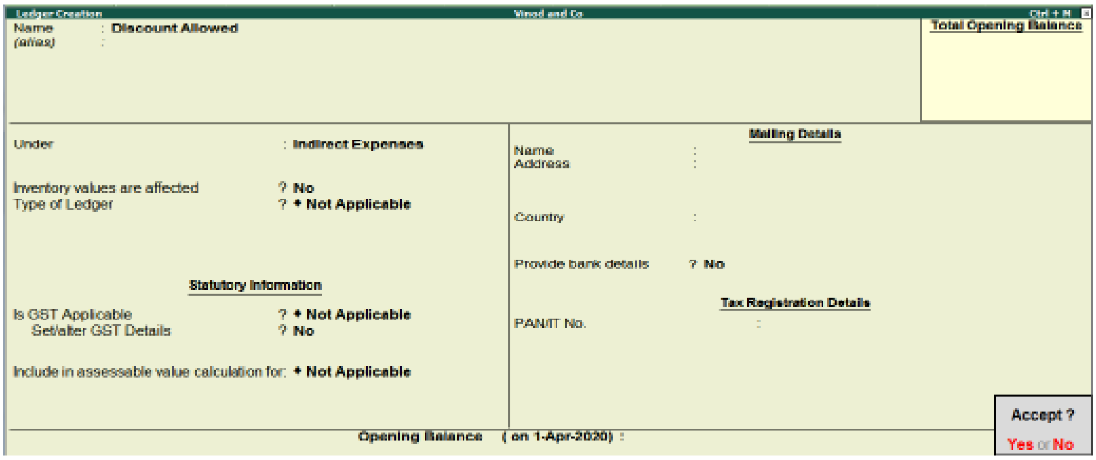
<u>Statutory Information</u>

Is GST Applicable – Not Applicable

Set/Alter GST Details – No

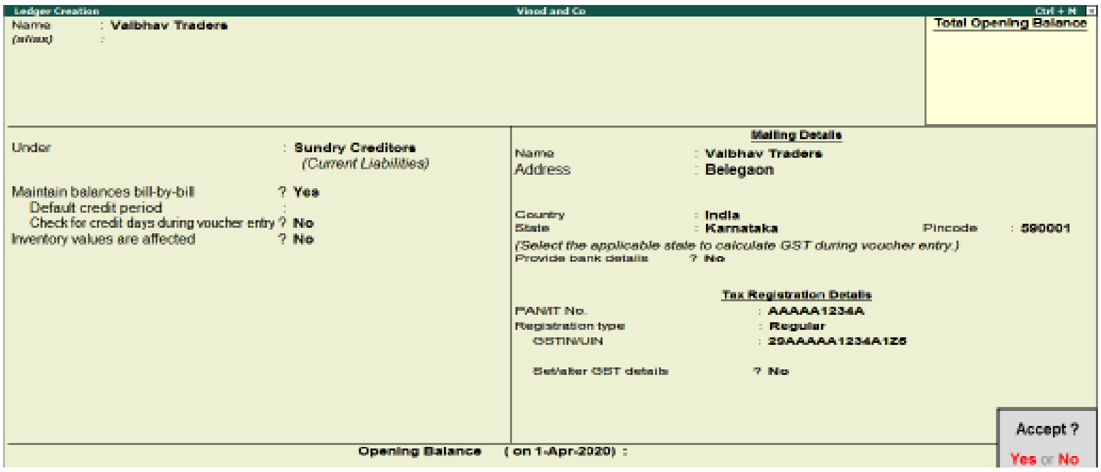
Include in assessable value calculation for – Not Applicable

<u>Discount Allowed</u>



Fill all information as per Discount Received ledger just we have to change Group i.e. Indirect Expenses which is shown in above image.

Vaibhav Traders



Name – Vaibhav Traders

Under – Sundry Creditors

Maintain balance bill by bill - Yes

Default credit period – leave blank

Check for credit days during entry – No

Inventory values are affected – No

Mailing Details

Name – Vaibhav Traders

Address – Belgaon

Country – India

State – Karnataka (Note – GST code start with 29 for Karnataka)

Pincode – 590001

Provide bank details – No

Tax Registration Details

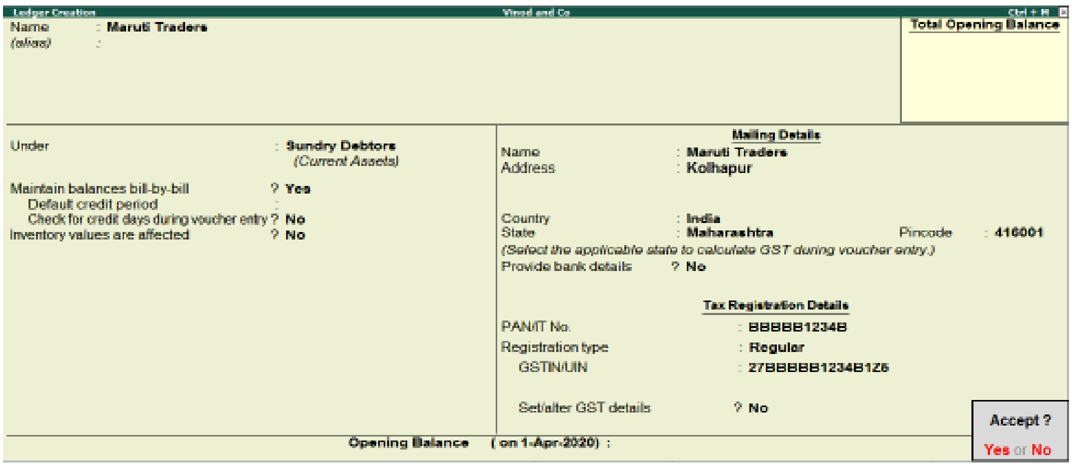
PAN/ IT No. – AAAAA1234A

Registration Type – Regular (as given in illustration)

GSTIN/UIN – 29AAAAA1234A1Z5

Set/Alter GST details – No

Maruti Traders



Fill up all information same as above Vaibhav Traders just we have make little changes which are shown below

Name – Maruti Traders

Under – Sundry Debtors

State – Maharashtra (GST code start with 27 for Maharashtra)

<u>Tax Registration Details</u>

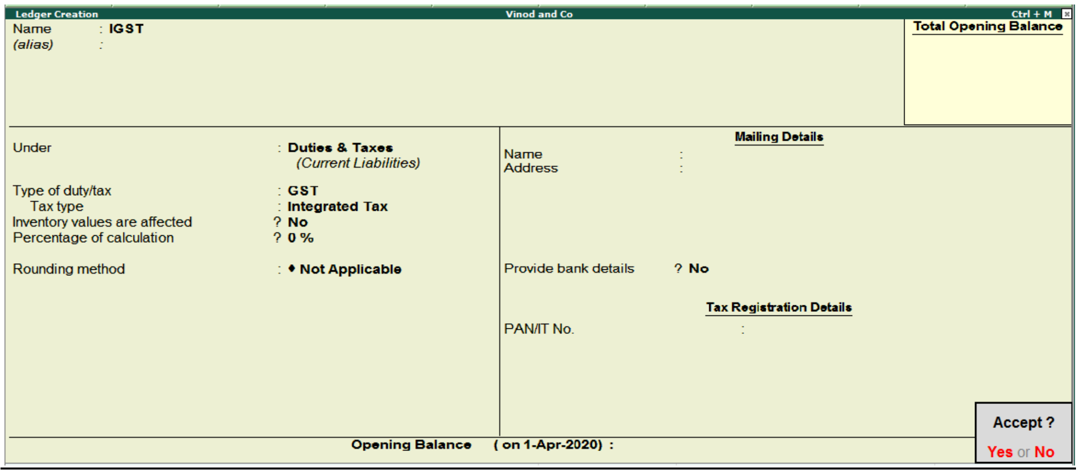
PAN/ IT No. – AAAAA1234A

Registration Type – Regular (as given in illustration)

GSTIN/UIN – 29AAAAA1234A1Z5

Set/Alter GST details – No

<u>IGST ledger</u>



Name – IGST

Under – Duties & Taxes

Type of Duty/Tax – GST

Tax Type – Integrated Tax

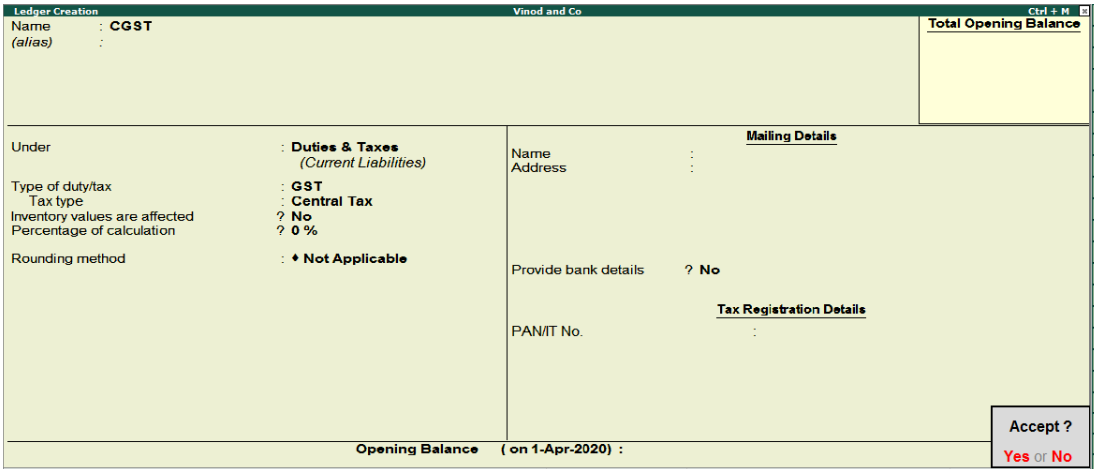
Inventory Values are affected – No

Percentage of calculation – 0%

Rounding Method – Not Applicable

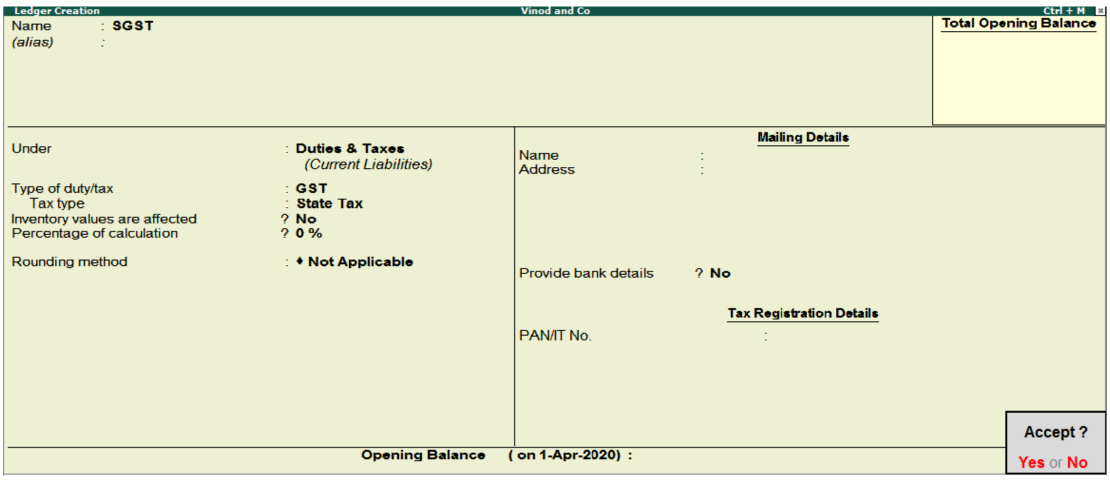
After filling all details we have to save this

<u>CGST ledger</u>



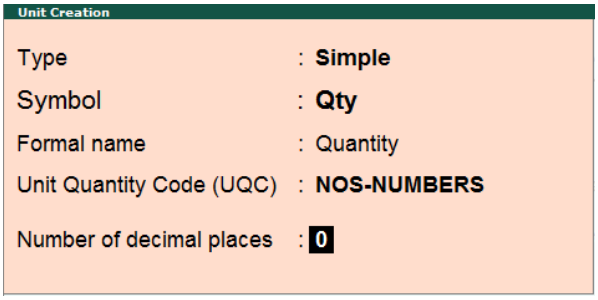
Fill up all details same as above IGST ledger just we have change Tax type to Central Tax

<u>SGST ledger</u>



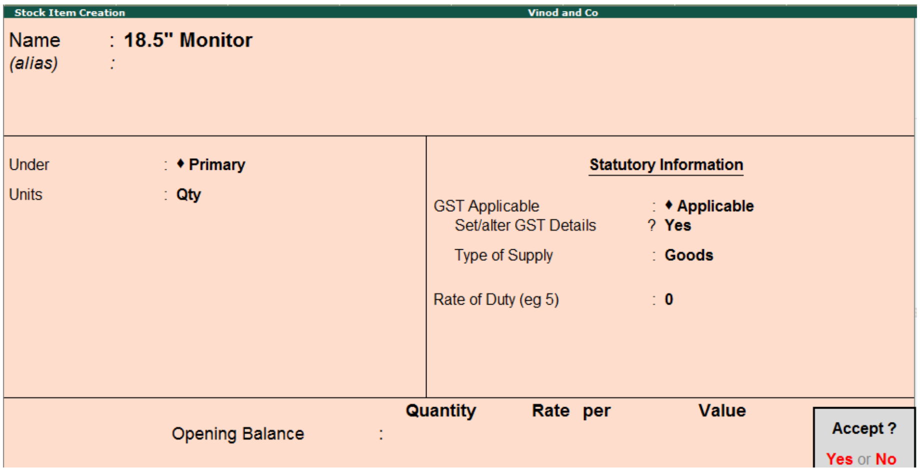
Again here we have to create SGST ledger same as above two tax ledgers just we have to change Tax type to State Tax.

After creating all ledgers we have to create Stock Item but before creating Stock Item we have to create Units first. To create Units Go to Gateway of Tally screen → Select Inventory Info → Select Units of Measure → Create



After filling above all details we have to save this

<u>Stock Item</u>



Name – 18.5” Monitor

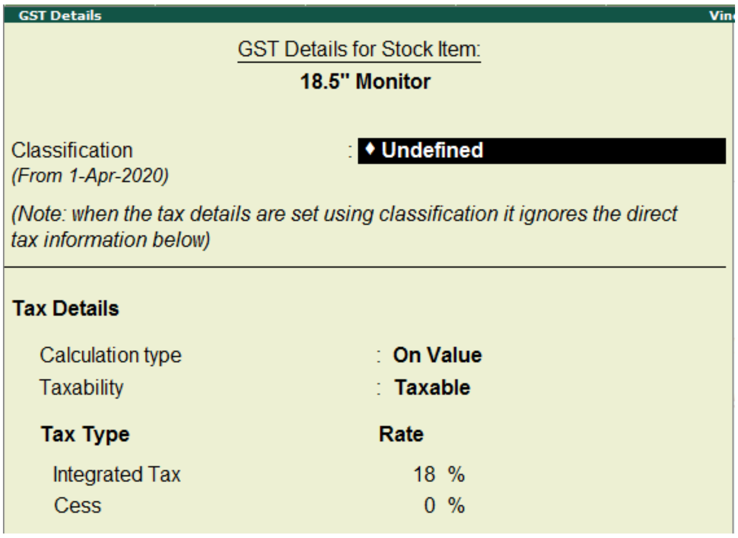
Under – Primary

Units – Qty

Statutory Information

GST Applicable – Yes

Set/Alter GST details – Yes (and fill all details shown as in below image)



Type of supply – Goods

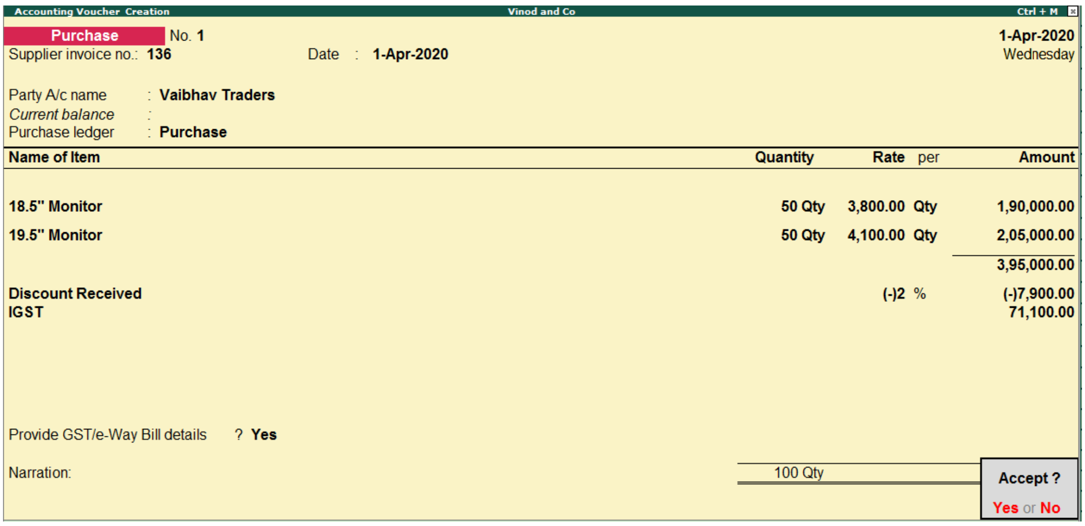
Rate of duty – 0%

After filling above all details we have to save this and create remaining stock item by same way

After creating all Masters we will learn how to record GST transactions in Tally which are shown below

To make Purchase entry in Tally Go to Gateway of Tally → Select Accounting Vouchers → Press F9 (Purchase Voucher)

<u>Purchase entry</u>



Suppliers Invoice No – 136

Date – 1-Apr-2020

Party Name – Vaibhav Traders

Purchase ledger – Purchase

Then select Stock Item, quantity and rate

Then select Discount Received ledger and Press '-2' which amount will calculate automatically

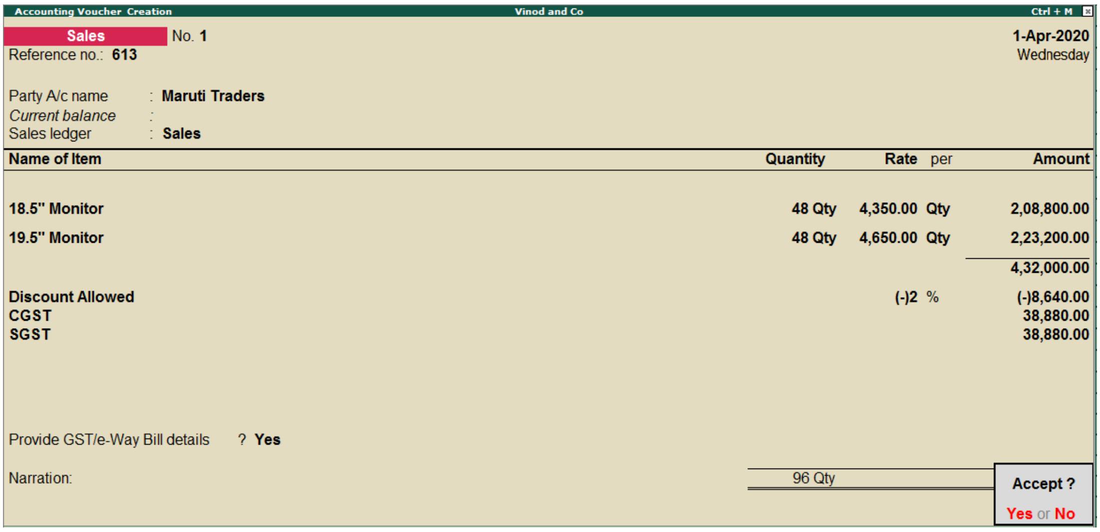
After that also select IGST ledger and amount of IGST will calculate as per given rate which is defined while creating stock item

Then provide GST/e-Way Bill details – Yes

After filling above all details we have to save this

To make Sale entry press F8 (Sales Voucher)

<u>Sales entry</u>



Reference No – 613

Party A/c Name – Maruti Traders

Sales Ledger – Sales

Then select Stock Item, quantity and rate

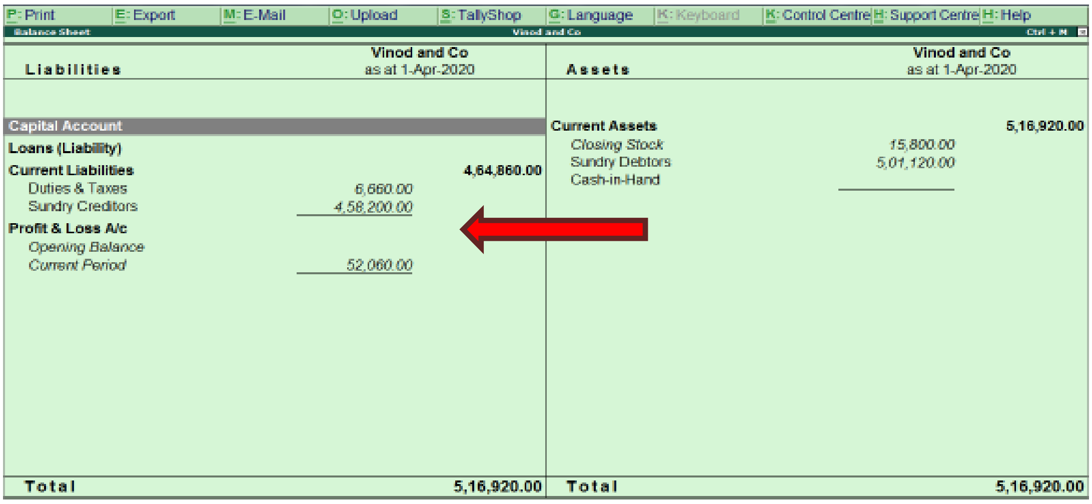
Then select Discount Allowed ledger and Press '-2' which amount will calculate automatically

After that also select CGST & SGST ledgers and amount of CGST & SGST will calculate as per given rate which is defined while creating stock item

Then provide GST/e-Way Bill details – Yes

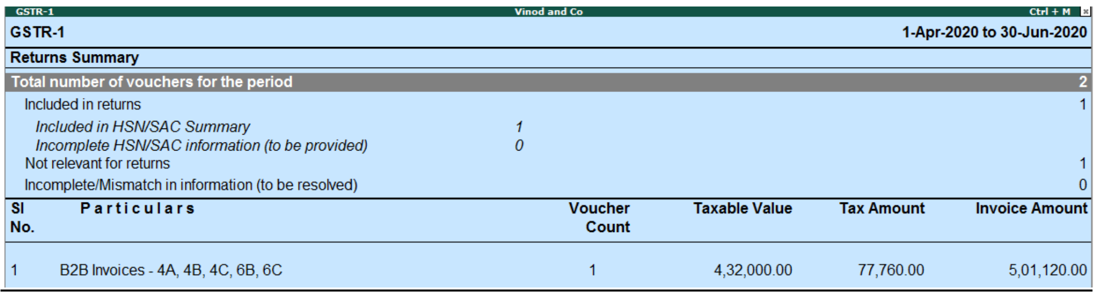
After filling above all details we have to save this

4.17 GST Reports and Returns: Tax payment as per calculation



Liabilities	Vinod and Co as at 1-Apr-2020		Assets	Vinod and Co as at 1-Apr-2020	
Capital Account			Current Assets		5,16,920.00
Loans (Liability)			Closing Stock	15,800.00	
Current Liabilities		4,64,860.00	Sundry Debtors	5,01,120.00	
Duties & Taxes	6,660.00		Cash-in-Hand		
Sundry Creditors	4,58,200.00				
Profit & Loss A/c					
Opening Balance					
Current Period	52,060.00				
Total		5,16,920.00	Total		5,16,920.00

GSTR1(Display →Statutory Reports→GST→GSTR-1)



Total number of vouchers for the period					2
Included in returns					1
Included in HSN/SAC Summary	1				
Incomplete HSN/SAC information (to be provided)	0				
Not relevant for returns					1
Incomplete/Mismatch in information (to be resolved)					0

Sl No.	Particulars	Voucher Count	Taxable Value	Tax Amount	Invoice Amount
1	B2B Invoices - 4A, 4B, 4C, 6B, 6C	1	4,32,000.00	77,760.00	5,01,120.00

GSTR2(Display →Statutory Reports→GST→GSTR-2)

GSTR-2	Vinod and Co	Ctrl + M
GSTIN/UIN : 27AAAAA1234A1Z5		1-Apr-2020 to 30-Apr-2020

Returns Summary

Number of vouchers for the period		2
Included in returns		1
Invoices ready for returns	*0*	
Invoices with mismatch in information	*1*	
Not included in returns due to incomplete information		0
Not relevant for returns		1
Incomplete HSN/SAC information (to be provided)		0

Particulars	No. of Invoices	Taxable Value	Total Tax	Total ITC Available	Reconciliation Status
To be reconciled with the GST portal					
B2B Invoices - 3, 4A	1	3,95,000.00	71,100.00	71,100.00	

<u>GSTR3B</u>(Display →Statutory Reports→GST→GSTR-3B)

GSTR-3B	Vinod and Co	Ctrl + M
GSTR-3B		1-Apr-2020 to 30-Apr-2020

Returns Summary

Total number of vouchers for the period		2
Included in returns		2
Participating in return tables	*2*	
No direct implication in return tables	*0*	
Not relevant for returns		0
Incomplete/Mismatch in information (to be resolved)		0

Table No.	Particulars	Taxable Value	Tax Amount
3.1	Outward supplies and inward supplies liable to reverse charge	4,32,000.00	77,760.00
3.2	Of the supplies shown in 3.1 (a) above, details of inter-state supplies made to unregistered persons, composition taxable persons and UIN holders		
4	Eligible ITC		71,100.00

Problems for Practice

Problem No. 1

1. Purchased following material from A Traders (RD from Maharashtra) on credit, @ 3% Discount, Invoice No. 152, GST @ 12%

a.	Single Line Note Book 100 pgs	1000 Qty.	27/- each
b.	Single Line Note Book 200 pgs	1000 Qty.	52/- each
c.	Double Line Note Book 100 pgs	1000 Qty.	29/- each
d.	Double Line Note Book 200 pgs	1000 Qty.	56/- each

2. Sold following material to B Traders (RD from Karnataka) on credit, @ 3% Discount, Invoice No. 522, GST @12%

a.	Single Line Note Book 100 pgs	1000 Qty.	27/- each
b.	Single Line Note Book 200 pgs	1000 Qty.	52/- each
c.	Double Line Note Book 100 pgs	1000 Qty.	29/- each
d.	Double Line Note Book 200 pgs	1000 Qty.	56/- each

Problem No. 2

1. Purchased following material from X Traders (RD from Karnataka) on credit, @ 5% Discount, Invoice No. 2254, GST @ 18%

a. 32” LED TV 10 Qty. 8,560/- each

b. 40” LED TV 10 Qty. 16,350/- each

c. 32” Smart LED TV 10 Qty. 10,280/- each

d. 40” Smart LED TV 10 Qty. 18,940/- each

2. Sold following material to Y Traders (RD from Karnataka) on credit, @ 5% Discount, Invoice No. 6521, GST @ 18%

a. 32” LED TV 05 Qty. 9,150/- each

b. 40” LED TV 05 Qty. 16,850/- each

c. 32” Smart LED TV 05 Qty. 10900/- each

d. 40” Smart LED TV 05 Qty. 19450/- each

3. Sold following material to Z Traders (RD from Maharashtra) on credit, @ 5% Discount, Invoice No. 6522, GST @ 18%

a. 32” LED TV 05 Qty. 9,150/- each

b. 40” LED TV 05 Qty. 16,850/- each

c. 32” Smart LED TV 05 Qty. 10,900/- each

d. 40” Smart LED TV 05 Qty. 19,450/- each

4.3 Summary:

Actually, in Tally, We do not need to create a GST return. It is automatically created if we create the sales and purchase bills correctly in a proper way.

The best thing is we can start entering Purchase and Sales bills in Tally while we are in our shop, since the interface is similar to creating a sales bill and anyone can do it once we know how to do it.

There is a very low learning curve. It doesn’t feel that we are creating a GST return, but just feels that we are creating a sales bill. It feels easy and simple.

4.4 Check your progress:

1. The Goods and Services Tax Act was passed in the Parliament on …………..

   a) 29th March 2017 b) 1St July 2017

   c) 29th March 2020 d) 1St July 2020

2. ………. is levied where transaction is inter-state

   a) IGST b) CGST c) SGST d) None of these

3. GSTIN number is based on ………………………

   a) PAN b) State c) PAN State d) State PAN

4. ITC stands for ………………..

   a) International Tax Credit b) Input Tax Credit

   c) Indian Tax Credit d) None of these

5. For inter-state supply following tax is applicable

   a) CGST b) IGST c) SGST d) CGST+SGST

4.5 Terms to remember

1. IGST
2. CGST
3. SGST
4. GSTIN
5. Input Tax Credit
6. GST Return

4.6 Answers to check your progress:

MCQ – (1- a, 2-a, 3-d, 4-b, 5-b)

4.7 Exercise

a) Broad Question

1. Explain GST Implementation in India

2. What is GST Taxation System in India?

3. Explain GST types of Dealer

4. Explain Input Tax Credit with Example

5. Explain the Tax Invoice

b) Shorts Notes

1. Why GST was introduced in India?

2. Explain Dual GST

3. Tax Invoice

4. Input Tax Credit Set Off

5. Structure of GST

4.8 References:

1. Vineet chouhan, Pushapkant Shakdwipee, Shagufta khan (2017) Measuring awareness about implementation of GST: "Survery of small Business owners of Rajasthan"-Pacific business Review international.

2. Rajeevchari (2017) "GST impact on service providers" impact on service providers with implementation of GST- Numberz.in

3. R.Rupa – (2017) "GST in India an overview" international education and research journal (IERJ)-E-ISSN No:2454-9916/volume-31issue:2017

4. Shefali Dani-(2016)"A research paper on an impact of goods and service tax on India economy." Business and economics Journal. Dani bus eco j 20167'4 DOI-10,4172/2151-6219

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Unit-1

Elements of Cost

Material, Labour & Overheads, Preparation of Cost Sheet, Quotation

Structure of Unit :

1.0 Objectives :

After studying this unit, you will be able to understand:

- Meaning of cost and classifications of costs.
- Elements of cost.
- Statement of Cost and Profit.
- Meaning of key terms.

1.1 INTRODUCTION :

For the purpose of preparing financial accounts the expenditure of a business is recorded under various accounts suitable from the view-point of final accounts. Expenditure is identified with the total turnover or income, but no detailed information is afforded of the exact manner in which the net profit or loss has been made. But under cost accounts the expenditure is analyzed by different methods and in a greater detail. The broad heading under which, the total expenditure analyzed is known as the elements of cost.

For exam, when we purchase a readymade dress by paying Rs.100. We are paying to-wards the cost of the dress and some margin of profit to the manufactures of dress., Now if the margin of profit is say Rs. 15, the remaining Rs. 85 are paid to-wards the cost. The cost covers all the expenses incurred by the manufacturer of dress such as cloth of the dress, thread, buttons, tailoring charges, supervision charges, depreciation of equipments used for manufacture of dress, rent of workshop, lighting, salaries of clerks, accountants, salesman, managers of garment manufacturing firm, advertisements, printing, stationery, insurance, packing and what not.

1.2 MEANING OF COST:

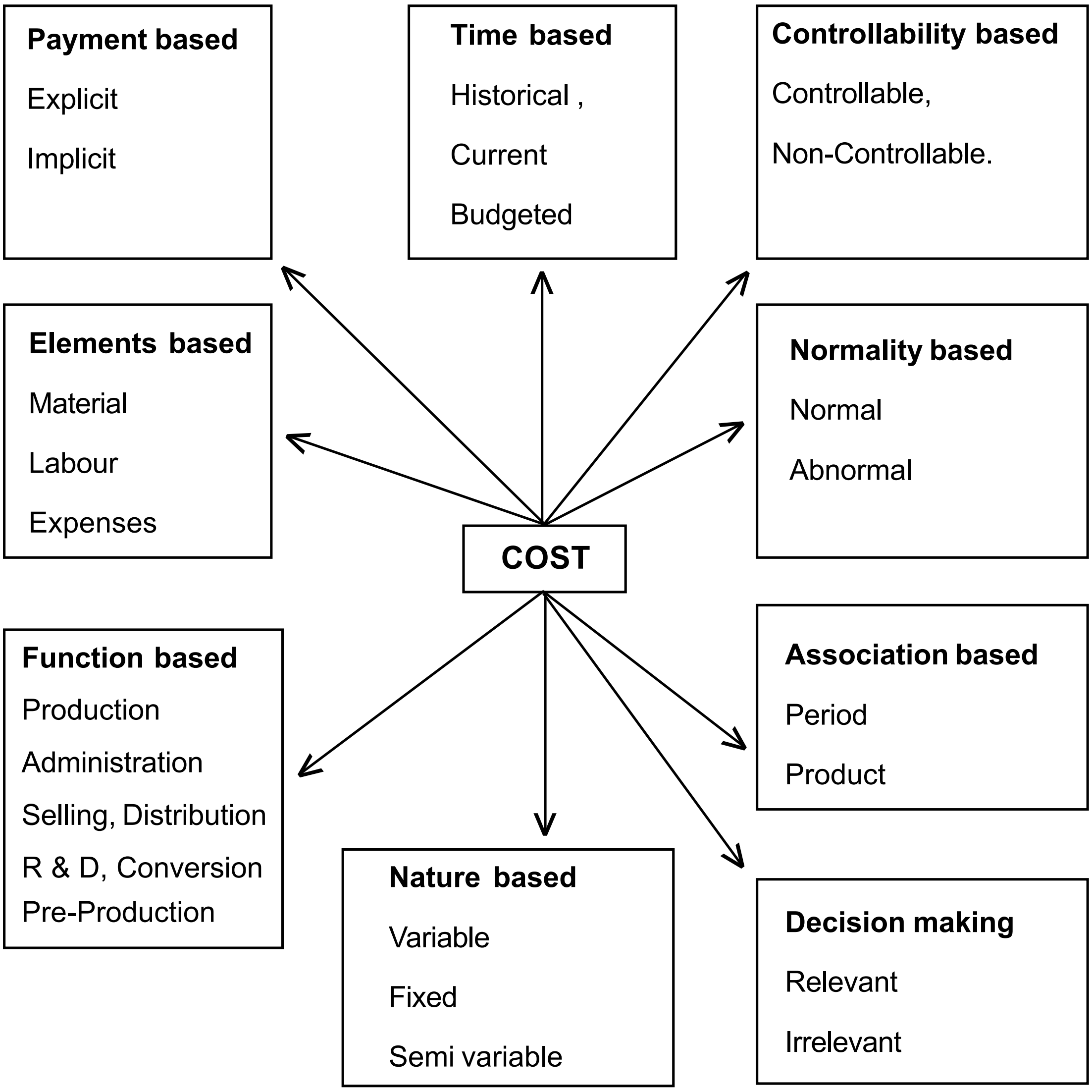
The monetary value of all sacrifices made to achieve an objective (i.e. to produce goods and services).

Cost refers to the expenditure incurred in producing a product or in rendering a service.

It is expressed from the producer or manufacturer's viewpoint (not that of consumer / end user)

Cost ascertainment is based on uniform principles and techniques. Hence cost is objectively determined.

Different classifications of costs.



- **Historical cost:** Cost relating to the past time period, cost which has already been incurred.
- **Current cost :** Cost relating to the present period.
- **Pre-determined costs :** Costs relating to the future period cost which *is* computed in advance, on the basis of specification of all factors affecting it.
- **Variable costs :** These are costs which tend to very are change in relation to volume of production.

- **Fixed costs :** These are costs which remain constant at various levels of production.
- **Semi-variable costs :** These are cost which are partly fixed and partly variable.
- **Materials:** Cost of tangible, physical input used in relation to output/production e.g. cost of raw materials, consumable stores, maintenance items etc.
- **Labour:** Cost incurrent in relation to human resources of the enterprise.
- **Expenses :** Cost of operating and running the enterprise,, other than materials and labour, they are the residual category of costs. e.g. factory rent, office maintenance, salesmen salary etc.
- **Direct costs:** Costs which are directly related to / identified with / attributable to cost centre or a cost unit.
- **Indirect Costs :** Cost which are not directly identified with a cost centre or cost unit. -
- **Controllable costs :** Cost which can be influenced and controlled by managerial action,
- **Non-Controllable costs :** These are cost that cannot be influenced and controlled by a specific member of the organization.
- **Normal cost :** Cost which can be reasonable expected to be incurred tinder normal, routine and regular operating conditions.
- **Abnormal cost:** Cost over and above normal cost, which is not incurred tinder normal operating conditions e.g. tines and penalties.
- **Production costs :** The cost of the set of operation commencing with supply of materials, labour and services and ending with the primary packing of product
- **Administration cost :** The cost of formulating the policy, directing the organization and controlling the operations of the undertaking which is not directly related to production, selling distribution, research or development activity or function.
- **Selling Cost :** The cost of seeking to create and stimulate demand and of securing orders. These are sometimes called marketing cost.
- **Distribution Cost :** The cost of the sequence of operations which begins with making the packed product available for dispatch and ends with making the

reconditioned returned empty package, if any available for re-use.

- **Research Cost :** The cost of researching for new or improved products, new applications of materials or unproved methods.
- **Development Cost :** The cost of the process which begins with the implementation of the decision to produce a new or improved product, or to employ a new or improved methods and ends with commencement of formal production of that product or by that method.
- **Pre-production Cost :** The part of development incurred in making a trial production run prior to formal production.
- **Period cost :** These are cost which are not assigned to the products but are charged as expenses against the revenue of the period in which they are incurred.
- **Product costs :** These are cost which are assigned to the product and are included in inventory valuation. These are also called as inventoriable costs.

1.3 ELEMENTS OF COST:

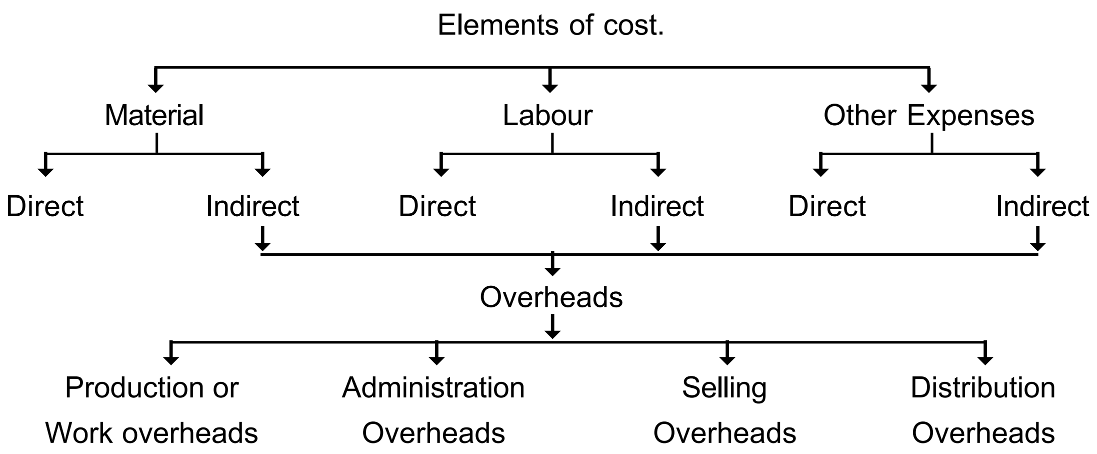
All these expenses can be basically classified in to three categories

viz. 1. Materials.

2. Labour.

3. Other expenses

These are called elements of costs. These elements are further classified in to different sub-elements.



By grouping the above elements of cost the following divisions of cost are obtained.

1. Prime Cost :

Direct Material + Direct Labour + Direct Expenses

2. Works or factory cost :

Prime cost + Works or Factory overheads

3. Cost of Production :

Works cost + Administration Overheads

4. Total cost or cost of sales :

Cost of production + selling and distribution overheads.

The difference between the cost of sales and selling price represents; profit or loss, Now all those terms will be examined in detail.

Direct Materials : are those materials which can be identified in the product and can be conveniently measured and directly charged to the product. Thus these materials directly enter the product and form a part of the finished product, for exam timber in furniture making, cloth in dress making, leather used in shoe making, bricks and cement: used in construction of building are called direct material. The direct material normally include,

i) All raw materials like jute in the manufacture of gunny bags, pig iron in foundry and fruits in canning industry.

ii) Parts or components purchased or produced such as spare parts of mechanical goods such as scooters, car radio, fan, machines etc. arid tyres for cycles.

iii) Primary packing materials like wooden or card board boxes, cartons wrapping etc.

iv) Buying expenses on raw materials / spare parts/ packing materials such as carriage and freight, import duty, custom duty, octroi etc.

However, if such material forms the part of a product but is of very small value it may be treated as indirect material for exam, thread or buttons used in dress making, nail paint, polish paper etc. used in furniture making threads, nails, polish etc. used in shoe making. Because such materials are of small value and they are incurred on all items jointly and efforts involved in identifying those with a particular product will not commensurate with the advantage gained by doing so.

Direct Laibour :

The labour costs which can be conveniently identified in the particular product and which can be easily measured and charged to the product are called direct wages. It is also defined as "all labour expended in altering the construction, composition, conformation of condition of the product.'' In simple words, direct labour refers to the wages of workers who are directly engaged in the production of product. For exam, wages of a worker who stitches a shirt, wages of carpenters in furniture making and. wages of cobbler in shoe making, are treated as direct wages. Payments of the following groups of labour are treated as direct labour.

1) Labour engaged in the actual production or in the carrying out of an operation or process.
2) Inspectors, analysis etc. specially required for such production.
3) Labour assisting the production process by supervision, maintenance, materials handling, tool setting etc. if specially identified

However, the wages paid to labour who assists the direct labour in production process is treated as indirect labour, if it can not be conveniently charged to a particular product. For exam, wages of a supervisor in furniture workshop at Rs. 500 p.m. can be conveniently charged to the products, if suppose 50 chairs of same type are manufactured under his supervision (i.e. 500 / 50 = 10 per chair) but if ten sofa-sets, five dining sets, five tables and four cupboards are manufactured under the supervision of the same supervisor it will not be convenient to charge his wages to these different products. Hence it becomes indirect labour.

Direct expenses / Chargeable expenses /Productive expenses :

Include all expenditure other than direct material or direct labour that is specifically incurred for a particular product or process. Such expense is charged directly to the particular cost account concerned as part of the prime cost. Examples of direct expenses are - i) Excise duty, ii) Royalty, iii) Architects fees in construction work. iv) Cost of rectifying defective work. v) expenses of designing for the Product. vi) experimental expenses in developing the product. vii) Hire charges of special equipments obtained for a particular job or contract.

Overheads (On-Costs) :

These are the expenses over and above the cost of direct material, direct labour and direct expenses. In other words, the expenses of general nature over and above the cost of direct materials, direct labour and direct expenses are called overheads. These expenses are incurred in manufacture, sale and distribution of production, but they cannot be charged directly to a product; or process due to their general nature.

A) Functional classification of overheads-

The overheads can be further classified into following, categories.

a) Factory overheads (Works on costs or production overheads)

b) Administration overheads (Office on cost or Establishment on cost)

c) Selling and Distribution overheads (Selling and Distribution on cost)

a) Factory Overheads : (Works overhead, Factory on cost, Works on cost, Production overhead)

These are the expenses related to the production process. They include all indirect materials, indirect labour and indirect expenses incurred in the factory, from the receipt of work order till its completion. They include,

a) Indirect materials in production process such as lubricants, fuel and oil, cotton waste, belts, fasteners etc.

b) Indirect Labour such as wages of foremen, supervisors, store keepers, cleaners, maintenance personnel.

c) Indirect expenses such as factory rent and rates, insurance and lighting, deprecation and repairs of plants, equipments and factory building, motive power etc.

b) Administrative overhead : It includes all expenses incurred in relation to management or administration of business i.e. all office expenses means, printing and stationery office salaries, postage and telegram, office rent, ratio and insurance, legal charges, depreciation, audit fee, repairs of office building etc.

c) Selling and Distribution overheads : Expenses incurred in respect of getting orders for the commodity e.g. advertisement and publicity salaries and commission of salesmen, sales office expenses, bad debts, sales promotion expenses, after stiles service, market research expenses, show-room expenses etc. -

Distribution overheads-are the expenses incurred in dispatching, and delivering the finished goods to customers, such as warehouse rent, transportation on sales, loading arid unloading charges, salaries of dispatch clerk and workers, special packing charges., delivery van expenses, carriage outward etc.

B) Classification according to behavior :

Some costs; increase or decrease in direct proportion to the volume of production some costs remain unaffected, while others change but not in .direct production to the change in volume of production. -,

These are: i) Variable costs

ii) Fixed costs and

iii) Semi variable or semi-fixed cost.

i) Variable costs : These are costs which tend to vary or change in relation to volume of production. They increase in total as production. increases and vice-versa e.g. cost of raw materials, direct wages etc. However, variable costs pre unit are generally constant for every unit of the additional output ,

ii) Fixed costs : These are costs which remain constant at various levels of production. They are not affected by volume of production e.g. factory rent, insurance etc. Fixed costs per unit very inversely with volume of production i.e. if production increases, fixed cost per unit decreases and vice-versa, sometimes, these are also known as Capacity costs or Period costs e.g. rent and rates of building, salary of works manager, Depreciation of building, insurance, interest on capital, municipal taxes.

iii) Semi Variable costs : These are costs which are partly fixed and partly variable. These are fixed up to a particular volume of production and become variable thereafter for the next level of production. Hence they are also called Step Costs. Some examples are Repairs and maintenance, Electricity, Telephone etc.

1.4 Cost Concepts :

Some concepts which are often used in Cost Accounting are explained below.

1) Cost Unit: - Cost unit is a unit of measurement in which cost may be ascertained, Example.

Product/ Service	Cost Unit	Product/ Service	Cost Unit
Soaps Wire / Cable Dairy (Milk) Goods transport Passenger transport	Number/Carton Meter/ Kilometer Liter /Bag Tonne kilometer Passenger kilometer	Brickworks Building Cement Power Paper	Per 1000 brick Square foot Tonne Kilowatt hour Rim
Wood / Gas Food grains Sugar Hospital Automobile	Cubic Feet (cft) Kg./Quintal/Tonne Per Tonne Per patient clay Per vehicle/Number	Textiles Road contractors Bicycle Pharmaceuticals Steel	Meters Per mile/kilometer Number 1000 tablets Tonne

2) Cost centre : Cost center is a location, person or item of equipment (or group of these) for which cost may be ascertained and used for the purpose of cost control. Thus cost center represents a head of account under which cost are recorded or gathered to facilitate their distribution and control, in the process of ascertaining the cost of any product in the first stage, the general costs (expenses) of the firm are classified department-wise or equipment-wise or significant person-wise, depending upon the suitability of situation. These different departments/equipments/persons with reference to which costs are collected for cost ascertainment and cost control are called cost centre. After ascertaining the cost incurred at these cost centre, it is absorbed by the units that are turned out with the help of these centre.. Cost centre may be of following types :

1) Impersonal Cost Centre: Such as Department or Lathe machine in production department or Vehicle of transport agency.
2) Personal Cost Centre: Such as foreman or a group of foremen or salesmen.

3) Operation Cost Centre: Consisting of a group of machines and men carrying out similar operations.

4) Process Cost centre: Consisting of continuous sequence of operations.

The examples of cost centre are: production department's boiler house, power house, research & development laboratory, staff training centre, canteen, warehouse, maintenance shops, sales area, clock room etc.

Presentation of total cost :

First of all cost are classified on the basis of nature, such as materials, labour and other expenses. Further distinction should be made of direct cost and indirect costs. All the direct costs are grouped under the heading of prime cost and indirect costs are known as overheads. All these costs are grouped under separate functional heads and presented to the management in the form of a statement, known as cost sheet.

1.5 Cost Sheet :

Meaning : A cost sheet is a statement which shows the break-up and build-up of costs. It is a document which provides for the assembly of the detailed cost of & cost centre or a cost unit. The statement summarizes the cost of manufacturing a particular list of product and discloses.

i) The prime cost ii) Works Cost iii) Cost of production and iv) Total cost.

Purposes :

1) It gives the breakup of total cost by elements and sub divisions.

2) Iit discloses the total cost as well as the cost per unit of production,

3) It helps for preparation of tenders and quotations.

4) It helps for fixing selling price.

Uses : The following are the uses of the cost sheet.

a) Presentation on cost information.

b) Determination of selling price.

c) Ascertainment of profitability.

d) Product wise and Location wise cost Analysis.

e) Inter- firm and Intra- firm cost comparison.

f) Preparation of Cost Estimates for submitting tenders / quotation.

g) Preparation, of Budgets.

h) Disclosure of operational efficiency for Cost control.

Specimen form of Cost Sheet

For the year ended....

Particulars		**Total Cost**	**Cost per unit.**
Opening stock of raw materials	xx		
Add : Purchase of raw materials	xx		
Carriage inwards	xx		
Octroi	xx		
	xxx		
Less : Closing stock of raw material	xx		
Material lost	xx		
Material transferred to job or department	xx		
Material Consumed		xxx	xx
Direct Wages		xxx	xxx
Direct Expenses		xxx	xxx
PRIME COST		**xxx**	**xx**
Add : Factory Overheads or Works on cost.			
Indirect materials	xxx		
Indirect wages- inspection instructors , Gatemen,	xxx		
Drawings office salary	xxx		

(Conted. on next page)

Factor/ Rent, Rates, Taxes &	xxx		
Insurance	xxx		
Lighting heating	xxx		
Power & fuel	xxx		
Repairs & Maintenance Cleaning	xxx		
Expenses cost of research & experiments	xxx		
Works manager salary	xxx		
Printing & Stationery	xxx		
Consumable stores	xxx		
Depreciation of plant & machinery	xxx		
Welfare service expenses	xxx		
Water supply	xxx		
Loose tools written off	xxx		
Haulage or crane expenses	xxxx		
Cost of defective work, etc.	xxx		
	xxx		
Less-Sale of scrap	xxx		
WORKS COST	**xxx**	**xxx**	**xx**
Add : Opening Work in progress		xxx	
Less: Closing Work in progress		xxx	
WORKS COST OF FINISHED GOODS		**xxx**	**xx**
Add : Administration overheads			
Counting house salaries	xx		
Rent, Rate, Insurance	xx		
Telephone & Postage	xx		
Printing & Stationery	xx		
Legal expenses	xx		

(Conted. on next page)

Audit fees	xx		
Bank Charges, etc	xx		
Depreciation of furniture	xx	xxx	
equipments & Building			
COST OF PRODUCTION		xxx	xx
Add : Opening stock of finished goods		xxx	
		xxx	
Less : Closing stock of finished goods		xxx	
Production cost of goods sold		**xxx**	**xx**
Add : Selling & Distribution overheads			
Commission	xx		
Salesmen's salaries	xx		
Advertisement & samples	xx		
Carriage outwards	xx		
Bad Debts	xx		
Depreciation & expenses of	xx		
delivery van	xx		
Debt collection charges	xx		
Rent of warehouse	xx		
Sample & other free gifts	xx		
Showroom rent & rates	xx		
Traveler's salaries, commission, etc.	xx		
		xxx	xx
COST OF SALES		**xxx**	**xx**
Profit / Loss		**xxx**	**xx**
SALES		**xxx**	**xx**

Note : Wile preparing the cost sheet financial Items (income and expenses) are not considered, because such item do not form, a part of the costs. The following items are not including In cost sheet.

Examples of financial and non-cost expenses :

1) Preliminary expenses. 2) Interest on capital. 3) Cash discount. 4) Income tax. 5) Donation. 6) Capital losses. 7) Goodwill written off 8) Discount on issue of shares & debentures 9) Interest on loan, overdraft. 10) Capital expenditure. 11) Underwriting commission 12) Dividend to shareholders. 13) Commission to managing directors or partners. 14) Debenture interest transferred to sinking fund. 15) Provision for doubtful debts 16) Obsolescence loss. 17) Bonus to shareholders. 18) Excess depreciation. 19) Cash discount. 20) Abnormal loss. 21) Interest on debenture. 22) Fines and penalties. 23) Charities. 24) Damage paid under court order.

Examples of financial Incomes :

1) Capital gains or profit.
2) Interest on investment.
3) Abnormal gains.
4) Stores adjustments.
5) Interest on bank deposits.
6) Dividend received on share and investment.
7) Rent received and share transfer fees received.

1.6 Illustrations :

Illustration. 1) Prepare a cost sheet from the details given below for the year ended 31Slt March 2020.

Particulars	**Rs.**
Raw materials	1,98,000
Productive wages	2,10,000
Direct Expenses .	18,0 00
Unproductive wages	63,000
Factory rent & taxes	45,000
Factory lighting	13,200

Factory heating	35,400
Haulage	18,000
Directors fee (Works)	6,000
Directors fee (Office)	12,000
Factory cleaning	3,000
Sundry office expenses	1,200
Estimating (Factory)	4,800
Factory stationery	4,500
Office stationery	5,400
Loose tools written off	3,600
Rent & taxes (Office)	3,000
Water supply	7,200
Factory insurance	6,600
Office insurance	3,000
Law charges	2,400
Rent of warehouse	1,800
Depreciation on plant &. Machinery	12,000
Depreciation office building	6,000
Depreciation on delivery van	1,200
Bad debts	600
Income tax provisions	5,000
Donations	10,000
Advertisement	1,800
Sales department salaries	9,000
Upkeep of deliver van	4,200
Bank charges	300
Commission on sales	9,000
The total output for the period has been	60,000 units.

Solutions :

Cost Sheet

For the year ended on 3 Ist March 2020

Output 60,000 units.

Particulars	**Rs.**	**Rs.**
Raw material	1,98,000	
Productive wages	2,10,000	
Direct expenses	18,000	
		4,26,000
Prime Cost		
Add : Factory overheads:		
Unproductive wages	63,000	
Factory rent & taxes	45,000	
Factory lighting	13,200	
Factory heating	35,400	
Haulage	18,000	
Directors fees	6,000	
Factory cleaning	3,000	
Estimating	4,800	
Factory stationery	4,500	
Loose tools written off	3,600	
Water supply	7,200	
Factory insurance	6,600	
Depreciation on plant & Machinery	12,000	2,22,300
		6,48,300

Factory or Works Cost		
Add: Office Overheads:		
Directors fees	12,000	
Sundry office expenses	1,200	
Office stationery	5,400	
Rent & taxes	3,000	
Office insurance	3,000	
Law charges	2,400	
Dep. On office building	6,000	33,300
Bank charges	300	
		6,81,600
Cost of Production		
Add : Selling & Distribution		
Rent of Warehouse	1,800	
Dep. On delivery van	1,200	
Bad debts	600	
Advertisement	1,800	
Sales department salaries	9,000	
Upkeep of delivery van	4,200	
Commission on sales	9,000	27,600
Total Cost		**7,09,200**

Illustration No. 2

From the following particulars prepares a cost statement showing the component of total "and profit for the year-ended 3I[s:] March 2020

Particulars	On 1st April 2019	On 31st March 2020
Stock of finished goods	6,000	15,000
Stock of raw materials	40,000	50,000
Work in progress	15,000	10,000
Purchase of raw materials		4, 75,000
Carriage inwards		12,500
Wages		1,75,000
Works managers salary		30,000
Factory employees salary		60,000
Factory rent, taxes & insurance		7,250
Power expenses		9,500
Other production expenses		43,000
Saks for the year		8, 60,000
Income tax		5,000
Interest on debentures		10,000
Transfer to sinking fund for replacement		20,000
Of machinery		
Dividend received		2,500
Goodwill written off		10,500
Payment of sales tax		16,000
General expenses		20,500
Office rent		12,000

Solutions: -

Statement of Cost and Profit.

For the year ended 31-3-2020.

Particulars	**Rs.**	**Rs.**
Opening stock of Raw Materials	40,000	
Add:- Purchase of Raw Materials	4.75,000	
Carriage Inward	12,500	
	5,27,500	
Less : Closing stock of Raw Materials	50,000	
Material Consumed	4,77,500	
Wages	1,75,000	
Direct expenses	---	
PRIME COST		6,52,500
Add. Factory Overheads		
Factory employees salary	60,000	
Works managers salary	30,000	
Factory rent taxes & Ins.	7,250	
Power expenses	9,500	
Other production expenses	43,000	1,49,750
FACTORY COST		8,02,250
Add. Opening Work-in Progress		15,000
Less. Closing Work-in Progress		8,17,250
Add. Office & Administration		10,000
Overheads.		8,07,250
General expanses	20,500	
Office Rent	12,000	32,500
		8,39,750

(Conted. on next page)

COST OF PRODUCTION.		
Add : Opening stock of finished goods		6,000
		8,45,750
Less : Closing stock of finished goods		15,000
		8,30,750
COST OF GOODS SOLD		
Add :. Selling & Distribution Overheads		
Sales Tax		16,000
COST OF SALES		8,46,750
Profit (Balancing figure)		13,250
SALES		**8,60,000**

Illustration No. 3

(When units sold & produced are to he ascertained)

From the following figures, prepare the cost sheet to show the cost; of production of each unit of the goods manufactured. Also prepare a statement 1:0 show the profit earned.

Particulars	Rs.
Opening stock 1-7-2020. . ,	
Raw Material 500 units	300
Finished goods 500 units	1,610
Purchase:	
Raw Materials 10,000 units	9,635
Closing stock 31-7-2020:	
Raw Materials 300 units	755
Finished goods 700 units	1,834

Office Salaries, Rent & Rates	224
Repairs & depreciation of Plant &	
Machinery	1,020
Printing & Stationery	918
Manufacturing Wages	9,690
Coal Consumed	2,958
Rent & Rates of Factory	1,734
Commission on Sales	500

There was no wastage during production. Selling price was Rs. 3 per article (unit).

Solutions :

Statement of Cost and Profit.

For the Month ended 31 -7-2020

(No. of Units Produced 10,200)

Particulars		Total Cost Rs.	Cost Per Unit
Opening stock of raw materials	300		
Add :. Purchases of R. M.	+ 9,635		
Less : Closing of R.M.	– 755		
Material consumed		9,180	0.90
Manufacturing Wages		9,690	0.95
Direct expenses		---	---
PRIME COST			
Factory on Cost :			
Repairs & depreciation of plant	1,020		
Coal Consumed	2,958		

Rent & Rates	1,734		
		5,712	0.56
		24,482	2.41
FACTORY COST			
Office &. Administrative on cost :			
Salary, Rent & Rates	1,224		
Printing & Stationery	918	2,142	0.21
	Units	--	2.62
	10,200	26,724	
COST OF PRODUCTION			
Add. Opening stock of finished goods	500	1,610	
	10,700	1,610	
Less : Closing stock of finished good:	700	1,834	
	10,000	26,500	
PRODUCTION COST OF GOODS SOLD			
Selling & Distribution on-cost commission on sales		500	
		27,000	
COST OF SALES			
Profit (Balancing figure) SALE (@ Rs. 3 p.u. for 10,000 unitssold)		3,000	
		30,000	

Note:

1) The number of units produced during the month ended 31-7-2020 is ascertained as follows:

		Units
Opening stock of Raw Materials		500
Add: Purchase of Raw Materials		10,000
		10,500
Less: Closing stock of Raw Materials		300
	No. of Units Produced	10,200

2) Units sold during the month are 10,000

Illustration No. 4

Given below is Profit & Loss Account of a manufacturing Co. for the year ending 31st March.

Dr **Profit and Loss Account** Cr

Particulars		Rs.	Particulars	Rs.
To Opening stock of			By Sales	4,45,800
Raw Materials		10,000	By Closing stock	12,000
Purchase of Raw Materials				
Materials		1,50,000		
Wages		1,24,000		
Power		36,000		
Establishment Exp.				
Factory	8,000			
Office	15,300	23,000		
Rent				
Factory	2,000			
Office	3,000	5,000		
Advertisement		6,000		
Traveller's Commission		4,000		
Maintenance of Delivery Vans		5,000		
Rent of Warehouse Telephone		2,500		

(Conted. on next page)

Factor	300			
Office	510	800		
Electric Charges				
Factory	200			
Office	400	600		
Depreciation.				
Factory	100			
Office	700	800		
Depreciation of factory				
Machinery		3,000		
Interest on loan		1,000		
Bad debts		600		
Miscellaneous Exp.				
Factory	2,000			
Office	9,000	11,000		
Net Profit		74,500		
		4,57,800		**4,57,800**

The following analysis of office expenditure is given to you:

	Office Expenditure	Administration	Analysis Selling	Distribution
a.	Office Establishment	50%	40%	10%
b.	Office Telephone	30%	50%	20%
c.	Office Rent	40%	60%	Nil
d.	Office Electric charges	20%	70%	10%
e.	Office Miscellaneous Expenses	65%	20%	15%
f.	Use of office Furniture	60%	30%	10%

From the above Profit & Loss Account Prepare a statement showing different elements of cost bringing out figures for Administration, selling and distribution separately.

Solution :

Statement of Cost

Particulars	**Rs.**	**Rs.**
Opening stock of Raw Materials	10,000	
Add : Purchase of Raw Materials	1,50,000	
	1,60,000	
Less : Closing stock of Raw Mat.	12,000	
Material Consumed	1,48,000	
Wages	1,24,000	
Prime Cost		2,72,000
Add : Factory Overheads		
Power	36,000	
Establishment	8,000	
Rent	2,000	
Telephone	300	
Electricity Charges	200	
Dep. of Furniture	100	
Dep. of Machinery	3,000	
Miscellaneous Expenses	2,000	51,600
Factory Cost		3,23,600
Add : Office Overheads.		
A) Administration Overheads		
Establishment Rent	7,500	
Rent	1,200	

(Conted. on next page)

	Telephone	150	
	Electricity Charges	80	
	Dep. of Furniture	420	
	Miscellaneous Expenses	5,850	15,200
			3,38,800
B)	**Selling Overheads**		
	Establishment	6,000	
	Rent	1,800	
	Advertisement	6,000	
	Traveller's commission	4,000	
	Telephone	250	
	Electricity Charges	280	
	Bad Debts	600	
	Dep. of Furniture	210	
	Miscellaneous. Expenses	1,800	20,940
			3,59,740
C)	**Distribution Overheads**		
	Establishment	1,500	
	Rent of warehouse	2,500	
	Telephone	100	
	Electricity Charges	40	
	Maintenance of Delivery Van	5,000	
	Dep. of Furniture	70	
	Miscellaneous Expenses	1,350	
			10,560
	Total Cost :		**3,70,300**

Note : Interest on loan being a pure financial matter, it is excluded from cost.

Illustration No. 5

Following are the particulars for the production of 2000 Fans of Air-solution Co. Ltd. for the year 2020-21.

Particulars	Rs.
Cost of Raw Materials	3,20,000
Wages	4,80,000
Manufacturing Expenses	2,00,000
Salaries	2, 40,000
Rent, Rates & Insurance	40,000
Selling Expenses	1,20,000
General Expenses	80,000
Sales	16,00,000

The company plans to manufacture 3,000 Fans during 2021-22. The following additional information is supplied regarding it.

1) The price of material is expected to increase by 20%
2) Wage rates are expected to show an increase of 5%
3) Manufacturing expenses will rise in proportion to the combined cost of material and wages.
4) Selling expenses will remain the same
5) Other expenses will remain unaffected by rise in output.

You are required to prepare cost sheet for the year 2020-21 and 'Estimated price' for 3,000 Fans to be produced during the year 2021-22 at which the Fans would be sold as to show profit of 10% on sales.

Solution :

Air- Solution Co. Ltd.

Cost Sheet For the year 2020-2021

Output = 2000 Fans

Particulars	Rs.	Rs.
Materials		3,20,000
Wages		4,80,000
Prime Cost		8,00,000
Add : Factory Overheads		
Manufacturing Expenses		2,00,000
Factory Cost		10,00,000
Add : Office Overheads		
Salaries	2,40,000	
Rent, Rates & Insurance	40,000	
General Expenses	80,000	3,60,000
Cost of Production		13,60,000
Add : Selling Overheads		
Selling Expenses		1,20,000
Total Cost		14,80,000
Profit		1,20,000
Sales		16,00,000

Estimated price for 3000 Fans to Produced
During the year 2021-2022

Particulars	Rs.	Rs.
Materials		3,84,000
Wages		5,04,000
Prime Cost		8,88,000
Add : Factory Overheads		
Manufacturing Expenses		2,22,000
Factory Cost		11,10,000
Add : Office Overheads		
Salaries	2,40,000	
Rent, Rates & Insurance	40,000	
General Expenses	80,000	3,60,000
Cost of Production		14,70,000
Add : Selling Overheads		
Selling Expenses		1,20,000
Total Cost		15,90,000
Profit		1,76,667
Sales		17,66,667

Illustration No 6 :

The accounts of Pooja Company Ltd. show for 2018:- Materials Rs. 3,50,000; Labour Rs. 2,70,000; Factory Overheads Rs, 81.000; and Administration overheads Rs. 56,080.

What price should the company quote for a refrigerator? It is estimated that Rs. 5,000 in a material and Rs. 3,500 in labour will be required Jbr one refrigerator. Absorb Factory overheads on the basis of labour and Administration overheads on the basis of works cost. A profit of 12 ½ % on selling price is required

Solution :

Statement of Cost

	Rs.
Materials	3,50,000
Labour	2,70,000
Prime Cost	6,20,000
Factory Overheads	81,000
Works Cost	7,01,000
Administration Overheads	56,080
Total cost of production	7,57,080
A) Percentage of Factory overheads to Labour = Factory Overheads / Labour X 100 = 81,000 / 2,70,000 X 100 = 30%	
B) Percentage of Administration Overheads to Works. Administrative Over/Work Cost X 100 = 56,080 / 7,01,000 X 100 = 8%	

Statement of the Selling Price of a Refrigerator

	Rs.
Materials	5,000.00
Labour	3,500.00
Prime Cost :	8,500.00
Add :.Factory Overheads (30% on Labour)	1,050.00
Works Cost :	9,550.00
Add : Administration Overheads (8% of works cost)	764.00
Total cost of production	10,314.00
Add : Profit (1/S on sales or 1/7 of cost)	1,473.45
Selling Price:-	11,787.45

Illustration No 7 :

The following information is given for a year.

Direct Material	Rs.	200000
Direct Wages	Rs.	150000
Factory Expenses	Rs.	90000
Office and Administrative exp.	Rs.	88000

On the basis of above information ascertain cost of a job which will require materials of Rs. 2000 and wages Rs. 4000. What should be the quotation price if a profit of 20% on selling price is desired?

Solution

Statement of Cost

Particulars	**Rs.**
Direct materials	2,00,000
Direct wages	1,50,000
PRIME COST.....	3,50,000
Factory expenses	90,000
WORKS COST	4,40,000
Office and Administrative Overheads	88,000
TOTAL COST.....	5,28,000

1) Percentage of factory expenses to direct wages.

$\because$ Rs. 1,50,000 = 90,000

$\therefore$ 100 = 60%

2) Percentage of office expenses to work cost.

$\because$ Rs. 44,40,000 = 88,000

$\therefore$ 100 = 20%

3) Profit 20% on Sales

Sales - Profit = Cost

100 - 20 = 80

$\because$ 80 Cost = 20 profit

$\therefore$ 10080 cost = 2520

Quotation For a Job

Particulars	**Rs.**
Direct materials	2000
Direct wages	4000
PRIME COST.....	6000
Factory Overheads (60% on direct wages)	2400
WORKS COST	8400
Office and Administrative Overheads (20% on works cost)	1680
TOTAL COST.....	10,080
PROFIT (20% on selling price)	2520
SALES	12600

1.7 Summary :

For the purpose of preparing financial accounts the expenditure of a business is recorded under various accounts. The heading under which the total expenditure analysis are known as the elements of cost. All these expenses can be basically classified into three categories; i.e. Materials, Labour and Other expenses. There is need of different classification of cost some concepts i.e. Cost Unit, Cost Centre which are often used in Cost Accounting.

A Cost Sheer is a statement which shows the break-up and. build-up of costs. It discloses the total cost as well as the cost per unit of production. It also helps for determination selling price and ascertainment of profitability. While preparing the cost sheet financial items (income and expenses) are riot considered because such item does not form a part of the costs.

1.8 Key Terms :

1) **Cost Sheet :** A cost sheet is a statement which shows the break- *up* and build-up of costs.

2) **Element of Cost Remember :**

Direct Material + Direct Labour + Direct Expenses = Prime Cost

Indirect materials + Indirect Labour + Indirect expenses = Overheads

Overheads are further classified in to three categories :

1. Production Overheads
2. Administration Overheads
3. Selling & distribution Overheads.

Prime Cost + Production Overheads = Factory or Works Cost Factory Cost + Administrative Overheads = Cost of Production

Cost of Production + Selling & distribution Overheads = Cost of sales or Total Cost.

3) **Pure financial items are excluded from cost sheet.**

4) **Para meters of cost expression -**

Time parameter	—	Cost Period
Location Parameter	—	Cost Centre
Output / Product parameter	—	Cost unit

1.9 Self Assessment Questions :

Theoretical Questions :-

1. Tabulate the elements of cost showing the usual items of expenditures appertaining to each.
2. How are elements of cost useful for management? What are the different types of expenditure that are not included In cost accounts.

3. Define overheads arid explain the functional classification of overheads.

4. Short Notes:-

   a) Work in progress.

   b) Cost Centre.

   c) Cost Unit.

   d) Direct material.

   e) Direct Expenses.

   f) Direct Labour.

Exercise 1) (Treatment of various types of expenses)

Calculate the Prime cost, Factory Cost, Cost of production and the cost of Sales from the following particulars.

Direct materials	1,00,000	Lighting: Factory	1,250
Direct wages	25,000	Office	500
Direct expenses	5,000	Depreciation	
Oil & waste	250	Office Premises	1,250
Wages of Supervisor	2,500	Plant & Machinery	500
Wages of storekeeper	1,250	Consumable Stores	2,500
Motive Power	500	Managers Salary	
Rent: Factory	5,000	(3/4 factory, 1/4 office)	5,000
Office	2,500	Directors Fees	1,250
Repairs and Renewals		Office printing & Stationery	500
Factor Plant	1,250	Telephone Charges	125
Machinery	2,500	Postage & Telegramme	
Office Premises	500	Salesmen's	250
Carriage Outward	375	commission & salary	1,250
Sales	2,00,000	Travelling expenses	500
		Advertising	1,250
		Warehouse Charges	500

(Ans: Prime cost - Rs. 1, 30,000; Factory Cost - Rs. L 51,250; Cost of Production = Rs. 1, 59,375; Cost of Sales - Rs. 1, 63,250; Profit = Rs. 36,750).

Exercise 2 :

Prepare a cost sheet from following information.

			Rs.
Material Purchases			3, 20,000
Wages to direct workers			2,00,000
Salary of accountant			40,000
Repairs of Machines			20,000
Indirect material			30,000
Indirect wages			25,000
Expenses for industrial exhibition			12,000
Power for machine			24,000
Salary of factory Supervisor			30,000
Showroom expenses			50,000
Office expenses			34,000
Inventory work	Opening	Closing	
Raw material	40,000	60,000	
Work in progress	50,000	40,000	
Finished goods	35,000	30,000	
Sales			10,00,000

Ans. Prime Cost = Rs. 5, 00,000; Works cost gross - Rs. 6, 29,000 Work cost of finished goods = Rs. 6, 39,000 Cost of Production = Rs. 7, 13,000; Cost of production of goods sold = Rs.7, 18,000; Cost of sales = Rs. 7, 80,000, Profit = Rs. 2, 20,000/-.

Exercise 3

The following figures are extracted from the books of Anuya Ltd. for the year ended. Prepare a cost sheet showing clearly the cost per unit under the various elements, direct and indirect cost and also the profit/loss per unit.

Direct Material		24, 00,000
Direct Labour		5,00,000
Depreciation of factory building		15,000
Branch office expenses		40,000
Depreciation of office building		8,000
Depreciation of staff Cars		12,000
Insurance for staff Cars		1,500
Office Building		1,200
Factory Building		1,500
Delivery van maintenance & running Exp.		10,000
Salaries including-	3,00,000	
Sales Manager	25,000	
Factory Chief Engineer		25,000
Finished goods warehouse expenses		20,000
Electricity (including Rs. 4,000 for Administrative office)		40,000
Advertisement		20,000
Sundry factory expenses		3, 40,000
Sales Promotion		5,000
Office administration expenses		50,000
Expenses for participation in industrial exhibition		10,000
Units produced and sold (10,000) units)		

Note : Balance of salary considers Administrative salary.

Ans. Prime Cost = Rs. 29,00,000; Works Cost = Rs. 33, 17,500; Cost of production = Rs. 36,84,200; Cost of Sales - Rs. 37, 74,200; Profit - Rs. 4, 25,800/-

Exercise 4 :

Aishwarya Ltd. submits the following information on 31st March

Sales for the year		Rs. 2, 75,000
Inventories at the beginning of the year were-		
Finished goods	Rs. 7,000	
Work in progress	Rs. 4,000	
Purchase of material for the year were		Rs. 1,10,000
Materials inventor/ at the beginning of the year was	Rs. 3,000	
and at the end of the year	Rs. 4,000	
Direct labour was	Rs. 65,000	
Factory overheads were 60% of the direct Labour cost		
Inventories at the end of the year were-		
Work In progress	Rs. 6,000	
Finished goods	Rs. 8,000	

Other expenses for the year were-

Selling expenses 10% of sales

Administrative expenses 5% of the sales,

Prepare statement of Cost

Ans: i) Prime Cost - Rs. 1,74,000; ii) Works Cost gross = Rs. 2,13,000 iii) Works Cost of Finished goods - Rs. 2,19,000; iv) Cost of production - Rs. 2,24,750 v) Profit - Rs. 23,750/-

Exercise 5 :

The following extract of costing information relates to commodity ‘A’ for the half year ending 31st March 2018.

Purchase of Raw Materials	1,20,000
Works Overheads	48,000
Direct wages	1,00,000

Carriage on purchases	1,440
Stock (1st Oct. 2017)	
Raw Materials	20,000
Finished products (1,000 tons)	16,000
Stock 31st March 2018	
Raw Materials	22,240
Finished Products (2,000 tons)	32,000
Work in progress (1st Oct. 2017)	4,800
Work in progress (31st March 2018)	16,000
Sales - finished Products	3,00,000

Selling and distribution overheads are Rs. 1 per ton sold, 16,000 tons of commodity were produced during the period.

You are to ascertain i) Value of raw materials used, ii) Cost of output for the period, iii) Cost of sales, iv) Net profit for the period and v) Net profit per ton of the commodity:

Ans.: i) Value of raw materials used = Rs. 1,19,200 ii) Cost of output for the period - Rs. 2, 56,000, iii) Cost of sales = Rs 2, 55,000, iv) Net: profit = Rs. 45,000 v) Net profit per ton = Rs. 3/-

Exercise 6 :

Total Production in 2020 (tonnes) 5,000

	Rs.
Cost of Raw Materials	20,00,000
Carriage Inwards	2,00,000
Direct Wages	20,00,000
Indirect Wages (in factory)	1,00,000
Office expenses	10,00,000
Public relation expenses	50,000
Expenses on testing lab.	60,000
Selling Overheads	10,00,000
Salary of managing director	50,000

Payment of income-tax	3,00,000

Note : (i) A profit margin of 50% on cost in provided

(ii) The Government grants a special exports subsidy of Rs. 100 per tonne.

Prepare a cost sheet showing the price to be quoted.

Exercise 7 :

The following figures are available from the books on Best Manufacturing Company for the year ended 31-12-2020.

Material	**Rs.**
Stock on 1-1-2020	1,000
Stock on 31-12-2020	2,000
Purchased during 2020	10,000
Wages	7,500
Profit for the year	6,090
Selling Overhead	5,250
Factory Overhead	4,500
Administration Overhead	4,200

Prepare a cost sheet showing prime cost, cost of production, cost of sales & Sales.

1.10 Fuirther Readings:-

1) Vinodkumar Agarwal & CA Subodli Shah -- Cost Accounting.
2) V. A. Patil & Dr. P. M. Herekar-Advanced Accountancy.
3) M. G. Patkar— Accountancy & Costing.
4) S. P. Jain & K. L. Narang - Cost Accounting.

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Unit 2

a) Financial Statement Analysis

Structure of the Unit

2.0 Objectives:

After Studying this Unit you will be able to:

1. Understand the meaning of Financial Statement Analysis.
2. Explain various types of Financial Statement Analysis.
3. Discuss the Limitations of financial statements.
4. Understand the Meaning and Need of financial statement analysis.
5. Identify various Techniques of financial statement analysis.

2.1 Introduction :

Business is mainly concerned with the financial activities. In order to ascertain the financial status of the business every enterprise prepares certain statements, known as financial statements. Financial statements are mainly prepared for decision making purposes. But the information as is provided in the financial statements is not adequately helpful in drawing a meaningful conclusion. Thus, an effective analysis and interpretation of financial statements is required. The financial statements of a company reflect a true picture of its financial performances. They depict not only profits and losses, but also assets and liabilities. It is only at the end of all accounting processes that we can generate these statements. Government legislations require certain organizations to maintain proper accounts and draw financial statement. Public can understand from the financial statement the extent to which a company is discharging its social responsibilities. While issuing shares, bonds, financial statement become necessary as prospective investors can judge the financial position of the organization and able to take a proper decision. Workers union may study the financial statement and ascertain whether they can enforce their demand. Tax legislature makes it obligatory for the business entities to draw fair and objective financial statement. The financial statement serves as instruments to regulate equity and debentures issued by companies.

2.2 Presentation of Subject Matter

2.2.1 Meaning of Financial Statements

Financial statements are plain statements based on historical records, facts and figures. They are uncompromising in their objectives, nature and truthfulness. They reflect a judicious combination of recorded facts, accounting principles, concepts and conventions, personal judgements and sometimes estimates. Financial statements consist of 'Revenue Account' and 'Balance Sheet'. Financial statements are basically reports that depict financial and accounting information relating to businesses. A company's management uses it to communicate with external stakeholders. These include shareholders, tax authorities, regulatory bodies, investors, creditors, etc.

Foulke has defined these statement as "statement of financial position of business so designed as to provide time perspective to the consideration of various elements of financial position embodied in such statement.'' The term financial statement refers to statement of Changes in financial position, Statement of Retained Earnings, Balance Sheet, Profit and Loss Account, etc. But, generally, the financial statements include only two statements; they are profit and Loss Account and Balance Sheet. It is observed that the mere presentation of these statements does not serve the purpose of anybody in anyway. The importance of these statements lies in their analysis and interpretation. In the beginning, analysis was done only for extending credit, but now it is being used as most important function of Management Accountant for providing various useful information to many persons. Some of the schedules are prepared and submitted along with the financial statements for meaningful presentation. Such schedules are schedule of fixed assets, schedule of debtors, schedule of creditors, schedule of investments etc.

The term financial statements refer to two basic statements which an accountant prepares at the end of an accounting period for a business enterprise. These are:

1. Balance Sheet (or Statement of Financial Position) which reflects the assets, liabilities and capital as on a certain date, and
2. Profit and Loss Account (or Income Statement) which shows the results of operations i.e. profit or loss during a certain period.

   Other Statements - Apart from the Balance Sheet and Profit-and Loss Account, the following financial statements are also prepared.

3. Profit and Loss Appropriation Account - This shows how profit of a business is utilised for declaring dividends, transfer to general reserve or other reserves etc.
4. Funds Flow Statement' - This shows increase or decrease in working capital during the accounting period.
5. Cash Flow Statement - This shows changes in cash position between the beginning and end of the accounting period.

All these statements taken together are called package of financial statements

2.2.2 Features of Financial Statements

The important features of financial statements are as follows.

1. Financial Statements are prepared at the end of the accounting period.
2. Financial Statements disclose both facts and opinions.
3. Financial statements are prepared on the going concern value.
4. Financial statements are recorded facts of financial transactions based on historical cost.
5. Financial statements are greatly affected by personal judgement of the accountants.

2.2.3 Objectives of Financial Statements

The main object of financial statements is to provide information about the financial position, performance and changes taken place in an enterprise. Financial statements are prepared to meet the common needs of most users. The important objectives of financial statements are given below:

1. Providing information for taking Economic decisions:

The economic decisions that are taken by users of financial statements require an evaluation of the ability of an enterprise to generate cash and cash equivalents and of the timing and certainty of their generation. This ability ultimately determines the capacity of an enterprise to pay its employees and suppliers meet interest payments, repay loans and make distributions to its owners.

2. Providing information about financial position:

The financial position of an enterprise is effected by the economic resources it controls, its financial structures its liquidity and solvency and its capacity to adapt to changes in the environment in which it operates. Information about financial structure is useful in predicting future borrowing needs and how future profits and cash flows will be distributed among those with an interest in the enterprise. This information is useful in predicting how successful the enterprise is likely to be in raising further finance. Information about liquidity and solvency is useful to predicting the ability of the enterprise to meet the financial commitments as fall due.

3. **Providing information about performance (working results) of an enterprise:**

Another important objective of the financial statements is that it provides information about the performance and in particular its profitability, which requires in order assessing potential changes in the economic resources that are likely to control in future. Information about performance is useful in predicting the capacity of the enterprise to generate cash inflows from its existing resource base as well in forming judgment about the effectiveness with which the enterprises might employ additional resources.

4. **Providing Information about changes in financial position:**

The financial statements provide information concerning changes in the financial position of an enterprise, which is useful in order to assess its investing, financing and operating activities during the reporting periods. This information is useful in providing the user with a basis to assess the ability of the enterprise to generate cash and cash equipments and the needs of the enterprise to utilize those cash flows.

The different types of people are using the financial statements. They need different types of information. Hence, the main objective of financial statements is fulfilling the needs of such people. Even though, some more objectives are briefly explained below.

5. To provide an accurate and reliable financial information about the resources and usage in a business unit within the stipulated time.
6. To provide overall changes made in the financial information relating to resources and usage for a particular period.
7. To provide accurate and reliable financial information relating to net changes made between resources and usage for a particular period arising out of business activities.
8. To provide financial information which are helping the top management for estimating earning potential of business?

➢ **Parties interested in financial statements**

In recent years, the ownership of capital of many public companies has become truly broad based due to dispersal of shareholding. Therefore, one may say that the public in general has become interested in financial statements. However, in addition to the share holders, there are other persons and bodies who are also interested in the financial results disclosed by the annual reports of companies. Such persons and bodies include:

1. Creditors, potential suppliers or others doing business with the company;
2. Debenture-holders;
3. Credit institutions like banks;
4. Potential Investors;
5. Employees and trade unions;
6. Important customers who wish to make a long standing contract with the company;
7. Economists and investment analyst;
8. Members of Parliament, the Public Accounts Committee and the Estimates Committee in respect of Government Companies;
9. Taxation authorities;
10. Other departments dealing with the industry in which the company is engaged; and
11. The Company Law Board.

Financial Statement analysis, therefore has become of general interest.

2.2.4 Types of Financial Statements

1. Revenue Account / Income Statement:

Revenue Account refers to 'Profit and Loss Account' or 'Income and Expenditure Account' or simply 'Income Statement'. Revenue Account may be split up or divided into 'Manufacturing Account', 'Trading Account', 'Profit and Loss Account' and 'Profit and Loss Appropriation Account', Revenue Account is prepared for a period, covering one year. This statement shows the expenses incurred on production and distribution of the product and sales and other business incomes. The final result of this statement may be profit or loss for a particular period.

2. Balance Sheet:

Balance sheet shows the financial position of a business as on a particular date. It represents the assets owned by the business and the claims of the owners and creditors against the assets in the form of liabilities as on the date of the statement.

3. Funds Flow Statement:

It describes the sources from which the additional funds were derived and the use of these funds. Funds flow statement helps to understand the changes in the distribution of resources between two balance sheet periods. The statement reveals the sources of funds and their application for different purposes.

4. Cash flow Statement:

A cash flow statement shows the changes in cash position from one period to another. It shows the inflow and outflow of cash and helps the management in making plans for immediate future. An estimated cash flow statement enables the management to ascertain the availability of cash to meet business obligations. This statement is useful for short term planning by the management.

5. Schedules:

Schedule explains the items given in income statement and balance sheet. Schedules are a part of financial statements which give detailed information about the financial position of a business organization.

2.2.5 Limitations of financial statements

Following are the limitations of financial statements:

1. The information being of historical nature does not reflect the future.
2. It is the outcome of accounting concept, convention combined with personal judgment.
3. The statement portrays the position in monetary term. The profit or loss position excludes from their purview things which cannot be expressed or recorded in term of money.

   To overcome from the limitations it becomes necessary to analyse the financial statements.

Check Your Progress-I

1. The financial statements of a business enterprise include:
   (a) Balance sheet
   (b) Statement of Profit and loss account
   (c) Cash flow statement
   (d) All the above
2. The most commonly used tools for financial analysis are:
   (a) Horizontal analysis
   (b) Vertical analysis
   (c) Ratio analysis
   (d) All the above
3. An Annual Report is issued by a company to its:
   (a) Directors
   (b) Auditors
   (c) Shareholders
   (d) Management
4. Balance Sheet provides information about financial position of the enterprise:
   (a) At a point in time
   (b) Over a period of time
   (c) For a period of time
   (d) None of the above
5. Which of the following is not an annual financial statement?
   (a) Balance sheet
   (b) Profit and loss account
   (c) Statement of cash flows
   (d) Depreciation account

2.2.6 Meaning of Financial Statement Analysis

Analysis of financial statements means to critically examine the composition of an item or amount appearing in the financial statements. In other words, analysis means breaking up of an amount into its elements so that a particular element may be correlated to another and significant relationship may be established between them and conclusions may be drawn on the data presented in financial statements. Such an analysis makes use of various analytical tools and techniques to data of financial statements so as to derive from them certain relationships that are significant and useful for decision making.

In the words of John N. Myers, "Financial statement analysis is largely a study of the relationships among the various financial factors in a business as disclosed by a single set of statements and a study of the trends of these factors as shown in a series of statements."

According to Metcalf and Titard, "Financial statements analysis is a process of evaluating the relationship between component parts of a financial statement to obtain a better understanding of a firm's position and performance."

Interpretation is determining the meaning and drawing inferences or conclusions with regard to the results of significant relationship between the items correlated. Thus, financial statement analysis converts the mass of data into useful information which is always in scarce supply. It pinpoints the strengths and weaknesses of a business undertaking by use of various techniques such as ratio analysis, comparative statements etc. Such analysed information is used by management, bankers, creditors, investors and others to form judgment about the operating performance and financial position of the business. Thus financial statement analysis helps in evaluating a business performance according to some Analysis means establishing a meaningful relationship between various items of the two financial statements with each other in such a way that a conclusion is drawn.

By financial statements we mean two statements:

(i) Profit and loss Account or Income Statement

(ii) Balance Sheet or Position Statement

These statements are prepared at the end of a given period of time. They are the indicators of profitability and financial soundness of the business concern. The term financial analysis is also known as analysis and interpretation of financial statements.

It refers to the establishing meaningful relationship between various items of the two financial statements i.e. Income statement and position statement. It determines financial strength and weaknesses of the firm. Analysis of financial statements is an attempt to assess the efficiency and performance of an enterprise. Thus, the analysis and interpretation of financial statements is very essential to measure the efficiency, profitability, financial soundness and future prospects of the business units.

Financial statements viz. the income and the position statement i.e. Profit and Loss A/c the balance sheet, are indicators of two significant factors: profitability and financial soundness. Analysis of statements means such a treatment of the information contained in the two statements as to afford a full diagnosis of the profitability and financial position of the firm concerned. To have a clear understanding of the profitability and financial position, the data provided in the financial statements should be methodically classified and compared with figures of previous periods or other similar firms. Thereafter, the significance of the figures is established. Such a comparative study would lead us to further questioning, the answers for which have to be brought out by further and deeper analysis. We may work out the figure of income of two firms A and B for a period but to analyze systematically one should (i) arrange the cost and revenue, (ii) relate the income to the capital employed and (iii) compare the result. On this basis we may come to know that A is more profitable than B (vice versa). The next question is why is A more profitable than B. This question will require further analysis and study of the underlying situation. We may define financial statement analysis as the process of methodical classification, comparison and raising pertinent questions and then seeking answers for them.

Financial statement analysis is the process of reviewing and analyzing a company's financial statements to make better economic decisions. These statements include the income statement, balance sheet, statement of cash flows, and a statement of changes in equity. Financial statement analysis is a method or process involving specific techniques for evaluating risks, performance, financial health, and future prospects of an organization.

2.2.7 Objectives of Financial Statement Analysis

The different parties look at the company from their respective points of view, but the objects generally looked for are: (i) profitability and (ii) financial condition. It can be said that the objective of financial statement analysis is a detailed cause and effect study of the profitability and financial position. The objectives of financial statement analysis may also be broadly classified on the basis of the persons interested in the analysis as

(i) External: An external analyst usually has to rely only on the published information.

(ii) Internal: An internal analyst would really know the full story behind each and every figure of the financial statement, he would also get further supplementary information to properly assess the significance of the figures. Such analysis would be more reliable than that done by an outsider. However, internal analysis may be biased; external analysis would be unbiased and impartial.

The major objectives of financial statement analysis are to provide decision makers information about a business enterprise for use in decision-making. Users of financial statement information are the decision-makers concerned with evaluating the economic situation of the firm and predicting its future course.

Financial statement analysis can be used by the different users and decision makers to achieve the following objectives:

1. Assessment of Past Performance and Current Position:

Past performance is often a good indicator of future performance. Therefore, an investor or creditor is interested in the trend of past sales, expenses, net income, cash flow and return on investment. These trends offer a means for judging management's past performance and are possible indicators of future performance.

Similarly, the analysis of current position indicates where the business stands today. For instance, the current position analysis will show the types of assets owned by a business enterprise and the different liabilities due against the enterprise. It will tell what the cash position is, how much debt the company has in relation to equity and how reasonable the inventories and receivables are.

2. Prediction of Net Income and Growth Prospects:

The financial statement analysis helps in predicting the earning prospects and growth rates in the earnings which are used by investors while comparing investment alternatives and other users interested in judging the earning potential of business enterprises. Investors also consider the risk or uncertainty associated with the expected return.

The decision makers are futuristic and are always concerned with the future. Financial statements which contain information on past performances are analyzed and interpreted as a basis for forecasting future rates of return and for assessing risk.

3. Prediction of Bankruptcy and Failure:

Financial statement analysis is a significant tool in predicting the bankruptcy and failure probability of business enterprises. After being aware about probable failure, both managers and investors can take preventive measures to avoid or minimise losses. Corporate managements can effect changes in operating policy, reorganize financial structure or even go for voluntary liquidation to shorten the length of time losses. In accounting and finance area, empirical studies conducted have suggested a set of financial ratios which can give early signal of corporate failure. Such a prediction model based on financial statement analysis is useful to managers, investors and creditors. Managers may use the ratios prediction model to assess the solvency position of their firms and thus can take appropriate corrective actions.

Investors and shareholders can use the model to make the optimum portfolio selection and to bring changes in the investment strategy in accordance with their investment goals. Similarly, creditors can apply the prediction model while evaluating the creditworthiness of business enterprises.

4. Loan Decision by Financial Institutions and Banks:

Financial statement analysis is used by financial institutions, loaning agencies, banks and others to make sound loan or credit decision. In this way, they can make proper allocation of credit among the different borrowers. Financial statement analysis helps in determining credit risk, deciding terms and conditions of loan if sanctioned, interest rate, maturity date etc.

However, objectives of financial statements analysis may be stated to bring out the significance of such analysis:

5. To assess the earning capacity or profitability of the firm.
6. To assess the operational efficiency and managerial effectiveness.
7. To assess the short term as well as long term solvency position of the firm.
8. To identify the reasons for change in profitability and financial position of the firm.

9. To make inter-firm comparison.
10. To make forecasts about future prospects of the firm.
11. To assess the progress of the firm over a period of time.
12. To help in decision making and control.
13. To guide or determine the dividend action.
14. To provide important information for granting credit.

2.2.8 Steps involved in Financial Statement Analysis

There are three steps involved in the financial statement analysis and they are:

1. Selection of Information
2. Classification of Information
3. Interpretation

The first step involved refers to the selection of information relevant to the purpose of evaluation from the total of information contained in the financial statements. The second step involved is the classification or grouping of information in such manner to focus on the significant relationships. The final step is the interpretation which includes drawing of inferences and conclusions.

2.2.9 Need of financial statement analysis

Financial statement is prepared at a certain point of time according to established convention. These statements are prepared to suit the requirement of the proprietor. For measuring the financial soundness, efficiency, profitability and future prospects of the concern, it is necessary to analyse the financial statement. Following purposes are served by the Financial analysis: -

1. **Help in Evaluating the operational efficiency of the Concern:-**

It is necessary to analyze the financial statement for matching the total expenses incurred in manufacturing, Advertising, selling and distribution of the finished goods and total financial expanses of the current year comparing with the total expanses of the previous year and evaluate the managerial efficiency of concern.

2. **Help in Evaluating the short and long term financial position: -**

It is necessary to analyze the financial statement for comparing the current assets and current liabilities to evaluate the short term and long term financial soundness.

3. **Help in calculating the profitability: -**

It is necessary to analyze the financial statement to know the gross profit and net profit.

4. **Help in indicating the trend of achievements: -**

Analysis of financial statement helps in comparing the Financial position of previous year and also compare various expenses, purchases and sales growth, gross and net profit. Cost of goods sold, total value of assets and liabilities can be compare easily with the help of Analysis of financial statement.

5. **Forecasting, budgeting and deciding future line of action:-**

The potential growth of the business can be predicts by the analysis of financial statement which helps in deciding future line of action. Comparisons of actual performance with target show all the shortcomings.

Above points shows the need of financial statement analysis for various stake holders like shareholders, investors, creditors, debtors, tax authorities, regulatory bodies etc.

2.2.10 Techniques of financial statement analysis

As the information provided in the financial statements is not an end in itself as no meaningful conclusions can be drawn from these statements alone. However, the information provided in the financial statements is of immense use in making decisions through analysis and interpretation of financial statements. To overcome from the limitations it becomes necessary to analyse the financial statements. The analytical tools generally available to an analyst for this purpose are:

The following are the techniques of analysis of financial statements:

i) Comparative Financial Statements analysis.

ii) Common-size Financial Statements analysis.

iii) Trend Analysis.

iv) Ratio Analysis.

v) Benchmarking

vi) Fund Flow Analysis

vii) Cash Flow Analysis

i) Comparative Statements Analysis:

Meaning of Comparative Statements:

The comparative financial statements are statements of the financial position at different periods of time. The elements of financial position are shown in a comparative form so as to give an idea of financial position at two or more periods. The comparative statements are important tool of horizontal financial analysis. Financial data become more meaningful when compared with similar data for previous period or a number of previous periods. Such analysis helps as in forming an opinion regarding the progress of the enterprise. From practical point of view, generally, two financial statements (balance sheet and income statement) are prepared in comparative form for financial analysis purposes. Not only the comparison of the figures of two periods but also be relationship between balance sheet and income statement enables an in depth study of financial position and operative results. Balance Sheet and Income Statement are prepared in a Comparative from as the impact of the conduct of business is brought to bear in the Balance Sheet, Comparative statement are made to shown at the following value.

a. Increases and decreases in absolute data in term of money values.

b. Increases or decreases in absolute data in term of percentage.

c. Comparisons expressed in ratio.

d. Percentage of total.

The analyst is able to draw useful conclusions when figures are given in a comparative position. The figures of sales for a quarter, half -year or one year may tell only the present position of sales efforts. When sales figures of previous periods are given along with the figures of current periods then the analyst will be able to study the trends of sales over different periods of time. Similarly, comparative figures will indicate the trend and direction of financial position and operating results.

Comparative financial statements are very useful to the analyst as they provide information necessary for the study of financial and operating trend over a period of years. They indicate the duration of the movement with respect to the financial position and operating results. Financial data become more meaningful when compared with similar data for a previous period or a number of prior periods. The comparative profit and loss account presents a review of operating activities of the business. The comparative balance sheet shows the effect of operations on the assets and liability and changes in the financial position during the period under consideration.

Two comparable units can be compared regarding profitability and financial position. The two organization may not have the identical heads of account In order to get over the difficulty, the data must first be property set before comparison In the preparation of comparative financial statement, uniformity is essential.

Importance of Comparative Statement:

These statements are very useful in measuring the effect of the conduct of a business enterprise over the period under consideration. Regardless of its financial strength at a given point of time, the enterprises must operate successfully if it hopes to continue as a going concern. The income statement measures the effects of operation. But the progress of these operations may be viewed over number of periods by preparing the income statement in a comparative form. Similarly the effect of operation of financial position and the progress of a business in term of financial position can be presented by means of a comparative balance sheet. The accounting authorities in U. S. A. have strongly recommended and encouraged the preparation of financial statement in the comparative from recognising the importance of comparative financial date for two years, the Indian companies Act 1956 has made this fact compulsory that in the balance sheet of a company the figure for the previous year should also be given to facilitated comparison. Though the balance sheet is a useful statement, the comparative balance sheet is even more useful for the it contains not only the data of a single balance sheet but also for the past years which may be useful in studying the trends.

Types of Comparative Statements:

(a) Comparative Balance Sheet:

The comparative balance sheet analysis is the study of the trend of the same items, group of items and computed items in two or more balance sheets of the same business enterprise on different dates.' The changes can be observed by comparison of the balance sheet at the beginning and at the end of a period and these changes can help in forming an opinion about the progress of an enterprise. The comparative balance sheet has two columns for the data of original balance sheets. A third column is used to show increases or decreases in figures. The fourth column may be added for giving percentages of increases or decreases.

(b) Comparative Income Statement:

An income statement shows the net profit or net loss resulting from the operation of a business for a definite period of time. The changes in absolute data in money values and percentages can be determined to analyze the profitability of the business. A comparative income statement is prepared to show the net profit or loss for a number of years in comparative form. By comparing income statement for two or more years, it is possible to observe the progress of a business over a period of time. Like comparative balance sheet, income statement also has four columns. First two columns give figures of various items for two years. Third and fourth columns are used to show increase or decrease in figures in absolute amounts and percentages respectively.

Information contained in these financial statements for a particular year is extremely important and useful. However such information becomes still more useful if it is compared with the data shown in the financial statements of the previous few years. Such comparison of financial statements is accomplished by setting up balance sheet and profit and loss account of two or more years side by side and studying the changes that have occurred in the individual figures therein from year to year and over the years. Thus comparison of financial statements means financial statements of a company for any year are compared with financial statements of the same company for earlier years. Comparative financial statements take the form of comparative balance sheets and comparative profit and loss accounts.

ii) Common size financial statements analysis:

The common-size statements, balance sheet and income statement are shown in analytical percentages. The figures are shown as percentages of total assets, total liabilities and total sales. The total assets are taken as 100 and different assets are expressed as a percentage of the total. Similarly, various liabilities are taken as a part of total liabilities. These statements are also known as component percentage or 100 per cent statements because every individual item is stated as a percentage of the total 100. The short-comings in comparative statements and trend percentages where changes in items could not be compared with the totals have been covered up. The analyst is able to assess the figures in relation to total values.

Common size financial statement analysis is analyzing the balance sheet and income statement using percentages. All income statement line items are stated as a percentage of sales. All balance sheet line items are stated as a percentage of total assets. For example, on the income statement, every line item is divided by sales and on the balance sheet; every line item is divided by total assets. This type of analysis enables the financial manager to view the income statement and balance sheet in a percentage format which is easy to interpret. Comparative statement showing only the vertical percentage or ratio for financial data without giving any rupee value is known as common size statement.

The common-size statements may be prepared in the following way:

(1) The totals of assets or liabilities are taken as 100.

(2) The individual assets are expressed as a percentage of total assets, i.e., 100 and different liabilities are calculated in relation to total liabilities. For example, if total assets are Rs 5 lakhs and inventory value is Rs 50,000, then it will be 10% of total assets.

Types of Common-Size Statements:

(a) Common-Size Balance Sheet:

In common size balance sheet, the total of assets side or liabilities side is taken as 100 and all figures of assets and liabilities capital and reserves are expressed as a proportion to the total i.e. 100. The common size balance sheet reveals the proportion of fixed assets to current asserts composition of fixed assets and current assets proportion of long term funds to current liabilities and provisions composition of current liabilities etc. It also helps in making inter firm comparison and highlights the financial health and long term solvency ability to meet short term obligations and liquidity position of the enterprise. A statement in which balance sheet items are expressed as the ratio of each asset to total assets and the ratio of each liability is expressed as a ratio of total liabilities is called common-size balance sheet. In common size balance sheet, each item of asset is shown as a percentage of total assets and each, item of liability and capital is shown as a percentage of total liabilities and capital (which is the same as total assets). In other words, the total of the assets and also that of liabilities and capital is taken as 100 per cent and each item appearing on the assets side as well as liabilities side is shown as a proportion of the total of 100.

(b) Common Size Income Statement:

In common size income statement the sales figures is taken as 100 and all other figures of costs and expenses are expressed as percentage to sales. When other costs and expenses are reduced from sales figure of 100, the balance figure is taken as net profit. This reveals the efficiency of the firm in generating revenue which leads to profitability and we can make analysis of different components of costs proportion to sales. Inter firm comparison of common size income statements reveal the relative efficiency of costs incurred. The items in income statement can be shown as percentages of sales to show the relation of each item to sales. A significant relationship can be established between items of income statement and volume of sales. The increase in sales will certainly increase selling expenses and not administrative or financial expenses.

In case the volume of sales increases to a considerable extent, administrative and financial expenses may go up. In case the sales are declining, the selling expenses should be reduced at once. So, a relationship is established between sales and other items in income statement and this relationship is helpful in evaluating operational activities of the enterprise. In Short the common size income statement, total sales figure is taken as 100 per cent and each item is then calculated as a percentage of sales.

iii) Trend analysis:

Trend analysis is also called time-series analysis. Trend analysis helps a firm's financial manager determine how the firm is likely to perform over time. Trend analysis is based on historical data from the firm's financial statements and forecasted data from the firm's pro forma, or forward-looking, financial statements.

One popular way of doing trend analysis is by using financial ratio analysis. If you calculate financial ratios for a business firm, you have to calculate at least two years of ratios in order for them to mean anything. Ratios are meaningless unless you have something to compare them to, in this case other years of data. Trend analysis is even more powerful if you have and use several years of financial ratios.

Trend analysis involves the collection of information from multiple time periods and plotting the information on a horizontal line for further review. The intent of this analysis is to spot actionable patterns in the presented information. A trend analysis is a technique of studying financial statements of a company over a number of years. Under this method, a representative year is selected as the base year and the values of items in the base year are assumed to be 100. Then the relationship of each item in the subsequent years is expressed as a percentage of the same item in the base year. This means, when an item is expressed as 100, all other values expressed in term of the base year will reflect in trend, upward or downward, in relation to 100. Any year may be taken as the base but generally the starting or initial year is taken as the base year.

In business, trend analysis is typically used in two ways, which are as follows:

(a) Revenue and cost analysis.

Revenue and cost information from a company's income statements can be arranged on a trend line for multiple reporting periods and examined for trends and inconsistencies. For example, a sudden spike in expense in one period followed by a sharp decline in the next period can indicate that an expense was booked twice in the first month. Thus, trend analysis is quite useful for examining preliminary financial statements for inaccuracies, to see if adjustments should be made before the statements are released for general use.

(b) Investment analysis.

An investor can create a trend line of historical share prices, and use this information to predict future changes in the price of a stock. The trend line can be associated with other information for which a cause-and-effect relationship may exist, to see if the causal relationship can be used as a predictor of future stock prices. Trend analysis can also be used for the entire stock market, to detect signs of a impending change from a bull to a bear market, or the reverse.

When used internally (the revenue and cost analysis function), trend analysis is one of the most useful management tools available. The following are examples of this type of usage:

1. Examine revenue patterns to see if sales are declining for certain products, customers, or sales regions.
2. Examine expense report claims for evidence of fraudulent claims.

3. Examine expense line items to see if there are any unusual expenditures in a reporting period that require additional investigation.

4. Extend revenue and expense line items into the future for budgeting purposes, to estimate future results.

When trend analysis is being used to predict the future, keep in mind that the factors formerly impacting a data point may no longer be doing so to the same extent. This means that an extrapolation of a historical time series will not necessarily yield a valid prediction of the future. Thus, a considerable amount of additional research should accompany trend analysis when using it to make predictions.

This is an important and useful technique of analysis and interpretation of financial statement. In this technique the relation of different items for various periods are calculate over a definite period of time say three to five years and then we can analysis trend highlighted by this ratio. Trend analysis can be done in following three way:

(i) Trend percentage,

(ii) Trend ratio,

(iii) Graphic and diagrammatic representation.

Here the percentage columns are more relevant than the figure.

Average Analysis is an improvement over trend analysis method. Here the trend can be presented on the graph paper also in the shape of curve. In this from the analysis and comparison become more comprehensive and impressive.

iv) Ratio Analysis

The analysis of the financial statements and interpretations of financial results of a particular period of operations with the help of 'ratio' is termed as "ratio analysis." Ratio analysis used to determine the financial soundness of a business concern. Alexander Wall designed a system of ratio analysis and presented it in useful form in the year 1909.

Meaning and Definition

The term 'Ratio' refers to the mathematical relationship between any two interrelated variables. In other words, it establishes relationship between two items expressed in quantitative form. Ratio means the relationships expressed in mathematical terms between two figures which are connected with each other in some manner.

According **J. Batty**, Ratio can be defined as "the term accounting ratio is used to describe significant relationships which exist between figures shown in a balance sheet and profit and loss account in a budgetary control system or any other part of the accounting management." Ratio can be used in the form of (1) percentage (20%) (2) Quotient (say 10) and (3) Rates. In other words, it can be expressed as a to b; a: b (a is to b) or as a simple fraction, integer and decimal. A ratio is calculated by dividing one item or figure by another item or figure.

Interpretation of Ratios:

Ratios may be interpreted in the following four different ways:

(a) Interpretation or Analysis of an Individual (or) Single ratio.

(b) Interpretation or Analysis by referring to a group of ratios.

(c) Interpretation or Analysis of ratios by trend.

(d) Interpretations or Analysis by inter-firm comparison.

Principles of Ratio Selection

The following principles should be considered before selecting the ratio:

(1) Ratio should be logically inter-related.

(2) Ratio must measure a material factor of business.

(3) Cost of obtaining information should be borne in mind.

(4) Ratio should be in minimum numbers.

(5) Ratio should be facilities comparable.

v) Benchmarking:

Benchmarking is also called industry analysis. It involves comparing a company to other companies in the same industry in order to see how one company is doing financially compared to the industry. This type of analysis is very helpful to the financial manager as it helps to see if any financial adjustments need to be made. Financial ratio analysis is usually used for benchmarking analysis. Financial ratios for other companies can be obtained from a number of sources. Here is an excellent source of industry average ratios. In order to do benchmarking, you compare the ratios for one company to the ratios for other companies in the same industry. You have to be sure that the industry average ratios are calculated in the same way the ratios for your company are calculated when you do benchmarking. Using these four financial statement analysis techniques help a financial manager know where a business firm is financially both internally and as compared to other firms in the industry. Together, they are powerful analysis tools that will help every business firm stay solvent and profitable.

vi) Funds Flow Statements analysis

Funds flow statement is a financial statement which shows as to how a business entity has obtained its funds and how it has applied or employed its funds between the opening and closing balance sheet dates (during the particular year/period). It can be described as – WHERE GOT-WHERE GONE statement Funds usually refers to cash resources and funds statement is prepared to show the net effect of various business events on the current resources of the organization. In this topic fund should be understood as working capital & funds flow as to mean any change in working capital. Funds Flow Statement is a statement prepared to analyse the reasons for changes in the financial position of a company between Two Balance Sheets. It shows the inflow & outflow of funds i.e. SOURCES and APPLICATIONS of funds for a particular period. In other words Funds flow statement is prepared to explain the changes in the working capital position of a company. There are two types of inflows of funds –

a. Long term funds raised by issue of Shares, Debentures or sale of Fixed Assets

b. Funds generated from operations

If the long term fund requirements of a company are met just out of the Long term Sources of funds, then the whole fund generated from operations will be represented by increase in working capital. However if the funds generated from operations are not sufficient to bridge a gap of long term fund requirement, then there will be a decline in working capital.

vii) Cash Flow Statements Analysis

In financial accounting, a cash flow statement, also known as statement of cash flows, is a financial statement that shows how changes in balance sheet accounts and income affect cash and cash equivalents, and breaks the analysis down to operating, investing and financing activities. Cash Flow Statement gives information about cash receipts (sources) and cash payments (application). It contains opening balances & closing balances of cash for a given period and explains how the closing balance as per last balance sheet changed by various inflows & outflows of cash to a closing balance of cash as per the next balance sheet. As per AS-3, cash would include cash in hand and savings, current a/c balances with banks & cash equivalents. Cash equivalents are short term & highly liquid investments that are readily convertible into cash. An investment would normally be called a cash equivalent only when it has a short-term maturity of say 3 months or less from the date of acquisition.

Check your progress-II

1. Comparative statements are also known as……………

   (a) Dynamic analysis (b) Horizontal analysis

   (c) Vertical analysis (d) External analysis

2. In order to assess a company's ability to fulfill its long-term obligations, an analyst would most likely examine……………

   (a) Activity Ratios (b) Liquidity Ratios

   (c) Solvency Ratios (d) None of the above

3. Which ratio would a company most likely use to measure its ability to meet short-term obligations?

   (a) Current Ratio (b) Gross Profit Ratio

   (c) Creditors turnover Ratio (d) Debts-Equity Ratio

4. The two statements which are generally included in the definition of financial of Statements are …………

   (a) Profit & Loss A/c & Balance Sheet (b) Cash A/c & Balance Sheet

   (c) Creditors A/c & Balance Sheet (d) Debtors A/c & Creditors A/c

5. In the case of Ltd. Co. the term financial statement includes………………

   (a) P & L A/C & B/S.

   (b) P & L A/C, P & L appropriation A/C & B/S.

   (c) P & L A/C & B/S.

   (d) P & L appropriation A/C & B/S.

2.3 Summary

Financial statements are mainly prepared for decision making purposes. The term financial statements refer to two basic statements which an accountant prepares at the end of an accounting period for a business enterprise. These are Balance Sheet and Profit and Loss Account. Financial statements are basically reports that depict financial and accounting information relating to businesses. Users of financial statement information are the decision-makers concerned with evaluating the economic situation of the firm and predicting its future course. Revenue Account / Income Statement , Balance Sheet, Funds Flow Statement, Cash flow Statement, Schedules etc. are the types of financial statements.

Financial statement analysis means to critically examine the composition of items or amount appearing in the financial statements. The major objectives of financial statement analysis are to provide decision makers information about a business enterprise for use in decision-making. The purposes of financial analysis are measuring the profitability, indicating the trend of achievements, assessing the growth potential of the business, compare with other firms, assess overall financial strength, assess solvency of the firm etc. There are three steps involved in the financial statement analysis and they are Selection of Information, Classification of Information, and Interpretation.

There are different techniques of financial statements analysis, such as Comparative Financial Statements analysis, Common-size Financial Statements analysis, Trend Analysis, Ratio Analysis, Benchmarking, Fund Flow Analysis and Cash Flow Analysis etc. Comparative Financial Statements data become more meaningful when compared with similar data for previous period or a number of previous periods. Common size financial statement analysis is analyzing the balance sheet and income statement using percentages. Trend analysis involves the collection of information from multiple time periods and plotting the information on a horizontal line for further review. Ratio analysis is a one of the important methods of analysis of financial statements. The term ratio refers to the mathematical relationship between any two interrelated variables.

2.4 Terms to Remember

- **Financial Statements-** The term financial statements refer to two basic statements which an accountant prepares at the end of an accounting period for a business enterprise. These are Balance Sheet (or Statement of Financial

Position) which reflects the assets, liabilities and capital as on a certain date, and Profit and Loss Account (or Income Statement) which shows the results of operations *i.e.* profit or loss during a certain period.

- **Financial Statement Analysis-** Financial statement analysis is largely a study of the relationships among the various financial factors in a business as disclosed by a single set of statements and a study of the trends of these factors as shown in a series of statements.
- **Accounting Ratio**- The term accounting ratio is used to describe significant relationships which exist between figures shown in a balance sheet and profit and loss account in a budgetary control system or any other part of the accounting management.
- **Ratio Analysis-** Ratio analysis is the relationship between two accounting figures to highlight the significant information to the management or users who can analyse the business situation and to monitor their performance in a meaningful way.

2.5 Answers to check your progress-

Answers to check your progress-I

1- d 2- d 3- c 4- a 5- d

Answers to Check your progress-II

1- b 2- c 3- a 4- a 5- b

2.6 Exercise

1. What is mean by financial statements? Explain the Types of Financial Statements.
2. Discuss the meaning and limitations of Financial Statement.
3. What is the difference between comparative statement and common size financial statement?
4. Explain the various techniques of analyzing the financial statements.
5. What do you mean by Comparative Balance Sheet and Comparative Profit and Loss Account?
6. Explain the utility of financial statement analysis to various parties interested in business.

Write short notes

a. Types of financial statements

b. Comparative Financial statements

c. Trend analyses

d. Common size Statement

e. Ratio Analysis

2.7 Reference for further study

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Unit : 2

b) Ratio Analysis

Meaning Advantages and Limitations - Classification of Ratio - Profitability Ratios, Turnover Ratios, Solvency Ratios and Liquidity Ratios.

Structure :

2.0 Objectives :

After studying this unit you should be able to –

- understand the meaning of Ratio and Analysis.
- Know the importance of Ratio Analysis.
- Explain the limitations of Ratio Analysis.
- Understand the classification of Ratios.
- Compute various ratios.

2.1 Introductions :

The main financial statements prepared by each business organization are – (i) The profit and loss Account or Revenue statement and (ii) The Balance Sheet. These statements show the profit or loss of a business during a particular period and the financial position on a particular date respectively. But the figures given in the financial statements will not be of much useful, if they are considered independently. They will be very useful only when one item is compared with another item. Management as well as other parties need different type of information for decision making and such information can be made available from the analysis of financial statement .There are various tools or techniques of analyzing the financial statement. The important tools or techniques of financial analysis are comparative financial statement analysis, common-size statement analysis , Trend analysis, Ratio analysis, Funds flow analysis, cash flow analysis etc. Ratio analysis is the important and the most widely used technique for the analysis of financial statements.

2.2 Presentation of Subject Matter

2.2.1 Meanings of Ratios :

Ratios are relationships expressed in mathematical terms between figures which are connected or interrelated with each other in some manner. It is simply an expression of one number in terms of another. It also be defined as the relationship or proportion that one amount bears to another, the first number being the numerator and the latter the denominator. Ratios can be expressed in three ways.

1) Pure ratio or proportion : When proportion of one accounting figure to another accounting figure is shown it is termed as pure ratio or proportion e.g. current

Assets : Current Liabilities are Rs.100000 : Rs. 50000 = 2:1

2) Times – When one value is divided by another, the unit used to express the ratio is termed as, “Times”,

e.g. $\dfrac{\text{Current Assets}}{\text{Current liabilities}} = \dfrac{100000}{50000} = 2 \text{ Times.}$

3) Percentage - when one figure is divided by another figure and multiplied by 100 the unit of expression is termed as, “percentage”.

$$\text{e.g.} = \frac{\text{Current Assets}}{\text{Current liabilities}} \times 100$$

$$= \frac{1,00,000}{50,000} \times 100 = 200\%$$

In short, accounting ratios or financial ratios are mathematical relationships expressed between inter – connected or inter – related accounting figures. A ratio is on index or yardstick for evaluating the financial position and performance of a firm. It is to be noted that a ratio indicates a quantitative relationship which can be, in turn, used to make a quantitative judgment.

2.2.2 Meaning of Ratio Analysis :

Ratio analysis the technique of the calculation of a number of accounting ratios from the data or figures founded in the financial statement. It involves compares for useful interpretation of the financial statements. It involves comparison for useful interpretation of the financial statements A signal ratio cannot indicate favorable or unfavorable condition. It should be compared with some slandered. Standards of comparison may be post rations of the same firm or estimated / projected ratios of the same firm or ratios of some selected firms or ratios of the industry to which the form belongs. Ratio analysis includes not only the calculation of ratios but also its interpretation. In short, it is the technique of interpretation of financial statements with the help of the accounting ratios derived from the financial statements.

2.2.3 Importance / Advantages of Ratio Analysis :

The ratio analysis is the most important tool of the financial analysis. People in different fields are interested in the analysis of financial statements for different purposes and use ratio analysis as a tool of analysis. Management, shareholders, creditors, government, financial institutions, investors etc use the tool of ratio analysis. The importance or advantages of ratio analysis are as follows –

i) **Simplifies financial statement :** Ratio analysis simplifies the understanding of financial statements. Ratios tell the significance of various inter-related items and their effect on financial position.

ii) **Facilitates inter-firm comparison :** Ratio analysis provides data for inter-firm comparison. Ratios of a particular firm are compared with the ratios of another firms and strong points / areas and weak points / areas are found out. They also helpful in deciding successful and unsuccessful firms, strong firms and weak firms.

iii) **Facilitates inter-firm comparison :** Ratio analysis helps in comparison of the performance of different activities as well as different departments of the firm. They are helpful in deciding the efficiency of each activity.

iv) **Assist management :** The basic function of management are forecasting, planning, co-ordinating, controlling etc. Ratio analysis by providing various information assist management in carrying its functions effectively.

v) **Financial diagnosis :** With the help of ratio analysis a financial diagnosis of a firm can be possible Ratios tell the whole story of the changes in financial condition or position of the business. They evaluate the liquidity, solvency, profitability of the firm.

vi) Ratios are very helpful in the establishing standard costing system and budgetary control.

vii) Ratio analysis is useful not only to the insiders but also to outsiders like creditors, investors, financial institutions etc. The interested outsiders can know the liquidity, solvency, profitability position of the firm and take the decisions regarding lending or investing.

2.2.4 Limitations of Ratio Analysis :

Though, ratio analysis is the most powerful tool of the financial analysis, it suffers from certain limitations. These limitations are as under –

i) **Limitation of data :** Ratios are based on the financial information available in financial statements. If the data is not reliable, the ratios calculated from such data also doubtful.

ii) **No consistency in meaning :** There is no consistency in the meaning of certain accounting ratios. The items used in the calculation of ratios differ from one analyst to another.

iii) **Supplementary nature :** Ratios are supplementary to and not substitute of the original data. They must be studied with the related data from which they are derived.

iv) **Changes in price level :** Ratios do not present true information in case of changing price level of the variables. In such case ratios will provide misleading results.

v) **Not helpful for preparing budget :** Ratios are computed on the basis of past result. It does not help properly to predict the future, the prepare budgets and estimates since the business policies are constantly changing.

vi) **Difficult to ascertain standard ratio :** It is very difficult to ascertain the normal or standard ratio in order to make proper comparison. Because it differs from firm to firm.

vii) **Not possible to solve the problems :** Analysis and interpretation of ratios helps us to locate the problems relating to the variables but cannot help us to solve such problems.

viii) **Window dressing :** There is the danger of window dressing in ratio analysis. As a result a particular ratio cannot be used as a definite indicator.

ix) **Mere Symptoms :** Ratios are mere symptoms and the management must make a proper diagnosis on the basis of such symptoms. The real success of ratio analysis depends upon proper diagnosis of the ratio.

x) **Need expert knowledge :** The success of ratio analysis depends on the expert knowledge of the analyst. Therefore the ratios are significant only in the hands of expert analyst and not in the hands of everybody.

2.2.5 Classification of Ratios :

Different peoples use ratio as a tool of financial analysis. One ratio is used for one particular purpose and another ratio is used for another purpose. Management as well as other parties are interested in use of ratios. To fulfill their requirements ratios are classified into different categories on the different basis. Some of the important bases of classification of accounting ratios and the classification based thereon are as follows–

a) On the basis of the source of Figure :

i. Balance Sheet Ratios / Financial Ratios

ii. Profit and Loss Account Ratios / Revenue Statement Ratios.

iii. Mixed / Combined Ratios.

b) On the Basis of Time :

i. Structural Ratios

ii. Trade Ratios

c) On the Basis of the Importance :

i. Primary Ratios

ii. Secondary Ratios

d) On the Basis of Functions / Nature :

i. Liquidity Ratios

ii. Profitable Ratios

iii. Solvency Ratios

iv. Turnover Ratios

e) On the Basis of the users :

i. Ratios for Management

ii. Ratios for Creditors

iii. Ratios for Shareholders

As per the prescribed syllabus, out of the above classification, the classification on the basis of function / nature is explained in this unit.

2.2.6 Classification on the Basis of Functions / Nature :

Though there are different bases of classification of ratios, the most widely accepted classification is based on the functions or nature. As per this classification accounting ratios are classified as under –

Functional Classification of Ratios

Liquidity Ratios	Profitability Ratios	Turnover Ratios	Solvency Ratios
i) Current Ratio	i) Gross Profit Ratio	i) Stock Turnover Ratio	i) Debt. Equity Ratio
ii) Liquid Ratio	ii) Net Profit Ratio	ii) Debtors Turnover Ratio	ii) Proprietary Ratio
iii) Absolute Liquid Ratio	iii) Operating Ratio	iii) Creditors Turnover Ratio	iii) Total Liabilities to Total Assets Ratio.
	iv) Operating Profit ratio	iv) Working Capital Turnover Ratio	
	v) Return on Capital Employed	v) Fixed Assets Turnover Ratio.	

a) Liquidity Ratios :

Liquidity ratios show short term financial position of the firm. Liquidity means one's ability to meet claim and obligations as and when they become due. Liquidity ratios indicate whether it will be possible for the firm to meet its short term obligations or Liabilities out of its short term resources or assets. These ratios are also termed as working Capital Ratios or Short Term Solvency Ratios. These ratios are helpful to short-term creditors, like trade creditors, bankers and other short-term lenders. The important Liquidity ratios are as follows –

1) Current Ratio : This ratio shows relation between current assets and current liabilities. It is an indicator of the firm's ability to meet its short term liabilities. It is expressed as follows -

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Current assets are those assets which change their form into cash within a year's time or during the normal operating cycle of the business, whichever is longer. Generally, current assets include cash in hand, cash at bank bills receivables, sundry debtors / books debts, stock / inventory, short term investments, advances, prepaid expenses, accrued incomes etc. Sundry debtors outstanding for more than 6 months and loose tools should not be included in current assets. Current liabilities means liabilities payable within a year or during the operating cycle, whichever is longer. Current liabilities are composed of sundry creditors, bills payables, bank overdraft, outstanding expenses, provision for taxation, proposed dividend, unclaimed dividend, cash credit, short term loans and advance, incomes received in advance, outstanding interest.

An ideal current ratio is 2 : 1 but application of current ratio is depend on the situation of the firm. Some times a lower current ratio than ideal or standard many be adequate. A very high current ratio is also not desirable since it means less efficient use of funds. In fact the current ratio should be seen in relation to the component of current assets and their liquidity.

2) Liquid Ratio : This ratio is also known as Quick Ratio or Acid Test Ratio. It is ascertained by comparing the liquid assets to liquid liabilities. Liquid assets means those assets which are immediately convertible into cash without much loss. Liquid assets include all current assets except stock and prepaid expenses. Liquid liabilities include all current liabilities except bank overdraft and cash credit. Some accountants use current liabilities than liquid liabilities for ascertaining this ratio. It is expressed as follows –

$$\text{Liquid Ratio} = \frac{\text{Liquid Assets}}{\text{Liquid Liabilities}} \quad \text{or} \quad \frac{\text{All C. A. - Stock \& Prepaid Expenses}}{\text{All C. L. - Bank Overdraf}}$$

The normal liquid ratio is 1 : 1. It indicates the ability of the business to meet its commitment without delay. A comparison of the current ratio and liquid ratio shall indicate the inventory hold ups.

3) Absolute Liquid Ratio : It is also termed as Super Quick Ratio or Cash Position Ratio. This is a more rigorous ratio introduced recently to measure the liquidity of a concern. This ratio expresses the relationship between absolute liquid assets and Liquid Liabilities. Absolute liquid assets include cash in hand, cash at bank and marketable securities. It is expressed as follows -

$$\text{Absolute Liquid Ratio} = \frac{\text{Absolute Liquid Assets}}{\text{Liquid Liabilities.}}$$

Illustration -1 :

From the following compute the Current Ratio, Liquid Ratio and Absolute Liquid Ratio.

Particulars	Rs.	Particulars	Rs.
Sundry Debtors	40,000	Sundry Creditors	20,000
Prepaid Expenses	20,000	Debentures	1,00,000
Short term Investments	10,000	Inventories	20,000
Loose Tools	5,000	Outstanding Expenses	20,000
Bills Payable	10,000	Bank overdraft	10,000

Solution :

i) Current ratio $= \dfrac{\text{Current Assets}}{\text{Current Liabilities}}$

$$= \frac{\text{Rs. } 90{,}000}{\text{Rs. } 60{,}000}$$

$$= 1.5 : 1$$

Where, Current Assets = Sundry Debtors + Prepaid Expenses + Short term Investments + Inventories

= 40,000 + 20,000 + 10,000 + 20,000

= 90,000

Current Liabilities : Bills Payable + Sundry Creditors + Outstanding Expenses + Bank overdraft.

= 10,000 + 20,000 + 20,000 + 10,000

= 60,000

ii) Liquid Ratio $= \dfrac{\text{Liquid Assets}}{\text{Liquid Liabilities}}$

$$= \frac{\text{Rs. } 50{,}000}{\text{Rs. } 50{,}000} = 1 : 1$$

Where, Liquid Assets = Total current Assets – (Inventories + Prepaid Expenses)

= 90,000 – (20,000 + 20,000)

= 50,000

Liquid Liabilities = Total Current Liabilities – Bank overdraft.

= 60,000 – 10,000

= 50,000

iii) Absolute Liquid Ratio $= \dfrac{\text{Absolute Liquid Assets}}{\text{Liquid Liabilities}}$

$= \dfrac{\text{Rs. } 10{,}000 = 0.20 : 1}{\text{Rs. } 50{,}000}$

Where, Absolute Liquid Assets = Short Term Investments

= Rs. 10,000

b) Profitability Ratios :

Profitability is an indication of the efficiency with which operations of the business are carried on Profitability should be distinguished from profit . Profitability can be measured in relation with sales or overall performance. Profitability ratios are of much importance to the enterprise, management, owners, creditors, employees, customers, government and the country. The important profitability ratios are as under –

i) Gross Profit Ratio : This is the ratio of Gross Profit to Net sales and expressed as a percentage. It is also called Turnover Ratio. It is highly significant and important since the earning capacity of the business can be ascertained by taking the margin between cost of goods and sales. The higher the ratio, the greater will be the margin, and this is why it is also called Margin Ratio. It is very useful as a test of profitability and management efficiency. 20% to 30% Gross Profit Ratio may be considered normal. It is expressed as follows -

Gross Profit Ratio $= \dfrac{\text{Gross Profit}}{\text{Net Sales}} \times 100$

(Net Sales = Gross Sales – (Return Inward + Cash Discount Allowed)

ii) Net Profit Ratio : This is the ratio of Net Profit to Net sales and is also expressed as a percentage. It is very useful to the proprietors and investors because it reveals the overall profitability of the concern. If indicates the net margin earning in sales. It indicates the amount of sales left form shareholders after all costs and expenses have been met. The higher the ratio, the greater will be profitability and the higher the returns to the share holders. This ratio measures the overall efficiency of the management through the firm's overall profitability. 5% to 10% Net profit Ratio may be considered the normal. It is expressed as follows –

$$\text{Net Profit Ratio} = \frac{\text{Net Profit}}{\text{Net Sales}} \times 100$$

iii) Operating Ratio : This is the ratio of operating expresses or operating cost to net sales. It is also called operating cost Ratio and is expressed as a percentage. Operating cost refers to all expenses incurred for operating or running a business. It comprises cost of goods sold plus operating expenses such as office and administrative expresses and selling and distribution expenses. The lower the ratio, the higher is the profitability and the better is the management efficiency. 80% to 90% operating Ratio may be considered as normal. It is expressed as follows -

$$\text{Operating Ratio} = \frac{\text{Cost of Goods Sold + Operating Expenses}}{\text{Net Sales}} \times 100$$

iv) Operating Profit Ratio : It is a modified version of Net Profit Ratio. It is the ratio between operating Net Profit to Net Sales and is expressed as a percentage. Here the non-operating incomes and expenses are to be adjusted (i.e. to be excluded) with the net profit to find out the amount of operating net profit. It is expressed as follows -

$$\text{Operating Profit Ratio} = \frac{\text{Operating Net Profit}}{\text{Net Sales}} \times 100$$

Where, Operating Net Profit = Net Profit – Income from external securities and non-operating / non-trading incomes + Non-operating expenses.

v) Return on Capital Employed (ROCE) Ratio : It is also called as Return on Investment (ROI) or overall Profitability Ratio. It indicates the percentage of return on the total capital employed in the business. It is calculated as follows -

$$= \frac{\text{Operating Profit}}{\text{Capital Employed}} \times 100$$

The term capital employed has different measuring. The most used term is as follows –

Capital Employed = Fixed Assets (at cost less depreciation) + Net Current Assets (Current Assets – Current Liabilities)

OR

Capital Employed = Equal share capital + Preference Share Capital + reserves & Surplus + Long term Loans – (Non-Business/ Operating Assets + Fictions Assets)

The term operating Profit means 'Profit before Interest and Tax.' The term investment means 'Interest on Long term Borrowings.'

Illustration – 2 :

XZY ltd. Presented the following Trading and Profit and Loss Account for the year ended 31st March, 2019 and Capital Employed Rs. 1,50,000/-

Dr. **Trading and Profit and Loss Account** Cr.

Particulars	**Rs.**	**Particulars**	**Rs.**
Operating Stock	1,00,000	By Sales	5,00,000
To Purchases	3,50,000	By Closing Stock	2,00,000
To Wages	50,000		
To Gross Profit c/d	2,00,000		
	7,00,000		**7,00,000**
To Administration Expenses	1,50,000	By Gross Profit b/d	2,00,000
To Selling & Distribution Expenses	20,000	By Profit on Sales of Plant	10,000
To Loss on Sale of Assets	15,000		
To Net Profit	25,000		
	2,10,000		**2,10,000**

Compute : i) Gross Profit Ratio, ii) Net Profit Ratio, iii) Operating Ratio, iv) Operating Profit Ratio, v) Return on Capital Employed Ratio.

Solution :

i) Gross Profit Ratio $= \dfrac{\text{Gross Profit}}{\text{Net Sales}} \times 100$

$= \dfrac{\text{Rs. } 2,00,000}{\text{Rs. } 5,00,000} \times 100$

$= 40\ \%$

ii) Net Profit Ratio $= \dfrac{\text{Net Profit}}{\text{Net Sales}} \times 100$

$= \dfrac{\text{Rs. } 25,000}{\text{Rs. } 5,00,000} \times 500$

$= 5\%$

iii) Operating Ratio $= \dfrac{\text{Cost of Goods Sold + Operating Expenses}}{\text{Net Sales}} \times 100$

$= \dfrac{3,00,000 + 1,70,000}{5,00,000} \times 100$

$= 94\%$

Cost of Goods Sold = Sales – Gross Profit

= Rs. 5,00,000 – 2,00,000

= Rs. 3,00,000

Operating Expenses = Administration Expenses + Selling and Distrubution Expenses

= Rs. 1,50,000 + 20,000

= Rs. 1,70,000

iv) Operating Profit Ratio $= \dfrac{\text{Operating Net Profit}}{\text{Net Sales}} \times 100$

$= \dfrac{\text{Rs. } 30{,}000}{\text{Rs. } 5{,}00{,}000} \times 300$

$= 6\%$

Operating Net Profit = Net Profit – Profit on Sales of Plant + Loss on Sale of Assets

= Rs. 25,000 = 10,000 + 15,000

= Rs. 30,000

v) Return on Capital Employed Ratio

$= \dfrac{\text{Operating Profit}}{\text{Capital Employed}} \times 100$

$= \dfrac{\text{Rs. } 30{,}000}{\text{Rs. } 1{,}50{,}000} \times 100$

$= 20\%$

C) Turnover Ratio :

The Turnover Ratios are also known as Activity or performance or Efficiency or Velocity Ratios. These ratios indicate the effective utilization of the various assets or existing resources in relation to Turnover / Sales / Cost of Goods sold. These ratios supply the information about the speed with which the stock or working capital or debtors or creditors etc are turned in to sales. The important turnover ratios are as follows –

1) Stock Turnover Ratio : This ratios indicates the number of times the stock is turned over during a year. In other words, it is the ratio between stock or inventory and the cost of goods sold or sales. It is expressed as follows.

$$\text{Stock Turnover Ratio} = \frac{\text{Cost of Goods Sold}}{\text{Average Stock}}$$

$$\text{Where, Average Stock} = \frac{\text{Opening stock + Closing Stock}}{2}$$

If the information of opening stock is not available the closing stock can be taken as the average stock. Also, if the cost of goods sold is not available, the sales can be used for the calculation of the stock turnover ratio. A high stock turnover ratio reveals the effective in inventory management, on the other land a low stock turnover ratio reveals undesirable accumulation of absolute stock.

2) Debtors Turnover Ratio : Debtors constitute an important item of current assets. The quality of debtors determine the liquidity of a firm to a great extent. The Debtors Turnover Ratio is useful to know the quality of the debtors. It is also called as Receivable Turnover Ratio or Debtors velocity. In indicates the number of times on an average, that debtors turnover each year. There are two approaches of this ratio which are as follows –

i) $$\text{Debtors Turnover Ratio} = \frac{\text{Credit Sales}}{\text{Average Debtors / Accounts Receivables.}}$$

Here, Average Debtors means average of opening and closing debtors and Debtors includes sundry debtors and bills receivables. A high debtors turnover ratio is good for the business. If the details regarding opening and closing debtors and credit sales are not available, the ratio is calculated by dividing total sales by closing debtors.

ii) $$\text{Debt Collection Period Ratio} = \frac{\text{Average Debtors}}{\text{Credit Sales}} \times \text{Months or days in a year}$$

It indicates the extent to which the debts have been collected in time. It gives the average debt collection period. Generally, the shorter the average collection period, the better is the quality of debtors. This ratio is also calculated by using following formulas.

$$= \frac{\text{Months or days in a year}}{\text{Debtors Turnover Ratio}}$$

OR

$$= \frac{\text{Average Debtors}}{\text{Average months or daily credit sales}}$$

3) Creditors Turnover Ratio : It is similar to Debtor's Turnover Ratio. It indicates the number of times the creditors are paid in a year. There are two approaches of this ratio which are as follows –

i) Creditors Turnover Ratio $= \dfrac{\text{Credit Purchases}}{\text{Average Creditors / Account Payables}}$

Here, Average Creditors means average of opening and closing creditors and creditors includes sundry creditors and bills payables. A lower creditors turnover ratio is good for the business. If the details regarding opening and closing creditors and credit purchases are not available, the ratio is calculated by dividing total purchases by closing creditors.

ii) Indicates the average credit period enjoyed from the creditors. It is also calculated by using following formulas -

$$= \frac{\text{Months or days in a year}}{\text{Creditors Turnover Ratio}}$$

OR

$$= \frac{\text{Average Creditors}}{\text{Average monthly or daily credit purchases}}$$

4) Working Capital Turnover Ratio : This is also known as working capital leverage Ratio. If indicates whether or not working capital has been effectively utilized in making sales. It explains the relationship between sales / turnover and working capital. This ratio is calculated as follows -

$$= \frac{\text{Not sales / Turnover}}{\text{Working Capital}}$$

Here, Net sales / Turnover means Total Sales Less Sales Returns and working capital means Current Assets Less, Current Liabilities. The higher the ratio, the lower is the investment in working capital and higher is the profitability and vice versa. But too high a ratio indicates over-trading.

5) Fixed Assets Turnover Ratio : It is the ratio between net sales and fixed assets. This ratio indicates as to what extent the fixed assets have been utilized. The ratio is calculated as follows -

$$= \frac{\text{Net Sales / Turnover}}{\text{Fixed Assets}}$$

Here, fixed assets means net fixed assets i.e. fixed assets less depreciation.

Illustration – 3 :

Following is the Balance Sheet of ABC Ltd. As n 31st March, 2020

Balance Sheet

Liabilities	Rs.	Assets	Rs.
Share Capital	2,00,000	Goodwill	30,000
Reserves	50,000	Buildings	1,20,000
Profit and Loss A/c	12,750	Plant and Machinery	29,000
Bank overdraft	11,250	Stock	66,000
Sundry Creditors	36,000	Debtors	85,000
Provision for Taxation	20,000		
	3,30,000		**3,30,000**

Other Information :

Sales for the year	Rs.	8,40,000
Average stock in hand	Rs.	63,000
Purchases for the year	Rs.	4,50,000
Gross Profit	Rs.	2,10,000

Compute :- 1) Stock Turnover Ratio, ii) Debtors Turnover Ratio, iii) Creditors Turnover Ratio, iv) Working Capital Turnover Ratio, v) Fixed Assets Turnover ratio.

Solution :

i) Stock Turnover Ratio $= \dfrac{\text{Cost of Goods Sold}}{\text{Average Stock}}$

$= \dfrac{\text{Rs. } 6,30,000}{\text{Rs. } 63,000}$

$=$ 10 Times

Cost of Gods sold $=$ Sales – Gross Profit

$=$ 8,40,000 – 2,10,000

$=$ 6,30,000

ii) Debtor’s Turnover Ratio $= \dfrac{\text{Credit Sales}}{\text{Average Debtors}}$

$= \dfrac{\text{Rs. } 8{,}40{,}000}{\text{Rs. } 85{,}000}$

= 9.88 Times

iii) Creditors Turnover Ratio $= \dfrac{\text{Credit Purchases}}{\text{Average Creditors}}$

$= \dfrac{\text{Rs. } 4{,}50{,}000}{\text{Rs. } 36{,}000}$

= 12.5 Times

iv) Working Capital Turnover Ratio $= \dfrac{\text{Net Sales}}{\text{Working Capital}}$

$= \dfrac{\text{Rs. } 8{,}40{,}000}{\text{Rs. } 83{,}750}$

= 10.03 Times

Working Capital = Current Assets – Current Liabilities

= (Stock + Debtors) – (B/o + Sundry Creditors + Provision for Taxation)

= (66,000 + 85,000) – (11,250 + 36,000 + 20,000)

= 83,750

v) Fixed Assets Turnover Ratio $= \dfrac{\text{Net Sales}}{\text{Fixed assets}}$

$= \dfrac{\text{Rs. } 8{,}40{,}000}{\text{Rs. } 1{,}49{,}000}$

= 5.64 Times

Fixed Assets = Building + Plant and Machinery

= 1,20,000 + 29,000

= 1,40,000

(Note – Goodwill is not included)

d) Solvency Ratios :

Solvency refers to the capacity of a firm to pay off its long debtors. So, long term financial position is tested by solvency ratios. This ratios are also called as Leverage Ratios or Capital Structure Ratios or Stability Ratios. Long term creditors are interested about the repayment capacity of their principal and about the regular payment of interest as soon as it becomes due. Solvency ratios give information about it. The important solvency ratios are as follows –

1) Debt Equity Ratio : This ratio indicates the relationship between Debt and Equity that means the relationship between the claims of outsiders and owners against the assets of the firm. In short it expresses the relationship between the external equities and internal equities or borrowed capital and owned capital. It is expressed as follows–

$$\text{Debt Equity Ratio} = \frac{\text{External Equities}}{\text{Internal Equities}}$$

The term external equities refers to total outside liabilities and the term internal equities refers to shareholders fund. The normal or ideal Debt-Equity Ratio is 2:1. It is also calculated as –

$$= \frac{\text{Long term Debt.}}{\text{Proprietor's Equity / Share holders Fund}}$$

2) Proprietary Ratio : It is a variant of the Debt Equity Ratio. It is also called as Equity Ratio or Net worth Ratio. This ratio expresses the relationship between the proprietor's / Shareholders fund or net worth and total tangible assets. It is calculated as –

$$= \frac{\text{Proprietors / Shareholders Fund / Net Worth}}{\text{Total Tangible Assets.}}$$

There is no hard and fast norm about the standard, yet 60% + 75% of the total assets should be financed by the proprietors fund.

3) Total Liabilities to Total Assets Ratio : This ratio explains the relationship between the total liabilities to outsiders and the total assets of a firm. It is calculated as-

$$= \frac{\text{Total Liabilities to outsiders}}{\text{Total Assets}}$$

If the ratio is fond high, it will indicate that the long term solvency position of the firm is unsatisfactory and vice-versa.

Illustration – 4 :

Following is the Balance Sheet of Swaraj Ltd.,

Liabilities	**Rs.**	**Assets**	**Rs.**
20,000 Eq. Shares of		Fixed Assets	4,00,000
Rs. 10 each fully paid	2,00,000	Current Assets	3,00,000
10,000 8% Pref. Shares of Rs. 10 each	1,00,000	Miscellaneous Expenditure	10,000
8% Debentures	1,00,000		
Reserves and Surplus	1,10,000		
10% Long term Loans	50,000		
Bank Overdraft	50,000		
Creditors	1,00,000		
	7,10,000		**7,10,000**

Compute : i) Debt – Equity Ratio, ii) Proprietary Ratio, iii) Total Liabilities to Total Assets Ratio.

Solution :

i) Debt Equity Ratio $= \dfrac{\text{External Equities}}{\text{Internal Equities}}$

$= \dfrac{\text{Rs. } 3{,}00{,}000}{\text{Rs. } 4{,}00{,}000}$

= 0.75 : 1

External Equities = 8% Debentures + 10% Long-term Loans + Bank overdraft + creditors.

= 1,00,000 = 50,000 + 50,000 + 1,00,000

= 3,00,000

Internal Equities / shareholders Fund = Eq. share Capital + Prof. Share Capital + Reserve & Surplus – Misc. Expenditure.

$$= 2,00,000 + 1,00,000 + 1,10,000 - 10,000$$

$$= 4,00,000$$

ii) Proprietary Ratio $= \dfrac{\text{Proprietary / Shareholders Fund}}{\text{Total Tangible Assets}}$

$$= \frac{\text{Rs. } 4,00,000}{\text{Rs. } 7,00,000}$$

$$= 0.57 : 1$$

Total Tangible Assets = Fixed Assets + Current Assets

$$= 4,00,000 + 3,00,000$$

$$= 7,00,000$$

iii) Total Liabilities to Total Assets Ratio :

$$= \frac{\text{Total Liabilities to outsiders}}{\text{Total Assets}}$$

$$= \frac{\text{Rs. } 3,00,000}{\text{Rs. } 7,00,000}$$

$$= 0.43 : 1$$

Illustration – 5 :

From the following particulars ascertain the following ratios – Current Ratio, Liquid ratio, Proprietary Ratio, Debt- Equity Ratio, Gross Profit Ratio, Net Profit Ratio, Operating Ratio, Operating Profit Ratio, Return on Capital Employed, Return on Proprietor's Fund, Earning per share, Dividend Per share, Capital Turnover Ratio, stock Turnover Ratio, Debtors Turnover Ratio, Creditors Turnover Ratio, Capital Gearing Ratio.

Balance Sheet as on.......

Liabilities	Rs.	Assets	Rs.
1,00,000 Eq. Shares of		Land & Building	3,50,000
Rs. 5 Each	5,00,000	Plant & Machinery	2,50,000
General Reserve	2,00,00	Stock	3,00,000
Profit & Loss A/c.	2,00,000	Sundry Debtors	2,00,000
8% Debentures	1,00,000	Cash at Bank	1,00,000
Sundry Creditors	2,00,000		
	12,00,000		12,00,000

Trading And Profit and Loss Account

Dr. **for the year ended ....** Cr.

Particulars	Rs.	Particulars	Rs.
To Opening Stock	1,00,000	By Sales	16,00,000
To Purchases – credit	8,00,000	(Credit less Returns)	
To Gross Profit	9,00,000	By Closing Stock	2,00,000
	1,80,000		**1,80,000**
To office and Administration		By Gross Profit	9,00,000
Expenses	2,00,000	By Profit on sale of	
To Selling and Distribution		Assets	25,000
Expenses	1,00,000		
To other Expenses	25,000		
To Net Profit	6,00,000		
	9,25,000		**9,25,000**

Rate of tax is at 50%

Dividend paid to Equity shareholders amounted to Rs. 1,00,000

Solution :

i) Current Ratio $= \dfrac{\text{Current Assets}}{\text{Current Liabilities}}$

$= \dfrac{\text{Rs. } 6{,}00{,}000}{\text{Rs. } 2{,}00{,}000}$

$= 3 : 1$

Current Assets = Stock + Debtors + Cash at Bank

Current Liabilities = Sundry creditors

ii) Liquid Ratio $= \dfrac{\text{Liquid Assets}}{\text{Liquid Liabilities}}$

$= \dfrac{\text{Rs. } 3{,}00{,}000}{\text{Rs. } 2{,}00{,}000}$

$= 1.5 : 1$

Liquid Assets = Current Assets – Stock

iii) Proprietary Ratio $= \dfrac{\text{Proprietor's Fund}}{\text{Total Assets}}$

$= \dfrac{\text{Rs. } 9{,}00{,}000}{\text{Rs. } 12{,}00{,}000}$

$= 0.75 : 1$

Proprietary Fund = Eq. share Capital + General Reserve + Profit & Loss A/c.

iv) Debt – Equity Ratio $= \dfrac{\text{Total Debt}}{\text{Proprietor's Fund}}$

$= \dfrac{\text{Rs. } 3{,}00{,}000}{\text{Rs. } 9{,}00{,}000}$

$= 0.33 : 1$

Total Debt = 8% Debentures + Sundry Creditors.

v) Gross Profit Ratio $= \dfrac{\text{Gross Profit}}{\text{Net Sales}} \times 100$

$= \dfrac{\text{Rs. } 9{,}00{,}000}{\text{Rs. } 16{,}00{,}000} \times 100$

$= 56.25\%$

vi) Net Profit Ratio $= \dfrac{\text{Net Profit}}{\text{Net Sales}} \times 100$

$= \dfrac{\text{Rs. } 6{,}00{,}000}{\text{Rs. } 16{,}00{,}000} \times 100$

$= 37.5\ \%$

vii) Operating Ratio $= \dfrac{\text{Cost of Goods sold + operating Expenses}}{\text{Net Sales.}} \times 100$

$= \dfrac{\text{Rs. } 7{,}00{,}000 + 3{,}25{,}000}{\text{Rs. } 16{,}00{,}000}$

$= 64.1\%$

Cost of Goods Sold = Sales – Gross Profit.

Operating Expenses = office & Adm. Expenses + Selling & Distribution Expenses + Other Expenses.

viii) Operating Profit Ratio $= \dfrac{\text{Operating Net Profit}}{\text{Net Sales}} \times 100$

$= \dfrac{\text{Rs. } 5{,}75{,}000}{\text{Rs. } 16{,}00{,}000} \times 100$

$= 35.94\%$

Operating Net Profit = net Profit – Profit on sale of Assets

ix) Return on Capital Employed $= \dfrac{\text{Operating Profit}}{\text{Capital Employed}} \times 100$

$$= \frac{\text{Rs. } 5,57,000}{\text{Rs. } 10,00,000} \times 100$$

= 57.5%

Capital Employed = Fixed Assets + Net Current Assets

= Rs. 6,00,000 + 4,00,000 (6,00,000 – 2,00,000)

= Rs. 10,00,000

x) Return on Propriteot's Fund = $\frac{\text{Net Profit (After Tax)}}{\text{Proprietors Fund}} \times 100$

$$= \frac{\text{Rs. } 3,00,000}{\text{Rs. } 9,00,000} \times 100$$

= 33.33%

xi) Earning per Share (EPS) = Net Profit available to Eq. share holders.

Total Number of Eq. Shares.

$$= \frac{\text{Rs. } 3,00,000}{\text{Rs. } 1,00,000}$$

= Rs. 3

xii) Earning per share (EPS) = $\frac{\text{Net Profit available to Eq. shareholders}}{\text{Total Number of Eq. shares}}$

$$= \frac{\text{Rs. } 3,00,000}{\text{Rs. } 1,00,000}$$

= Rs. 3

xii) Dividend Per Share = $\frac{\text{Dividend Paid}}{\text{Total No. of Eq. Shares}}$

$$= \frac{\text{Rs. } 1,00,000}{\text{Rs. } 1,00,000}$$

= Rs. 1

xiv) Stock Turnover Ratio $= \frac{\text{Cost of Goods Sold}}{\text{Average Stock}}$

$= \frac{\text{Rs. 7,00,000}}{\text{Rs. 1,50,000}}$

= 4.67 Times

Average Stock $= \frac{\text{Opening Stock + Closing Stock}}{2}$

xv) Debtor's Turnover Ratio $= \frac{\text{Debtors x Days in a year}}{\text{Credit Sales}}$

$= \frac{\text{Rs. 2,00,000}}{\text{Rs. 1,60,000}} \times 365$

= 46 days

xvi) Creditors Turnover Ratio $= \frac{\text{Creditors}}{\text{Credit Purchases}} \times \text{Days in a year}$

$= \frac{2{,}00{,}000}{8{,}00{,}000} \times 365$

= 91 days

xvii) Capital Gearing Ratio $= \frac{\text{Fixed Interest Securities}}{\text{Equity Share Capital}}$

$= \frac{\text{Rs. 1,00,000}}{\text{Rs. 5,00,000}}$

= 1 : 5

Check Your Progress

a) Objective Type Questions.

1) State 'True' or 'False'.

i) Ratio analysis is a technique of planning and control.

ii) Debt-equity ratio is a ‘Solvency Ratio’.

iii) ‘Acid Test’ denotes liquidity.

iv) A decreased stock turnover ratio usually indicates expanding business.

v) Normal current ratio is 1 : 1

b) Choose the correct alternative.

i) Ratio of Net sales to Net working Capital is called as ………..

a) Working Capital Turnover Ratio b) Profitability Ratio

c) Liquidity Ratio d) Solvency Ratio.

ii) The statistical yardstick that provides a measure of the relationship between two accounting figures is …………..

a) a current ratio b) the accounting ratio

c) a input-output ratio d) non of above.

iii) Ratio of Net Profit before Interest and Tax to sales is called as……….

a) Operating Profit ratio b) Operating Ratio

c) Capital Gearing Ratio d) solvency Ratio

iv) The turnover Ratio helps management in …………

a) Managing resources b) Managing a debt.

c) Evaluating Performance d) Non of above.

v) Long-term solvency is indicated by ………….

a) Current Ratio b) Debt Equity Ratio

c) Net Profit ratio d) Debtors Turnover Ratio.

2.3 Summary :

Management as well as other parties need different type of information for decision making and such information can be made available from the analysis of financial statement. There are various tools or techniques of analysis financial statements such as Comparative Financial Statements. Analysis, Common size Statements Analysis, Trend Analysis, Ratio Analysis, Funds Flow Analysis, Cash Flow Analysis etc. Ratio analysis is the important and the most widely used tool for the analysis of Financial

Statements.

Ratios are relationships expressed in mathematical terms between figures which are inter-connected or inter-related with each other in some manner. Ratio analysis is the tool or techniques of interpretation of financial statements with the help of the accounting ratios derived from the financial statements. Ratios are useful to different parties for different purposes. Therefore they are classified on the different bases such as source of data, time, importance, functions or nature, users etc. As per functional basis ratios are classified into different categories such as liquidity ratios, profitability ratios, turnover ratios, solvency ratios etc.

2.4 Key Terms :

1) **Ratio :** Ratio is a mathematical relationship expressed between inter-connected or inter-related accounting figures.

2) **Ratio Analysis :** It is the technique of interpretation of financial statements with the help of the accounting ratios derived from the financial statement.

3) **Liquidity :** Liquidity means ones ability to meet claims and obligations as and when they become due.

4) **Solvency :** Solvency refers to the capacity of the firm to pay off its long term debts.

2.5 Answer to check your progress

A) i) False, ii) True, iii) True, iv) False, v) False)

B) i) – a, ii) – b, iii) – a, iv) – c, v) – b)

2.6 Exercise

1. Define Accounting Ratios, Discuss the importance of Ratio Analysis.
2. Discuss the significance of ratio Analysis in the analysis of financial statements.
3. Explain the limitations of Accounting ratios.
4. Discuss the following accounting ratios with their significance. (Short Note)

   a) Current Ratio   b) Liquid Ratio   c) Cross Profit Ratio

   d) Net Profit ratio   e) Operating Ratio   f) Debt. Equity ratio

   g) Proprietary Ratio   h) Debtors Turnover Ratio

c) Practical Problems :

5) Following is the Trading and Profit and Loss Account of Bharat Co. Ltd. For the year ending 31st March, 2009 and the Balance Sheet as on the date.

Dr. **Trading and Profit and Loss Account** Cr.

Particulars	**Rs.**	**Particulars**	**Rs.**
To Opening Stock	1,45,000	By Sales	7,50,000
To Purchases	6,10,000	By Closing Stock	1,55,000
To Gross Profit	1,50,000		
	9,05,0000		**9,05,000**
To Expenses	80,000	By Gross Profit	1,50,000
To Net Profit	70,000		
	1,50,000		**1,50,000**

Balance Sheet

Liabilities		**Rs.**	**Assets**	**Rs.**
Share Capital		7,00,000	Fixed Assets	5,50,000
Reserve and Surplus			Current Assets	
Balance	50,000		Stock	1,55,000
Profit for the year	70,000	1,20,000	Debtors	80,000
Bank overdraft		35,000	Cash	2,20,000
Creditors		1,50,000		
		10,05,00		**10,05,000**

You are required to calculate the following ratios –

a) Current Ratio, b) Liquid Ratio, c) Cross Profit Ratio, d) Net Profit Ratio, e) Stock Turnover Ratio, f) Debtors Turnover ratio, g) Debt. Equity Ratio, h) Proprietary Ratio

(**Ans.:** A) – 2.46 : 1, b) 2 : 1, c) 20%, d) 9.33%, e) 4 Times, f) 9.38 Times, g) 0.23 : 1, h) 0.82 : 1)

6) Following is the summarized Balance Sheet of ITC Ltd., as on 31st March, 2009.

Balance Sheet

Liabilities	Rs.	Assets	Rs.
6% Pref Share Capital	1,50,000	Goodwill	20,000
Eq. Share Capital	2,50,000	Land & Building	2,50,000
General Reserve	20,000	Machinery	1,75,000
Profit & Loss A/c	15,000	Furniture	10,000
5% Debentures	1,00,000	Stock	90,000
Sundry Creditors	28,000	Sundry Debtors	21,000
Bills Payable	12,000	Cash at Bank	5,000
	5,75,000		**5,74,000**

Other Information :

Total sales Rs. 4,00,000, 20% of which is m ade on credit. Gross Profit and Net Profit (after tax) for the year amounted to rs. 80,000 and Rs. 20,000 respectively.

Compute – a) Current Ratio, b) Liquid Ratio, c) Cross Profit Ratio, d) Net Profit Ratio, e) Stock Turnover Ratio, f) Debtors Turnover Ratio, 9) Debt. Equity Ratio, h) Proprietary Ratio.

(**Ans.** A) 2.9 : 1, b) 0.65 : 1, c) 20%, d) 5%, e) 3.6 times, f- 96 days, 9) 0.34 : 1, h 0.75 : 1)

7) The following is Profit and Loss A/c of SURYA BULB LTD., for the year ended 31st March, 2015.

Dr. **Profit and Loss A/c.** Cr.

Particulars	**Amt.**	**Particulars**	**Amt.**
To Opening Stock	1,25,000	By Sales	9,00,000
To Purchases	5,25,000	By Closing Stock	75,000
To Gross Profit Old	3,25,000		
	9,75,0000		**9,75,000**

To Administrative expenses	1,15,000	By Gross Profit Old	3,25,000
To Selling and distribution expenses	50,000	By Other income	25,000
To Finance expenses	10,000		
To Net Profit	1,75,000		
	3,50,000		**3,50,000**

Calculate : i) Gross Profit ratio ii) Operating ratio iii) Operating Profit ratio iv) Net Profit ratio v) Administrative expenses ratio vi) Selling and distribution expenses ratio.

8) Given below is the Balance Sheet of Atharv & Co. as on 31st March, 2015

Balance Sheet

Liabilities	**Rs.**	**Assets**	**Rs.**
E/S capital	1,50,000	Goodwill	50,000
6% preference shares	75,000	Land & Building	1,50,000
General Reserve	75,000	Machinery	1,75,000
Dividend equalization fund	25,000	Inventory (Stock)	1,00,000
5% Debentures	2,00,000	Sundry Debtors	75,000
Current liabilities	2,00,000	Cash at Bank	17,500
		Outstanding Income	7,500
	5,75,000		**5,75,000**

Find out :

a) Solvency ratio

b) Proprietary ratio

c) Debt. - Equity ratio

d) Fixed Assets to shareholders fund ratio

e) Current Assets to Net worth ratio

2.7 Reference for Further Reading :

1) Pandy I. M., Management Accounting, Vikas Publishing House, Pvt. Ltd, New Delhi.

2) Paul S. Kr. Financial Statement Analysis, New Central Book Agency (P) Ltd., Kolkata.

3) Dr. Maheshwari S. N., Principles of Management Accounting Sultan Chand & Sons, New Delhi.

4) Raman B. S., Management Accounting, United Publishers, Mangalore.

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Unit 3

Cash Flow Analysis

Index

3.0 Objectives:

After studying this unit we will be able to :-

1. Understand the meaning of Cash Flow Statement.
2. Describe the operating activities, investing activities and financing activities.
3. Identify the transactions that cause inflow and outflow of cash.
4. Know the salient features of Accounting Standards (AS-3) on Cash Flow Statement.
5. Understand the method of preparation of Cash Flow Statement.

3.1 Introduction:

Balance Sheet, Profit and Loss Account, Funds Flow Statement and Cash Flow Statement are the financial statements which an accountant prepares at the end of an accounting period for business enterprise. Balance Sheet and Profit and Loss Account are the basic Financial Statement. Balance Sheet shows financial position of the business enterprise, which reflects the assets, liabilities and capital as on a certain date, Profit & Loss Account shows operating result of business i.e. profit or loss during a certain period. Funds Flow Statement explains increase and decrease in working capital during the accounting period.

While Cash Flow Statement explains changes in cash position between the beginning and end of the accounting period.

3.2 Presentation of Subject Matter

Now we are going to learn important points. It is main part of this unit which includes meaning of Cash Flow, Cash Flow Statement, Uses of Cash Flow Statement, Classification of Cash Flows and method of preparation of Cash Flow Statement.

3.2.1 Meaning Cash Flow Analysis/Statement

Cash Flow Statement is a Summary of cash book. It is statement which summarizes the sources of cash from which cash payments are made during a particular period of time, say a month or a year. In other words, a cash Flow statement shows the various sources of cash inflow and uses of cash outflow during a period thus explaining the changes in cash position of the business.

A cash flow statement is not very much different from a funds flow statement. In fact, the main difference between funds flow statement and cash flow statement relates to meaning and concept of the term 'Fund'. The term 'Fund' as used in funds flow statement mean's net working Capital i.e. the difference between current currents and current Liabilities. But in cash flow statement the term 'Cash' mean Cash Fund as defined by Accounting Standard-3.

3.2.2 Accounting Standard- 3 (AS-3): Cash Flow Statement

The Institute of Chartered Accountants of India (ICAI) issued AS-3 (Revised): Cash flow Statement in March 1997. This standard supersedes AS-3: Changes in financial position which was issued in June 1981. It is in tune with international trends because Cash Flow Statements have replaced statement of changes in financial positional in almost every country.

This AS-3 has become mandatory w.e.f. 1-4-2001 for following enterprises:

i) Enterprise whose equity or debt securities are listed or going to be listed on a recognized stock exchange in India.

ii) All other commercial, industrial and business reporting enterprises whose turnover for the accounting period exceeds Rs.50 Crores.

The companies in respect of which AS-3 is mandatory are required to comply with AS-3 under section 211 of companies Act 1956. This means that statutory auditors of such companies are required to give an assertion in respect of companies with AS-3.

Securities and Exchange Board of India (SEBI) requires that all listed companies should submit a cash flow statement along with other financial results of the company, prepared as per Accounting Standard (AS-3) issued by ICAI.

Definition of Cash Fund:

As per Accounting Standard (AS-3) issued by the Institute of Chartered Accountant ants of India, the term cash includes:

1. Cash in hand
2. Demand deposits with banks (Cash at Bank)

3. Cash equivalents. These are short term highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

3.2.3 Meaning of Cash Flow and Cash Flow Statement

1. Cash flow means to movement both inflow and outflow of cash and cash equivalents during a period.
2. Inflow of cash means to increase in cash and cash equivalents refers to all transaction.
3. Outflow of cash means to decrease in cash & cash equivalents relating to all transaction.
4. Cash Flow Statement is defined as a statement which shows flow of cash and cash equivalents during a period.

OR

The Cash flow statement means the statement of changes in cash and cash equivalents during a particular accounting period. It shows-

1. Net Cash flows from Operating Activities.
2. Net Cash flows from Investing Activities.
3. Net Cash flows from Financing Activities.
4. Net Changes in Cash and Cash equivalents.

3.2.4 Uses / Advantages of Cash Flow Statement

Following are the uses of Cash flow Statement.

1) To Ascertain Net Cash Flows:

Cash Flow Statement facilities to ascertain Net Cash Flows from operating, investing and financial activities and net change in cash and cash equivalents

2) To Evaluate Cash Financial Performance

It facilities to evaluate cash financial performance by providing information on Net Cash Flows from operating activities.

3. To Evaluate Cash Financial Position

It facilities to evaluate cash financial position by providing information on Net Cash Flows form investing, activities & financial activities.

4. To Facilitates Efficient Cash Management

The management can kwon the situation of shortage or surplus cash and can plan for effective use of surplus cash or can make arrangement of shortage of cash.

5. To Facilities Comparison

It facilities the comparative study of the operating performance of different enterprises.

6. Useful to Preparation of Cash Budget

Cash Flow Statement is useful in preparing cash budgets of an enterprises.

7. Facilities Capital Structure Decision

It facilities capital structure decision by providing information on net cash flows from financial activities.

8. Useful to Short term Planning

Cash flow statement gives information for a specific period. It is useful to short term planning of an enterprises.

9. Useful to Management Decisions

It is useful in determining the urgencyness of management decisions.

10. Useful to Dividend Policy

This statement also helps an enterprise in planning a good dividend policy.

3.2.5 Limitation of Cash Flow Statement

1) Non-Cash transaction are not covered. It does not take into consideration these transactions which do not affect the cash. for example Issue of share against purchase of fixed Assets, Conversion of debentures into shares.
2) Cash Flow Statement is not a suitable for income statement. (Profit/loss)
3) Cash Flow Statement is not substitute for position statement (Balance Sheet)
4) Cash Flow Statement is historical nature.
5) It ignores the fundamental assumption of Accural.

3.2.6 Cash and Cash Equivalents

Meaning	Cash means Cash includes cash on hand and demand deposits with banks.
Example	Cash in hand, Cash at bank.

'Cash Equivalents'

Meaning	Cash equivalents are short term highly liquid investments that are readily convertible into known amount cash and which are subject to an insignificant risk of changes in value.
Purpose	Cash equivalents are held for the purpose of meeting short term cash commitments rather than for investment or other purpose.
Two Conditions for an investment to quality as a cash equivalent	1. It must be ready convertible to known amount of cash. 2. Investment normally qualifies as a cash equivalent only when it has a short maturity of, say 3 months or less from the date of acquisition.
Example	Treasury Bills, Commercial Bills, Call money, Certificate of Deposits and Commercial papers.

Check Your Progress- 1

A) State whether the following statement are True or False.

1) Every listed company has an option to prepare and enclose the cash flow statement along with the financial statements.

2) Cash Flow Statement describes the inflow and outflows of cash.

3) Cash & Cash equivalents are short term, highly liquid investments that are readily convertible into Cash.

B) Fill in the blanks with appropriate words.

1) Cash Flow Statement is a ...... which shows flow of cash and cash equivalents during a period.

2) Cash flow refers to the movement both inflow and outflow of ...... and .... during a period.

3) Cash equivalents are usually of short term, but highly ..... investments.

4) Cash flow statement (based on AS-3) should be prepared and presented under ..... method.

3.2.7 Classification of Cash Flows

Accounting Standard (AS -3) requires cash flow statement should report cash flow during the period classified by operating, investing and financing activities.

3.2.7.1 Operating Activities

Operating activities are the principal revenue activities of the enterprise. Cash flows from the activities result from transactions and other events that enter into the determination of net profit or loss.

Examples of Cash Flow from Operating Activities.

Cash Inflows		Cash Outflows	
1	Cash sales and cash received from debtors	1	Cash purchase and payment to trade creditors.
2	Cash received from royalty commission, fees etc.	2	Payment to operating expenses (e.g. Salaries & wages, Administration Exp. Selling Exp)
3	In case of financial enterprise the following activities are classified as operating activities since they relate to the main revenue-producing activity of the enterprise. - Cash received sale of Shares & Debenture. - Interest & dividend receipts.	3	In case of financial enterpirse the following activities are classified as operating activities since- they relate to the main revenue producing activity of enterprise. - Cash payment of Shares & Debenture - Interest & dividend paid

3.2.7.2 Investing Activities

Investing activities are the acquisitions and disposal of long term assets (Such as Plant, Machinery, Furniture, Land & Building etc) other investments not included in cash equilants.

Examples Cash Flow from Investing activities

Cash Inflows		Cash Outflows	
1	Sales of Fixed Assets.	1	Purchase of Fixed Assets
2	Sale of Investments such as shares, debentures.	2	Purchase shares, debentures etc. as investment (long term)
3	Receipts of income on investment (Interest & dividends)	3	Loan & Advances granted (Short term & long term)
4	Receipts from repayment of loans & advances.	4	Brokerage paid on purchase of Investments (long term / short term)

3.2.7.3 Financing Activities

Financial activities are the activities that result in changes in the size and composition of the owners capital (including Preference share capital in the case company) and borrowings (short term or long term) of the enterprise.

Examples of Cash Flow from Financing Activities.

Cash Inflows		Cash Outflow	
1	Issues of shares, Pref. Share and debentures for cash.	1	Buy-back of equity share for cash.
2	Loan taken (short term / long term)	2	Redemption of preference shares & debentures for cash.
3	Interest received on calls in arrears (short term / long term)	3	Loan repaid (short term / long term)
		4	Interest on debenture & loan paid.
		5	Interim & final dividend on equity

			& preference shares paid.
		6	Brokerage & Underwriting commission paid on issue of shares & Debenture.

3.2.8 Other Items

1. Extra Ordinary Items

The cash flows associated with extra ordinary items should be classified as arising from operating, investing and financial activities as appropriate and separately disclosed. for example- legal claim, cost of winning a law suit or lottery, receipt of claim from insurance company etc are extra ordinary items.

2. Income Tax

Cash flows arising from income tax should be classified as flow operating activities unless they can be specifically identified with financing and investing activities. for example, Capital gain tax on sale of land can be identified with investing activity and therefore in the cash flow statement, it should be shown as outflow from investing activities.

3. Non Cash Transitions

There are certain transitions which do not involve cash inflow or cash outflow. Although they do not affect the capital and assets of an enterprise, they are excluded from cash flow statement for obvious reasons. Example of non-cash transitions.

i) Acquision of assets by issue of shares / debentures.

ii) Conversion of convertiable debentures into shares.

iii) Acquision of fixed assets, say machinery on credit etc.

3.2.9 Preparation of Cash Flow Statement

Cash Flow Statement may be prepared by two method a) Direct Method b) Indirect Method.

3.2.9.1 a) Direct Method

Under this method, cash receipts from operating revenues and cash payments for operating expenses are calculated and shown in the cash flow statement. The difference between the total cash receipts and total cash payments as shown as the net cash from operating activities.

Following are the example of cash inflows and cash outflows are –

Cash Inflows (Cash receipt)-

i) Cash received from customers.

ii) Cash sales of goods & services

iii) Cash receipt on royalties, frees, commission & so on.

Cash Outflows (Cash Payments)-

i) Cash payment of purchase goods, inventories & so on.

ii) Cash payment to Creditors.

iii) Cash payment for wages, salaries & other operating expenses.

iv) Cash payment of income tax etc.

Direct Method Performa
or
Cash Flow Statement for the year ended.

	Particular	**₹**	**₹**
1	**Cash from operating activities**		
	A) Operating Cash Receipts:		
	- Cash Sales	×××	
	- Cash received from Debtors	×××	
	- Trading Commission received	××	
	- Royalties, Fees received	××	××××
	B) Operating Cash Payments		
	- Cash purchases	×××	
	- Cash paid to Creditors	×××	
	- Cash paid to business expenses	×××	
	- (Office & Administration Exp, Manufacturing Exp. & Selling Exp)	×××	
	- Others		− ×××
		××	×××

	C) Cash generated from operation before Tax (A- B)		xxx
	D) Income Tax paid (Net of Refund Tax)		– xxx
	E) Cash Flow before extra ordinary items (C-D)		xxx
	F) Extra ordinary item		xxx
	G) Net Cash from operating activities		xxxx

Illustration No. 1

From the following particulars, calculate cash flows from operating Activities.

Particulars	₹	Particulars	₹
Cash Sales	2,00,000	Manufacturing Overhead Paid	30,000
Cash Purchase	50,000		
Cash receipts from Debtors	4,00,000	Office & Administration Expenses paid	20,000
Cash paid to Suppliers	1,00,000		
Trading commission received	1,00,000	Selling & Distribution expenses paid	10,000
Trading Commission paid	25,000		
Wages & Salaries paid	40,000	Income Tax paid	1,18,000
Rent paid	10,000	Insurance proceeds from earthquakes – disaster settlement	1,00,000
		Income Tax Refund received	3000

Solution

Cash Flow Statement from Operating Activities

Particular	₹	₹
A) **Operating Receipt of Cash:**		
- Cash Sales	2,00,000	
- Cash receipts from Debtors	4,00,000	
- Trading commission received	1,00,000	7,00,000
B) **Operating payment of Cash:**		
- Cash purchase	50,000	

- Cash paid to Suppliers - Trading Commission paid - Wages & Salaries paid - Rent paid - Manufacturing overheads paid - Office & Administration exp paid - Selling & Distribution exp paid	1,00,000 25,000 40,000 10,000 30,000 20,000 10,000	– 2,85,000
C) Cash generated from operations before Taxes (A-B)		4,15,000
D) Income Tax paid (Net of Refund) (1,18,000-3000)		– 1,15000
E) Cash Flow before extra ordinary item		3,00,000
F) Insurance proceeds from earth-quakes disaster settlement		1,00,000
G) Net Cash from operating activities		4,00,000

3.2.9.2 Indirect Method

Under this method, net cash from operating activities is determined by making necessary adjustment in the net profit (or loss) as disclosed by Profit & Loss Account. Adjustments in net profit or loss are for the effect of:

a) Non Cash item like depreciation.

b) Changes during the period in inventories and operating receivable & payables.

c) All other item for which cash effect are investing and financing activities.

This AS-3 requires a cash flow statement to be prepared and presented in manner that is shows cash flow from business transaction during a period, which is classified as-

1) Operating activities.

2) Investing activities.

3) Financing activities.

Check Your Progress- 2

A) State whether the following are True or False.

1) Cash Flow Statement is a summary of Cashbook.

2) As per AS-3 (Revised) Cash Flows resulting from the sale of fixed assets are classified as cash flow from investing activities.

3) Increase in provision for dutiful debts should be added back to net profit in order to find out cash from Operations.

B) Fill in the blanks with appropriate words.

1) Cash Flow Statement is based on past records. So it is .... in nature.

2) Tax paid on income should be shown separately as the cash flow from ...... activities.

3) Decrease in inventory .... Cash.

4) Buy-back of shares is shown under ....

3.2.10 Purpose of Cash Flow Statement

Cash Flow Statement is Summary of cash book. It is a statement which contains the inflows (sources) and outflows (uses) of cash and cash equivalents during specified period. A cash flow explains the causes of changes in the cash position of a business enterprise between two balance sheet dates. The firm may be profitable, yet it may experience difficulty, even to make payment of wages and salaries. The firm wants to understand where the profit has gone and for what purpose, the profit amount has been utilized. This is possible with cash flow statement. Though Cash Flow Statement, management can assess, monitor and control the available liquidity in the enterprise.

Indirect Method Performa

OR

Cash Flow Statement for the year Ended

	Particular	₹	₹
1)	**Cash from Operating Activities**		xxx
	A) Net profit before Taxation & Extra ordinary item		
	B) **Add**- Non-Cash & Non-operating expenses items		
	- Depreciation	xx	
	- Prelimary expenses written off / Goodwill written off	xx	
	- Discount on issue of share & debenture written off	xx	

	- Interest on borrowing & debenture (only finance company)	xx	
	- Loss on Sale of fixed Asset, Investment etc	xx	xxx
			xxxx
	C) **Less** – Non Cash & Non Operating income		
	- Interest income (only non-finance company)	xx	
	- Dividend Income (only non-finance company)	xx	
	- Rental Income	xx	
	- Profit on sale of fixed assets, investment etc.	xx	–xxx
	D) **Operating Profit Before Working Capital Changes**		xxx
	E) **Add** – 1) Increase in Current Liabilities	xxx	
	2) Decrease in Current Assets	xxx	
		xxx	
	F) **Less** 1) Increase in Current Assets	–xx	
	2) Decrease in Current Liability	–xx	xxx
	G) Cash inflow (Generated) from Operating Activities (D+E-F)		xxxx
	H) **Less** – Income Tax paid		–xx
	I) Cash Flow before Extraordinary item (Extra ordinary item + -)		xx
	J) **Net Cash from (or used) Operating Activities**		xxx
2)	**Cash Flow From Investing Activities**		
	- Sale of fixed Assets	xx	
	- Sale of Investment such as Share, debenture	xx	
	- Investment & Dividend received (Non-financing company)	xx	
	- Receipt from repayment of loans made to third parties	xx	
	- Rent Income	xxx	
		xxxx	
	Less - Purchase of Fixed Assets	–xx	
	Less - Purchase of Investment (Shares, debentures)	–xx	
	Less - Purchase of Intangible Assets (e.g. Goodwill)	–xx	
	- Extra Ordinary item (±)	–xx	xxx

	Net Cash from (used) in Investing Activities		xxx
3)	**Cash Flow from Financing Activities**		
	- Cash receipt from issue of shares, debenture etc.	xxx	
	- Cash receipt from long term loan	xxx	
	Less - Cash payment for redemption of pref. Shares & debentures	–xx	
	Less - Buyback of Shares	–xx	
	Less - Interest & Dividend paid	–xx	
	- Extraordinary items (±) or		xxx
	Net Cash from (used in) Financial Activities		xxxx
4)	Net Increase/Decrease in Cash & Cash Equivalents (1+2+3)		xxx
5)	**Cash & Cash Equivalents at the beginning of the year**		
	Cash in hand, Short-term deposit	xxx	
	Marketable securities (Less Bank overdraft)	–xxx	xxx
6)	**Cash & Cash Equivalents at the end of the year**		
	Cash in hand Less Bank overdraft	xx	
	Short term deposit, Marketable securities	xx	xxx
			xxxx

Illustration – 2 :

Classify the following activities as (1) Operating Activity, (2) Investing Activity, (3) Financing Activities.

i) Purchase of Machinery, ii) Sale of Land,

iii) Payment of Income Tax, iv) Refund of Income Tax,

v) Payment of Dividend, vi) Receipt of Dividend,

vii) Payment of Interest on Debenture, viii) Receipt of Interest on Debenture,

ix) Issue of Debenture, x) Buy-back of Equity Shares.

Solution :

1)	Operating Activity	-	iii, iv
2)	Investing Activity	-	i, ii, vi, viii
3)	Financing Activity	-	v, vii, ix, x

Illustration - 3 :

Classify the following activities as (1) Operating Activities, (2) Financial Activities, (3) Investing Activities, (4) Cash or Cash Equivalents

1	Purchase of Fixed Assets	2	Issue of equity share capital
3	Cash sale	4	Interest on short-term borrowings
5	Sale of Machinery	6	Cash received from customers
7	Commission and Royalty received	8	Purchase of Current Investment
9	Redemption of Preference Shares	10	Cash purchase of Goods
11	Sale of Investments	12	Purchase of Goodwill
13	Cash Credit	14	Cash paid to suppliers of Goods
15	Interim dividend paid on equity shares	16	Wages & Salaries paid
17	Dividend received on shares	18	Rent received on property
19	Selling & Distribution expenses paid	20	Income Tax paid
21	Dividend paid Preference Shares	22	Underwriting Commission paid
23	Rent paid	24	Brokerage paid on issue of shares
25	Brokerage paid on purchase of Investment	26	Bank overdraft
27	Short term deposits having maturity of 3 months	28	Marketable securities having maturity of 3 months
29	Sale of patents	30	Interest received on debentures held as investments
31	Interest paid on borrowings	32	Office & Adm. Expenses paid
33	Manufacturing expenses paid	34	Refund of Income Tax received
35	Discount allowed to customers	36	Discount received from suppliers
37	Purchase of securities having maturities of 6 months		

Solution:

Classification of Activities	
a) Operating Activity	3, 6, 7, 10, 14, 16, 19, 20, 23, 32, 33, 34, 35, 36
b) Investing Activity	1, 5, 8, 11, 12, 17,18, 25, 29, 30, 37
c) Financing Activity	2, 4, 9, 13, 15, 21, 22, 24, 26, 31
d) Cash & Cash Equivalents	27, 28

Illustration - 4 :

Calculate Cash from operating activities from the following

Particular	31-3-2019	31-3-2020
Profit and Loss Account	6,00,000	6,50,000
Sundry Debtors	8,50,000	4,80,000
Bills Receivable (B/R)	4,00,000	8,10,000
Wages Outstanding	2,60,000	80,000
Salaries Prepaid	80,000	1,00,000
Goodwill	7,00,000	6,00,000
General Reserve	17,20,000	20,70,000

Solution :

Calculation of Cash from Operating Activities

Particular	₹	₹
Net profit before Taxation & Extra Orderings item (6,50,000 – 6,00,000)		50,000
Add – Non Cash & Non-operation expenses		
- General Reserve (20,70,000 – 17,20,000)	3,50,000	
- Goodwill written of (7,00,000 – 6,00,000)	1,00,000	4,50,000
Operating profit before Working Capital Changes		5,00,000
Add – Decrease Sundry Debtors (8,50,000 – 4,80,000)	3,70,000	3,70,000
Increase in Current Liability		8,70,000
Less – Increase in C.A. (B.R. 8,10,000 – 4,00,000)	4,10,000	
- Increase in Salary prepaid (1,00,000 – 80,000)	20,000	
- Decrease in C.L.– O/s wages (2,60,000–80,000)	1,80,000	- 6,10,000
Less – Income Tax paid		-
Net Cash From operating Activities		**2,60,000**

Illustration – 5 :

From the following information, calculate Net Profit before Taxation and Extra ordinary item.

Particular	Closing Balance	Opening Balance
Profit & Loss Account	3,36,000	1,00,000
Reserve	1,50,000	50,000
Proposed Dividend	72,000	60,000
Interim dividend paid during the year		90,000
Provision for taxation made during the current year		1,50,000
Refund of Tax		3,000
Loss due to Earthquake		2,00,000
Insurance Proceeds from earthquake disaster settlement		1,00,000

Solution :

Calculation of Net profit before Taxation & Extraordinary item

Particular	₹
Net profit as per Profit & Loss Account (3,36,000 - 1,00,000)	2,36,000
Add- General Reserve (1,50,000 - 50,000)	1,00,000
Add - Proposed dividend for C.Y.	72,000
Add - Provision for Taxation for C.Y. (1,50,000–3,000 Tax Refund)	1,47,000
Add – Extra ordinary item (Loss due to Earthquake)	2,00,000
Add – Interim dividend paid during C. Y.	90,000
Total	8,45,000
Less – Extra ordinary item (i.e. Insurance Proceeds from earthquake disaster settlement)	-1,00,000
Net Profit Before Taxation & Extraordinary item	**7,45,000**

Illustration – 6 :

From the following particulars, calculate the Net Cash Flow from operating activities.

A) Profit made during the year was Rs. 8,00,000 after considering the following items.

Particular	₹
i) Depreciation on Fixed Assets	40,000
ii) Amortization of Goodwill	20,000
iii) Transfer to General Reserve	28,000
iv) Profit on Sale of Fixed Assets	17,000
v) Loss on Sale of Furniture	5,000
vi) Provision for Taxation	80,000

B) The following is the position of Current Assets & Current Liabilities

Particular	Closing Balance (₹)	Opening Balance (₹)
Trade Receivable	60,000	48,000
Trade Payable	40,000	60,000
Inventories	32,000	40,000
Outstanding expenses	24,000	16,000
Provision for Taxation	80,000	70,000

Solution :

Calculation of Cash Flow from Operating Activities

Particular	₹	₹
Net Profit before Taxation & Extra ordinary expenses		8,00,000
Add – **Non Cash & Non operating expenses**		
- Depreciation of F. A.	40,000	
- Amortization of Goodwill	20,000	
- Transfer to General Reserve	28,000	
- Provision for Taxation	80,000	
- Loss on Sale of Furniture	5,000	
- Profit on Sale F. A.	(17,000)	1,56,000
Operating profit before Working Capital charges		9,56,000
Changes of Current Asset & Liabilities		
Increase C. A. (T.R.) (48,000 – 60,000)	(12,000)	
Decrease C. L. (T. P.) (60,000 – 40,000)	(20,000)	
Decrease Inventory (40,000 – 32,000)	8,000	
Increase C.L. (24,000 – 16,000)	8,000	- 16,000
(Outstanding Expenses) Cash generated from operation		9,40,000
Less – Income Tax (P. Y.)		- 70,000
Net Cash Flow from Operating Activities		**8,70,000**

Illustration – 7 :

From the following Calculate Cash from operation.

Profit & Loss Account for the year ended 31-3-2020

Particulars	₹	Particulars	₹
To Salaries	50,000	By Gross Profit	2,50,000
To Rent	10,000	By Profit on Sale of Land	50,000
To Depreciation on Building	20,000	By Income tax refund	40,000
To Loss on Sale of Plant	10,000		
To Goodwill written of	40,000		
To Proposed dividend	50,000		
To Provision for Tax	50,000		
To Net Profit	1,10,000		
	3,40,000		**3,40,000**

Solution :

Calculation of Cash from Operation

Particular	₹	₹
Net Profit for the year		1,10,000
Add – Non Cash & Non Operating Expenses		
- Depreciation on Building	20,000	
- Loss on Sale of Plant	10,000	
- Goodwill written off	40,000	
- Proposed dividend	50,000	
- Provision for Tax	50,000	1,70,000
		2,80,000
Less – Non-operating income		
- Profit on Sale of Land	50,000	
- Income Tax refund	40,000	- 90,000
Cash from Operation		**1,90,000**

Illustration – 8 :

From the following information, Calculate Net Cash from Operating Activities

Particular	₹
Net Profit before Taxation & Extraordinary item	7,45,000
Depreciation	1,40,000
Loss on Sale of Machinery	30,000
Interest on Debentures	24,850
Interest on Bank Loan	6,650
Goodwill amortised	9,000
Prelimary expenses written off	2,000
Interest income on Non-current investments	6,000
Interest income on current investments	2,000
Profit on sale of Current Investment	5,000
Loss on sale of Non-current Investments	10,000
Tax paid during current year	1,18,000
Refund of Tax	3,000
Loss due to Earthquake	2,00,000
Insurance Proceeds from earthquake disaster settlement	1,00,000
Premium on redemption of preference shares	10,000

Position of Current Assets and Current Liabilities

Particular	Closing Balance ₹	Opening Balance ₹
Inventories	1,06,000	1,00,000
Trade Receivable (B.R.)	10,000	6,70,000
Trade Payable (B. P.)	25,000	1,80,000
Outstanding expenses	14,000	10,000
Cash & Cash Equilents	30,000	49,000

Solution :

Calculation of Operating Profit Before Working Capital Changes

Particular	₹	₹
A) Net Profit Before Taxation & Extraordinary item		7,45,000
B) **Add – Non Cash & Non operating expenses/item**		
- Depreciation	1,40,000	

- Loss of Machinery	30,000	
- Interest on Debentures	24,850	
- Interest on Bank loan	6,650	
- Goodwill amortised	9,000	
- Preliminary Expenses written off	2,000	
- Premium on Red. of Pref. Shares	10,000	
- Interest income on Non Current Assets	(6,000)	
- Interest income on Current Assets	(2,000)	
- Profit on Sale of Current Investment	(5,000)	
- Loss on sale of Non-Current Investment	10,000	2,19,500
C) Operating profit before Working Capital Changes		9,64,500
D) Changes in Current Assets & Current Liabilities		
- Inventories Increase	(6,000)	
- Decrease in Trade Receivable	6,60,000	
- Decrease in Trade Payable	(1,55,000)	
- Increase Outstanding Expenses	4,000	
		5,03,000
E) Cash generated from operations before Tax		14,67,500
F) **Less** – Income Tax (1,18,000 – 3,000 Tax Refund)		–1,15,000
G) Cash Flow before extraordinary item		13,52,500
Add – Extra ordinary item (Insurance proceed earthquake disaster settlement		1,00,000
		14,52,500
Less – Extraordinary item (Loss due to earthquake		–2,00,000
Net Cash Inflow from operating Activities		**12,52,500**

Illustration – 9 :

From the following balances calculate Cash from operation

Particular	Closing Balance ₹	Opening Balance ₹
Profit & Loss Account	70,000	10,000 (Dr.)
General Reserve	1,00,000	1,50,000
Proposed dividend	2,50,000	2,10,000
Provision for Taxation	2,50,000	1,50,000
15% Debentures	3,40,000	2,20,000
Trade Payable	2,20,000	2,40,000

Fixed Assets (Gross)	7,40,000	7,40,000
Accumulated Depreciation	3,00,000	2,40,000
10% Current Investment	2,00,000	1,00,000
Bills Receivable(Gross)	4,84,000	1,50,000
Provision for doubtful debts	1,00,000	50,000
Inventories	1,50,000	2,50,000
Cash & Equivalents	56,000	10,000

Note – Income Tax provided during the year Rs. 3,00,000/-

Working Note : 1

Provision for Taxation

To Cash/Bank A/c (Tax paid)	**2,00,000**	By Balance b/d	1,50,000
		By P & L A/c (Provision)	3,00,000
To Balance c/d	2,50,000		
	4,50,000		**4,50,000**

Working Note : 2. It is assured that the new debentures have been issued at the end of current accounting year.

Working Note : 3. It is assumed that New Current investment have been acquired at the end of current according year.

Solution :

Calculation of Cash from Operating Activities

Particular	₹	₹
Closing balance of P & L A/c	70,000	
Add – Opening balance of P & L A/c (Dr. balance- loss)	10,000	
	80,000	
Less – General Reserve transfer	(50,000)	
Add – Proposed dividend for C.Y.	2,50,000	
- Provision for Taxation for C.Y.	3,00,000	
Net profit before Tax		5,80,000
Add – Non – Cash & Non Operating item/exp		
- Interest on Debenture (2,20,000 x 15/100)	33,000	
- Depreciation (3,00,000 – 2,40,000)	60,000	

- Interest on Current Investment	(10,000)	
		83,000
Operating profit before Working Capital Charges		6,63,000
Less – Decrease Trade Payable	(20,000)	
Less – Increase in Trade Receivable (B.R.) (4,84,000-1,50,000)	(3,34,000)	
Add – Increase Provision for doubtful debts	50,000	
Add – Decrease in Inventors	1,00,000	(2,04,000)
Cash generated from operation before Tax		4,59,000
Less – Tax paid		(2,00,000
Net Cash in flow from operating Activities		**2,59,000**

Illustration – 10 :

From the following particulars, calculate the Net Cash Flow from operating activities.

Particular	Closing Balance ₹	Opening Balance ₹
Profit & Loss Account	14,000	2,000
General Reserve	30,000	20,000
Proposed dividend	50,000	42,000
Provision for Taxation	50,000	30,000
10% Debentures	50,000	40,000
Bills Payable	2,35,000	17,000
Machinery	88,000	1,00,000
Goodwill	16,000	20,000
Discount on Issue of Debenture	-	400
Current Investment	16,000	6,000
Inventories	49,000	12,000
Trade Receivable	2,24,600	14,600
Cash and Cash Equivalent	35,000	-

Note - Income Tax paid during the year Rs. 40,000

Working Note :

1) **Provision for Taxation A/c**

To Cash/Bank A/c (Tax paid) To Balance c/d	40,000 50,000	By Balance b/d By P & L A/c (Provision)	30,000 60,000
	90,000		**90,000**

Working Note : 2) It is assumed that new debenture Rs. 10,000. (50,000 – 40,000) issued at the end of current accounting year.

Solution :

Calculation of Net Cash Flow from Operating Activities

Particular	₹	₹
Closing balance of P & L A/c	14,000	
Less – Opening balance as per P & L A/c	-2,000	
	12,000	
Add – Transfer General Reserve	10,000	
Add – Proposed dividend for C. Y.	50,000	
Add – Provision for Taxation for C. Y.	60,000	
Net Profit before Taxation		1,32,000
Add – Non – cash and Non operating exp/item		
- Depreciation of Machinery (1,00,000 – 88,000)	12,000	
- Goodwill written off	4,000	
- Interest on Debentures (40,000 x $\frac{10}{100}$)	4,000	
- Discount on Issue of Debentures	400	20,400
Operating profit before Working Capital Changes		1,52,400
Charges in Current Assets & Current Liabilities		
Add – Increase in Bills Payable (2,35,000 – 17,000)	2,18,000	
Less – Increase in Inventories (49,000 – 12,000)	(37,000)	
Less – Increase Trade Receivable (2,24,600 – 14,600)	(2,10,000)	(29,000)
Cash generated from operation		1,23,400
Less – Income Tax paid		(40,000)
Net Cash Inflow for Operating Activities		**83,400**

Illustration – 11 :

The balance sheets of LMN Ltd as on 31st March of two years are given below:

Assets	31-3-2020 ₹	31-3-2020 ₹
Cash balance	60,000	50,000
Trade debtors	1,00,000	75,000
Stock	1,20,000	1,40,000
Land & Building	80,000	1,00,000
Plant & Machinery	3,00,000	2,40,000
Total	**6,60,000**	**6,05,000**
Capital and Liabilities		
Equity Share Capital	2,40,000	2,00,000
Profit & Loss A/c	1,60,000	1,25,000
Provision for depreciation on Plant & Machinery	80,000	60,000
Debentures	90,000	1,50,000
Sundry Creditors	40,000	30,000
Provision for Taxation	50,000	40,000
Total	**6,60,000**	**6,05,000**

Additional Information :

1) Income Tax paid during the years Rs. 40,000
2) Cash dividends of Rs. 25,000 have been paid during the year

You are require to prepare a Cash flow on indirect basis.

Solution :

Calculation of Cash Flow Statement

Particular	₹	₹
A) Net profit for the year (1,60,000 – 1,25,000)	35,000	
Add – Non-cash & Non-operating expenses		
- Depreciation (80,000 – 60,000)	20,000	
- Provision for Taxation	50,000	
- Dividend Paid	25,000	
Net Profit before Tax		1,30,000
Operating profit before Working Capital Charges		
B) **Cash Flow from operating activity**		
Add – Decrease of C. A. & Increase C. L		
- Increase Sundry Creditors (40,000 – 30,000)	10,000	
- Decrease of stock (1,40,000 – 1,20,000)	20,000	
Less – Increase of C. A. & Decrease C. L.		
- Increase Sundry Debtors (1,00,000 – 75,000)	(25,000)	
		5,000
Cash inflow from Operating Activity		1,35,000
C) **Cash flow from Investing Activity**		
- Sale of L & Building (1,00,000 – 80,000)	20,000	
- Purchase of P & Machinary (3,00,000-2,40,000)	(60,000)	
		(40,000)
Cash outflow from Investing Activity		95,000
D) **Cash flow from Financing Activity**		
- Issue of S. Capital (2,40,000-2,00,000)	40,000	
- Redeemption of Debenture (1,50,000 – 90,000)	(60,000)	
- Dividend paid in Cash	(25,000)	(45,000)
Net Cash Inflow		50,000
Less – Tax paid		- 40,000
Total		10,000
Add – Opening Balance of Cash		50,000
Cash Balance at the End		**60,000**

Working Note :

Provision for Taxation

To Cash/Bank A/c	40,000	By Balance b/d	40,000
(Tax paid)		By P & L A/c	50,000
To Balance c/d	50,000	(Provision)	
	90,000		**90,000**

Illustration – 12 :

The Balance Sheet of Unic Industries Ltd. as on 31st March 2020 and 31st March 2021 were as follows:

Balance Sheet

Liabilities	31-3-20	31-3-21	Assets	31-3-2020	31-3-2021
Share Capital	5,00,000	7,00,000	L & Building	80,000	1,20,000
P & L A/c	1,00,000	1,60,000	P & Machinery	5,00,000	8,00,000
General Reserve	50,000	70,000	Stock	1,00,000	75,000
Sundry Creditors	1,63,000	2,00,000	Sundry Debtors	1,40,000	1,50,000
Bills Payable	30,000	40,000	Prepaid expenses	14,000	12,000
Outstanding Expenses	7,000	5,000	Cash at Bank	16,000	18,000
	8,50,000	**11,75,000**		**8,50,000**	**11,75,000**

Additional Information :

1) Rs. 50,000 depreciation has been charged to plant and machinery during the year 2021.
2) A part of machinery was sold for Rs. 8,000 during 2021. It had cost Rs. 12,000. Depreciation of Rs. 7,000 has been provided on it.

Prepare Cash Flow Statement from the above details.

Solution :

Calculation of Cash Flow Statement

Particular	₹	₹
A) Profit for the year (1,60,000 – 1,00,000)	60,000	
Add – Non-cash & Non-operating expenses		
- Depreciation on machinery	50,000	
- General Reserve (75,000 – 50,000)	20,000	
Operating Profit before Working Capital Charges		1,30,000
B) **Cash Flow from Operating Activity**		
Add – Decrease of C. A. & Increase of C. L.		
- Increase of Sundry Cr. (2,00,000 – 1,63,000)	37,000	
- Increase of B. Payable (40,000 – 30,000)	10,000	
- Decrease of Stock (1,00,000 – 75,000)	25,000	
- Decrease of Prepaid Exp (14,000 – 12,000)	2,000	
Less – Increase of C. A. & Decrease of C. L.		
- Decrease of Outstanding Exp (7,000 – 5,000)	(2,000)	
- Increase in S. Debtors (1,50,000 – 1,40,000)	(10,000)	
Less - Profit on Sale of Machinery	(2,000)	59,000
C) **Cash from Investing Activities**		
Purchase of L & Building	(40,000)	
Purchase of P & Machinery	(3,55,000)	
Sale of Machinery	8,000	(3,87,000)
D) **Cash from Financing Activity**		
Issue of Shares (7,00,000 – 5,00,000)	2,00,000	2,00,000
Net Cash Inflow		2,000
Add – Opening Cash balance		16,000
Closing Cash Balance		**18,000**

Working Note:

Plant & Machinery A/c

To Bal b/d	5,00,000	By Depreciation A/c	50,000
To Profit on Sale	3,000	By Cash A/c (Sale)	8,000
To Cash (Purchase)	**3,55,000**		
		By Bal c/d	8,00,000
	8,58,000		**8,58,000**

Illustration – 13 :

Following are the Balance Sheet of Kotachha & Sons, Tasgaon.

Balance Sheet

Liabilities	31-3-20	31-3-21	Assets	31-3-2020	31-3-2021
Capital	2,50,000	3,06,000	Cash	20,000	14,000
Sundry Creditors	80,000	88,000	Sundry Debtors	60,000	1,00,000
Mrs. 'A's loan	50,000	–	Stock	70,000	50,000
Loans from Bank	80,000	1,00,000	Machinery	1,60,000	1,10,000
			Land	80,000	1,00,000
			Building	70,000	1,20,000
	4,60,000	**4,94,000**		**4,60,000**	**4,94,000**

During the year a machinery costing Rs. 20,000 (accumulated depreciation Rs. 6,000) sold for Rs. 10,000. The provisions for depreciation against Machinery as on 31^{st} March 2020 Rs. 50,000 and on 31-3-2021 Rs. 80,000. Net profit for the year amount Rs. 90,000.

You are required to prepare Cash Flow Statement.

Solution :

Calculation of Cash Flow Statement

Particular	₹	₹
A) **Cash flow from Operating Activities**		
Profit for the year	90,000	
Add – Depreciation on Machinery (30,000+6,000)	36,000	
- Loss on sale of Machinery	4,000	1,30,000
Changes in Current Assets & Current Liabilities		
Add – Decrease in C. A. & Increase in C. L.		
- Decrease in Stock (70,000 – 50,000)	20,000	
- Increase S. Creditors (88,000 – 80,000)	8,000	
Less – Increase in C. A. & Decrease in C. L.		
S. Debtors (1,00,000-60,000)	(40,000)	
Net-Cash out flow from Operating Activities		(12,000)
B) **Cash Flow from investing activities**		
Sale of Machinery	10,000	
Purchase of Land	(20,000)	

Purchase of Building (1,20,000-70,000)	(50,000)	
Net Cash outflow from Investing Activities		(60,000)
C) **Cash flow from Financing Activities**		
Repayment of loan	(50,000)	
Loan from Bank	20,000	
Drawings (2,50,000 + 90,000 - 3,06,000)	(34,000)	
Net Cash outflow from Financial Activity		(64,000)
Net Cash decrease		(6,000)
Cash and Cash Equivalents 1-4-2020		20,000
Cash and Cash Equivalent 31-3-2021		14,000

Working Note :

(1) Machinery A/c

Particulars	₹	Particulars	₹
To Balance b/d (1,60,000 + 50,000)	2,10,000	By Bank (Sale)	10,000
		By Provision for Depr.	6,000
		By P & L A/c (loss)	4,000
		By Bal c/d (55,000+ 45,000)	95,000
	2,00,000		**2,00,000**

(2) Depreciation A/c

Particulars	₹	Particulars	₹
To Machinery Sold	6,000	By balance b/d	50,000
To Balance c/d	80,000	By P & L A/c (Depreciation)	**36,000**
	86,000		**86,000**

(3) Sold Machinery A/c

Particulars	₹	Particulars	₹
To Balance b/d	20,000	By Bank (Sale)	10,000
		By Depreciation	6,000
		By P & L A/c (Loss)	**4,000**
	20,000		**20,000**

Capital A/c

Particulars	₹	Particulars	₹
To Drawing	**34,000**	By bal b/d	2,50,000
		By Net Profit	90,000
To balance c/	3,06,000		
	3,40,000		**3,40,000**

Illustration- 14 :

The following Balance Sheets are given.

Balance Sheet

Liabilities	2020	2021	Assets	2020	2021
Equity Share Capital	3,00,000	4,00,000	Goodwill	1,15,000	90,000
Redeemable Pref. Capital	1,50,000	1,00,000	Land & Building	2,00,000	1,70,000
General Reserve	40,000	70,000	Plant	80,000	2,00,000
Profit & Loss Account	30,000	48,000	Debtors	1,60,000	2,00,000
Proposed Dividend	42,000	50,000	Stock	77,000	1,09,000
Creditors	55,000	83,000	Bills Receivable	20,000	30,000
Bills Payable	20,000	16,000	Cash in hand	15,000	10,000
Provision for Taxation	40,000	50,000	Cash at bank	10,000	8,000
	6,77,000	**8,17,000**		**6,77,000**	**8,17,000**

Additional Information :

1) Income Tax Rs. 35,000 has been paid during the year 2021.

2) Interim dividend of Rs. 20,000 has been paid in 2021.

3) Depreciation of Rs. 20,000 on Land & Building and Rs. 10,000 on plant has been charged in 2021.

Prepare Cash Flow Statement for the year 2021.

Solution :

Calculation of Cash Flow Statement for the year 2021

Particular	₹	₹
A) Cash from Operating Activities		
Profit during the year (48,000-30,000)	18,000	
Add – Non-cash & Non operating expenses		
- Depreciation on L & Building	20,000	
- Depreciation on Plant	10,000	
- General Reserve	30,000	
- Proposed dividend	50,000	
- Provision for Taxation	45,000	
- Goodwill written off	25,000	
- Interim dividend	20,000	2,18,000
Changes in Current Assets & Current Liabilities		
Add – Decrease in C. A. & Increase in C. L.		
- Increase Sundry Creditor (83,000 – 55,000)	28,000	
Less – Increase in C.A. & Decrease in C. L.		
Decrease in B. Payable (20,000-16,000)	(4,000)	
Increase in S. Debtors (2,00,000 – 1,60,000)	(40,000)	
Increase in Stock (1,09,000-77,000)	(32,000)	(58,000)
Increase in B. Receivable (30,000 – 20,000)	(10,000)	
		1,60,000
Less – Tax paid		(35,000)
Net Cash Outflow from Operating Activities		1,25,000
B) Cash from Investing Activities		
Sale of L & Building	10,000	
Purchase of Plant	(1,30,000)	
Net Cash outflow from Investing Activities		(1,20,000)
C) Cash from Financing Activities		
Issue of Share Capital	1,00,000	
Redemption of Pref. Shares	(50,000)	
Dividend Paid	(42,000)	(12,000)
Interim Dividend Paid	(20,000)	
Net Decrease of Cash		(7,000)
Cash balance in the beginning (15,000+10,000)		25,000
Cash balance at the end (10,000 + 8,000)		**18,000**

Working Note

(1) L & Building A/c

Particulars	₹	Particulars	₹
To Bal b/d	2,00,000	By Depreciation	20,000
		By Bank (Sale)	**10,000**
		By Bal c/d	1,70,000
	2,00,000		**2,00,000**

(2) Plant

Particulars	₹	Particulars	₹
To Bal b/d	80,000	By Depreciation	10,000
To Purchase (Balance)	**1,30,000**		
		By Bal c/d	2,00,000
	2,10,000		**2,10,000**

(3) Provision for Taxation

Particulars	₹	Particulars	₹
To Cash/Bank A/c	35,000	By Bal b/d	40,000
(Tax paid)		By P & L A/c (Provision)	**45,000**
To Bal c/d	50,000		
	85,000		**85,000**

(4) Proposed Dividend

Particulars	₹	Particulars	₹
To Cash/Bank	42,000	By Bal b/d	42,000
(Dividend paid)		By P & L A/c (Provision)	**50,000**
To bal c/d	50,000		
	92,000		**92,000**

Illustration – 15 :

From the following information, prepare a Cash Flow Statement –

Balance Sheet as on ....

Particular	Note No	31-3-2021 ₹	31-3-2020 ₹
I) **Equity and Liabilities**			
1) **Shareholders Funds**			
a) Share Capital	A	5,00,000	4,50,000
b) Reserve & Surplus	B	1,28,000	70,000
2) **Non-Current Liabilities**	C	–	–
3) **Current Liabilities**			
Trade Payable		99,000	75,000
Other Current Liabilities (Bank Overdraft)	D	23,000	13,000
Short-term Provisions	E	1,00,000	82,000
Total		**8,50,000**	**6,90,000**
II) **Assets**			
1) **Non-Current Assets**			
i) Tangible Fixed Assets	F	3,70,000	2,80,000
ii) Intangible Assets (Goodwill)	G	90,000	1,15,000
2) **Current Assets**			
Current Investments	H	10,000	15,000
Cash & Cash Equivalents	I	41,000	23,000
Other Current Assets	J	3,39,000	2,57,000
Total		**8,50,000**	**6,90,000**

Note to Accounts –

Particular	31-3-2021 ₹	31-3-2020 ₹
1) **Share Capital**		
Equity Share Capital	4,00,000	3,00,000
15% Preference Share Capital	1,00,000	1,50,000
Total	5,00,000	4,50,000
2) **Reserve & Surplus**		

General Reserve	70,000	40,000
Profit & Loss Account	48,000	30,000
Security Premium	10,000	–
Total	**1,28,000**	**70,000**
3) **Short-Term Provisions**		
Proposed dividend	50,000	42,000
Provision for Taxation	50,000	40,000
Total	**1,00,000**	**82,000**

Additional Information :

1) A machine costing Rs. 50,000 (depreciation provided there on Rs.30,000) was sold for Rs. 10,000 Depreciation charged during the year was Rs. 20,000.

2) Interim dividend paid Rs. 20,000

3) Income Tax paid Rs. 35,000.

Solution :

Cash Flow Statement

for the year ended 31st March 2021

Particular	₹	₹
A) Cash Flow from Operating Activities		
Net profit for the year (48,000-30,000)	18,000	
Add – Non-cash & Non-operating expenses/items		
General Reserve	30,000	
Proposed dividend	50,000	
Interim dividend	20,000	
Provision for Taxation	45,000	
Goodwill written off	25,000	
Depreciation	20,000	
Loss on Sale of Machinary	10,000	
Net Profit before Tax		2,18,000
Changes in Current Assets & Current Liabilities		
Add – Decrease in C. A. & Increase in C. L.		
Increase Trade Payable	24,000	
Less – Increase in C. A & Decrease in C. L.		(58,000)
Increase other Current Assets	(82,000)	

Net Cash outflow from operating Activities before Tax		1,60,000
Less – Tax paid		(35,000)
Net Cash Inflow from operating Activities		1,25,000
B) Cash Flow from Investing Activities		
Sale of Machinery	10,000	
Purchase of Fixed Assets	(1,30,000)	
Sale of Current Investment	5,000	
Net Cash outflow from Investing Activities		(1,15,000)
C) Cash flow from Financing Activities		
Issue of Share Capital (1,00,000 + 10,000)	1,10,000	
Redemption of Pref. Shares	(50,000)	
Interim Dividend Paid	(20,000)	
Final dividend paid	(42,000)	
Net Cash outflow from Financing Activities		(2,000)
Net Cash Increase		8,000
Opening Cash & Cash Equivalents (23,000-13,000)		10,000
Closing Cash & Cash Equivalents (41,000-23,000)		**18,000**

Working Note

(1) Fixed Assets

Particulars	₹	Particulars	₹
To Bal b/d	2,80,000	By Bank (Sale of Machinery)	10,000
		By Depreciation (current year)	20,000
To Bank/Cash (Purchase)	**1,30,000**	By P & L A/c (Loss)	10,000
		By Bal c/d	3,70,000
	4,10,000		**4,10,000**

(2) Sale of Machinery Account

Particulars	₹	Particulars	₹
To Bal b/d	50,000	By Depreciation	30,000
		By Cash/Bank (Sale)	10,000
		By P & L A/c (Loss)	**10,000**
	50,000		**50,000**

(3) Provision for Taxation

Particulars	₹	Particulars	₹
To Bank A/c (Tax paid)	35,000	By bal b/d	40,000
		By P & L A/c (Provision)	**45,000**
To bal c/d	50,000		
	85,000		**85,000**

Illustration – 16 :

From the following information prepare a Cash Flow Statement

Balance Sheet as on ....

Particular	Note No	31-3-2021 ₹	31-3-2020 ₹
I) **Equity and Liabilities**			
1) **Shareholders Funds**			
a) Share Capital	A	15,00,000	15,00,000
b) Reserve & Surplus	B	6,20,000	(40,000)
2) **Non-Current Liabilities**			
(8% Debenture)		5,20,000	3,00,000
3) **Current Liabilities**			
Short-term Borrowings			
(8% Bank Loan)		80,000	1,00,000
Bills Payables		2,10,000	2,00,000
Other Current Liabilities	C		
(Bank Overdraft)		30,000	20,000
Short-term Provisions	D		
(Provision for Tax)		1,00,000	80,000
Total		**30,60,000**	**21,60,000**
II) **Assets**			
1) **Non-Current Assets**			
i) Tangible Assets	E	17,20,000	12,40,000
ii) Intangible Assets (Goodwill)		30,000	40,000
iii) Non-current Investments	F	2,50,000	1,60,000
iv) Non-current Assets		–	40,000

(Preliminary Expenses)			
2) **Current Assets**			
Current Investments		10,000	30,000
Cash & Cash Equivalents		2,60,000	50,000
Other Current Assets		7,90,000	6,00,000
Total		**30,60,000**	**21,60,000**

Notes to Accounts:

	31-3-2021	31-3-2020
1) **Share Capital**		
- Equity Share Capital	11,00,000	9,00,000
- 5% Preference Share Capital	4,00,000	6,00,000
Total	**15,00,000**	**15,00,000**
2) **Reserve & Surplus**		
- General Reserve	3,00,000	2,40,000
- Profit & Loss A/c	3,00,000	(2,80,000)
- Securities Premium	20,000	–
Total	**6,20,000**	**(40,000)**

Additional Information :

1) A piece of Machinery costing Rs. 1,20,000 on which depreciation charged was Rs. 40,000 and sold for Rs. 40,000. Depreciation provided on fixed Assets Rs. 1,20,000.

2) Preference shares were redeemed at a premium of 5% at the end of the year.

3) New debentures were issued at par on 1st October 2020 and Bank loan was repaid on the same date.

4) Dividend on equity shares at 8% was paid on opening balance.

5) Income Tax Rs. 90,000 has been provided during the year.

Solution :

Cash Flow Statement
for the year ended 31-3-2021

Particular	₹	₹
A) Net profit for the year (3,000,000 + 2,80,000) Dr. balance)	5,80,000	
Add – Cash & Non-operating Item/Expenses		
- General Reserve (3,00,000 – 2,40,000)	60,000	
- Provision for Tax	90,000	
- Dividend on Equity shares (9,00,000 x $\frac{8}{100}$)	72,000	
- Dividend on Pref. Shares (6,00,000 x $\frac{5}{100}$)	30,000	
Net Profit before Tax	8,32,000	
Add – Depreciation on fixed Assets	1,20,000	
- Loss on Sale of Machinery	40,000	
- Interest on Debenture old (3,00,000 x $\frac{8}{100}$)	24,000	
- Interest Debenture New (2,20,000 x $\frac{8}{100}$ x $\frac{6}{12}$)	8,800	
- Interest on Bank loan (1,00,000 x $\frac{8}{100}$ x $\frac{6}{12}$) = **4,000 + 3,200** (80,000 x $\frac{8}{100}$ x $\frac{6}{12}$)	72,00	
- Premium of Prof. Share Redemption (2,00,000 x $\frac{5}{100}$)	10,000	
- Goodwill Written off (40,000 – 30,000)	10,000	
- Prelimary Exp Written off	40,000	
Operating profit before W. Capital Changes		10,92,000
Changes in Current Assets & Current Liabilities		
Add – Decrease in C. A. & Increase C. L.		
- Increase in Bills Payable	10,000	
Less – Increase in C. A. & Decrease C. L.		
- Increase in C. A.	(1,90,0000)	(1,80,000)
		9,12,000
Less – Tax paid		(70,000)

Net Cash inflow from operating Activity after Tax		8,42,000
B) ***Cash Flow Investing Activities***		
- Sale of Machinery	40,000	
- Purchase of Fixed Assets	(6,80,000)	
- Purchase of Non-Current Investments (2,50,000-1,60,000)	(90,000)	
- Sale of Current Investments (30,000-10,000)	20,000	(7,10,000)
C) Cash flow from financing Activities		
- Issue of Equity Share Capital	2,00,000	
- Securities premium	20,000	
- Redeemption of Pref. Shares (2,00,000+10,000 premium)	(2,10,000)	
- Issue of 8% Debenture	2,20,000	
- Bank loan repaid (1,00,000-80,000)	(20,000)	
- Interest on Debenture (24,000 – 8,800) paid	(32,800)	
- Interest on loan (4,000 + 3,200)	(7,200)	
- Dividend on Equity Share paid	(72,000)	
- Dividend on Pref. Share paid	(30,000)	
		68,000
Net Cash Inflow (8,42,000 + 68,000 – 7,10,000)		2,00,000
D) Opening Cash & Cash Equivalents (50,000 – 20,000 Bank old)		30,000
E) Closing Cash & Cash Equivalents (2,60,000-30,000)		**2,30,000**

Working Note :

(1) Fixed Assets A/c

Particulars	₹	Particulars	₹
To Bal b/d	12,40,000	By Depreciation A/c (P & L A/c)	1,20,000
		By Bank A/c (Sale)	40,000
To Cash/Bank A/c (Purchase)	**6,80,000**	By P & L A/c (Loss on Sale)	40,000
		By Balance c/d	17,20,000
	19,20,000		**19,20,000**

(2) Machinery Sold A/c

Particulars	₹	Particulars	₹
To Balance b/d	1,20,000	By Depreciation A/c By Cash/Bank A/c (Sale) By P & L A/c (Loss)	40,000 40,000 40,000
	1,20,000		**1,20,000**

(3) Provision for Taxation A/c

To Cash/Bank A/c (Tax paid) To bal c/d	**70,000** 1,00,000	By Bal B/d By P & L A/c (Provision)	80,000 90,000
	1,70,000		**1,70,000**

4.3 Summary :

Cash Flow Statement is a summary of cashbook. It is a statement, which contain the inflows (sources) and outflows (uses) of cash and cash equivalents during a specified period. A Cash Flow Statement explains the causes of changes in the cash position of the business enterprise between two balance sheet dates. Now, preparation of cash flow statement is mandatory for all the companies. It is also mandatory for all business entities, which has turnover is more than Rs. 50 crores in a financial year.

The main 'sources' of cash inflows are – a) Sale of long term assets, b) long-term borrowings, c) Cash receipts from raising additional Share Capital, d) Cash receipts from non-business operations (e.g. investment, dividend etc.) and e) business operations.

The main uses of cash or cash outflows are – a) Payment of divided and interest, b) Purchase of assets, c) Redemption of debentures, d) Repayment of borrowings.

The cash flow statement shows cash flows (inflow and outflow) in terms of three components as per Accounting Standard-3 (i) Operating activities, (ii) Investing activities and (iii) Financial Activities.

The cash flow statement shows the net increase or decrease of cash and cash equivalents under each activity individually and collectively.

Operating activities are the principal revenue activities of the enterprise. Cash flows from those activities result from transactions and other events that enter into the determination of net profit or loss. Examples of cash inflow – cash sales and cash collected from debtors, cash received from fees, commission etc. Examples Cash outflows are – cash purchase and payment to creditor, payment of wages, salaries, rent etc. payment of tax.

Investing activities are the acquisions and disposal of long term assets (fixed Assets) and other investments not included in cash equivalents. Example of cash inflows are – sale of fixed Assets, sale of investments, Interest & dividend received. Example of cash outflows are purchase of Fixed Assets, purchase of shares, debentures etc.

Financing activities are the activities that result in changes in size and composition of the owner's capital and borrowings of the enterprise. Example of cash inflows are – cash received from issue of shares & debentures, Cash receipts from loan raised. Example of cash out flows are – cash payments for redemption of preference shares & debentures, payment of interest & dividends and buy-back of equity shares.

4.4 Key Terms

1) **Cash flow** - means inflow and outflow of cash.
2) **Cash Inflow** – means source of cash and increase of total cash available at the disposal of the firm.
3) **Cash Outflow** – means use of cash which decreases the total cash available at the disposal of the firm.
4) **Cash Flow Statement** – It is a statement of changes in cash position between the opening & closing of accounting period.
5) **Net Cash Flow** – means difference between cash inflows and cash outflows.
6) **Operating Activities** – Operating activities are the principal revenue activities of the enterprise. These belong to cash generated by sales and all operating expenses. These are the biggest source of cash flow.
7) **Investing Activities** – These belong to the acquision (Purchase) and disposal of long term assets such as plant, Machinery, Land & Building etc.

8) **Financing Activities** – Financing activities are those that result in changes in size and composition of the owner's capital & borrowings of the concerns.

4.5 Answers to check your progress

Check your progress-1

A) 1) False 2) True 3) True

B) 1) Statement 2) Cash and cash equivalents 3) Liquid 4) Indirect

Check your progress-2

A) 1) True 2) True 3) True

B) 1) Historic 2) Operating 3) Increase 4) Financing activities.

4.6 Exercise :

1) What do you mean by Cash Flow Statement?
2) Define Cash Flow Statement.
3) Explain the advantages of Cash Flow Statement.
4) Explain the main sources of cash or cash inflows.
5) Explain the main uses of cash or cash outflows.
6) Explain meaning of cash and cash equivalents.
7) Explain the purpose of Cash Flow Statement.
8) What do you mean by operating activities?
9) What do you mean by investing activities?
10) What do you mean by financing activities?
11) Discuss briefly the major classification of cash flow as per AS-3 (Revised)
12) Give the uses of cash flow statement.
13) Explain the following terms with two examples each.
    a) Cash
    b) Cash Equivalents
    c) Cash flow
    d) Operating activities
    e) Investing activities

f) Financing activities

14) Classify the following into Operating, Investing and Financing Activities.

a) Refund of Income Tax

b) Payment of Brokerage on purchase of shares of a finance company.

c) Dividend on shares and interest on Debentures received by a Bank.

d) Dividend on shares & interest on Debentures paid by a Mutual Fund Company.

e) Sale of shares & Debentures of other companies by a finance company.

15) From the following particulars, calculate the Net Cash flow from operating Activities.

A) Profit made during the year was Rs. 1,00,000 after considering the following items.

1)	Provision for Taxation	80,000
2)	Depreciation on Fixed Assets	4,000
3)	Amortization of goodwill	2,000
4)	Transfer to Reserve	2,800
5)	Profit on sale of L & Building	1,700
6)	Loss on sale of furniture	500

B) The following is the position of current Assets & Current Liabilities.

	Opening Balance ₹	Closing Balance ₹
Bills Receivables	4,800	6,000
Bills Payables	6,000	4,000
Stocks	4,000	3,200
Outstanding expenses	1,600	2,400
Provision for Taxation	70,000	80,000

16) Prepare a Cash flow statement on the basis of following information given in the Balance Sheet of S. N. Industries Ltd.

Liabilities	2019	2020	Assets	2019	2020
Share Capital	2,00,000	2,50,000	Goodwill	10,000	2,000
8% Debentures	1,00,000	80,000	Land & Building	2,00,000	2,80,000
General Reserve	50,000	70,000	Machinery	1,00,000	1,30,000
Sundry Creditors	40,000	60,000	Sundry Debtors	40,000	60,000
Bills Payable	20,000	1,00,000	Stock	70,000	90,000
Outstanding Expenses	25,000	20,000	Cash	15,000	18,000
	4,35,000	**5,80,000**		**4,35,000**	**5,80,000**

17) Following are the comparative Balance Sheet of ABC Ltd. Company

Liabilities	2019 (₹)	2020 (₹)	Assets	2019 (₹)	2020 (₹)
Share Capital	7,00,000	7,40,000	Cash	90,000	78,000
Profit & Loss A/c	1,00,400	1,05,600	Sundry Debtors	1,49,000	1,77,000
Debenture	1,20,000	60,000	Stock	4,92,000	4,27,000
Provision for doubtful debts	7,000	8,000	Land	2,00,000	3,00,000
Sundry Creditors	1,03,600	1,18,400	Goodwill	1,00,000	50,000
	10,31,000	**10,32,000**		**10,31,000**	**10,32,000**

Additional Information

1) Dividend was paid Rs. 35,000.

2) Land was purchased Rs. 1,00,000 and amount provided for the amortisation of goodwill Rs. 50,000.

3) Debentures of Rs. 60,000 were redeemed.

Prepare Cash Flow Statement.

18) The Balance Sheet of a Palus Engineering Ltd. company as on 31-3-2020 and 31-3-2021 were as follows.

	31-3-2020	31-3-2021
Liabilities		
Share Capital	4,50,000	6,50,000
General Reserve	50,000	75,000

Profit & Loss Account	1,00,000	1,50,000
Debentures	1,00,000	2,00,000
Sundry Creditors	87,000	1,10,000
	7,87,000	**11,85,000**
Assets		
Fixed Assets	4,60,000	8,30,000
Stock	1,10,000	1,30,000
Debtors	1,87,000	1,95,000
Cash	20,000	25,000
Preliminary Expenses	10,000	5,000
	7,87,000	**11,85,000**

Additional Information

Depreciation on Fixed Assets for the year 2020-21 was Rs. 1,17,000.

Prepare Cash Flow Statement.

19) From the following information, prepare a Cash Flow Statement

Balance Sheet as on ....

Particular	Note No	31-3-2021 ₹	31-3-2020 ₹
I) **Equity and Liabilities**			
1) **Shareholders Funds**			
a) Share Capital	1	5,00,000	4,50,000
b) Reserve & Surplus	2	1,28,000	70,000
2) **Non-Current Liabilities**		–	–
3) **Current Liabilities**			
Bills Payable		99,000	75,000
Other Current Liabilities			
(Bank Overdraft)		23,000	13,000
Short-term Provisions	3	1,00,000	82,000
Total		**8,50,000**	**6,90,000**
II) **Assets**			
1) **Non-Current Assets**			
Tangible Fixed Assets		3,70,000	2,80,000
Intangible Assets (Goodwill)		90,000	1,15,000

2) **Current Assets**			
Current Investments		10,000	15,000
Cash & Cash Equivalents		41,000	23,000
Other Current Assets		3,39,000	2,57,000
Total		**8,50,000**	**6,90,000**

Notes to Accounts

	31-3-2021 ₹	31-3-2020 ₹
1) **Share Capital**		
Equity Share Capital	4,00,000	3,00,000
15% Pref. Share Capital	1,00,000	1,50,000
	5,00,000	**4,50,000**
2) **Reserve & Surplus**		
General Reserve	70,000	40,000
Profit & Loss A/c	48,000	30,000
Securities Premium	10,000	--
Total	**1,28,000**	**70,000**
3) **Short term Provision**		
Proposed Dividend	50,000	42,000
Provision for Tax	50,000	40,000
	1,00,000	82,000

Addition Information

1) A machine costing Rs. 50,000 (depreciation provided there on Rs. 30,000) was sold Rs. 10,000. Depreciation charged during the year Rs. 20,000.

2) Interim dividend paid Rs. 20,000.

3) Income Tax paid Rs. 35,000.

20) From the following information, prepare Cash Flow Statement.

Balance Sheet as on ....

Particular	Note No	31-3-2021 ₹	31-3-2020 ₹
I) **Equity and Liabilities**			
1) **Shareholders Funds**			
a) Share Capital		4,00,000	3,00,000

b) Reserve & Surplus		1,45,000	1,02,000
2) **Non-Current Liabilities**			
(10% Debentures)		1,00,000	1,50,000
3) **Current Liabilities**			
Bills Payable		70,000	90,000
Other Current Liabilities			
(Dividend Payable)		4,000	–
Short-term Provisions		80,000	80,000
Total		**7,99,000**	**7,22,000**
II) **Assets**			
1) **Non-Current Assets**			
Tangible Fixed Assets		4,29,250	2,98,000
Intangible Assets (Goodwill)		90,000	1,00,000
Non-current Investments		60,000	1,00,000
2) **Current Assets**			
Investments		80,000	50,000
Trade Receivable		1,10,000	1,60,000
Cash & Cash Equivalents		24,000	10,000
Other Current Assets (Prepaid Exp.)		5,750	4,000
Total		**7,99,000**	**7,22,000**

Notes :

Particular	31-3-2021 ₹	31-3-2020 ₹
1) **Reserve & Surplus**		
General Reserve	1,00,000	80,000
Profit & Loss A/c	45,000	22,000
Total	**1,45,000**	**1,02,000**
2) **Short term Provision**		
Proposed dividend	40,000	30,000
Provision for Tax	40,000	50,000
	80,000	**80,000**

Additional Information

1) 15% Depreciation has been charged in the account on plant & machinery.

2) Old machines costing Rs. 50,000 has been sold Rs. 35,000 (written down value Rs. 20,000)

3) A machine costing Rs. 10,000 (WDV – Rs. 3,000) has been discarded.

4) Rs. 10,000 profit has been earned by sale of investments.

5) Debentures have been redeemed at 5% premium at the end.

6) Rs. 45,000 Income Tax has been paid & adjusted against Income Tax provision Account.

4.7 Reference for further study

1) V. Rajasekaran & Sunita Gupta (2013); Corporate Accounting, Derling Kindersley (India) Pvt. Ltd.

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6) M. N. Arora; Management Accounting - Theory, Problems and Solutions, Himalaya Publishing House.

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Unit 4

GST Accounting with Practical's using Tally Part-II

Structure

Theory

4.0 Objectives:

After studying this unit we will be able to understand

1. GST Registration
2. Accounting for Goods
3. Scope of Supply & Types of Supply
4. Accounting Practices for Returned Goods
5. Accounting for Services
6. GST Reports & Returns

4.1 Introduction:

GST is known as the Goods and Services Tax. It is an indirect tax which has replaced many indirect taxes in India such as the excise duty, VAT, Services tax, etc. The Goods and Service Tax Act was passed in the Parliament on 29th March 2017 and came into effect on 1st July 2017.

In other words, Goods and Service Tax (GST) is levied on the supply of goods and services. Goods and Services Tax Law in India is a comprehensive, multi-stage, destination-based tax that is levied on every value addition. GST is a single domestic indirect tax law for the entire country.

Goods and Services Tax (GST) is an indirect tax (or consumption tax) used in India on the supply of goods and services. It is a comprehensive, multistage, destination-based tax: comprehensive because it has subsumed almost all the indirect taxes except a few state taxes. Multi-staged as it is, the GST is imposed at every step in the production process, but is meant to be refunded to all parties in the various stages of production other than the final consumer and as a destination-based tax, it is collected from point of consumption and not point of origin like previous taxes.

Goods and services are divided into five different tax slabs for collection of tax - 0%, 5%, 12%, 18% and 28%. However, petroleum products, alcoholic drinks, and electricity are not taxed under GST and instead are taxed separately by the individual state governments, as per the previous tax system.[citation needed] There is a special rate of 0.25% on rough precious and semi-precious stones and 3% on gold. In addition a cess of 22% or other rates on top of 28% GST applies on few items like aerated drinks, luxury cars and tobacco products. Pre-GST, the statutory tax rate for most goods was about 26.5%, Post-GST; most goods are expected to be in the 18% tax range.

The tax came into effect from 1 July 2017 through the implementation of the One Hundred and First Amendment of the Constitution of India by the Indian government. The GST replaced existing multiple taxes levied by the central and state governments.

The tax rates, rules and regulations are governed by the GST Council which consists of the finance ministers of the central government and all the states. The GST is meant to replace a slew of indirect taxes with a federated tax and is therefore expected to reshape the country's 2.4 trillion dollar economy, but its implementation has received criticism. Positive outcomes of the GST includes the travel time in interstate movement, which dropped by 20%, because of disbanding of interstate check posts.

4.2 Presentation of Subject Matter:

4.2.1 Existing Registration:

To register as a normal taxable person, the process of GST registration is mandatory for businessmen whose turnover exceeds 40 Lakh. This process is known as GST registration. For North Eastern and hill states, the mandatory turnover limit for businessmen is 10 Lakh. The process of GST registration usually takes 2-6 working days.

All existing central excise and service tax assesses are being migrated to GST. An existing assesses would be provided a Provisional ID and Password by CBEC online on logging into their existing ACES login for excise or service tax. Provisional IDs are being issued to only those assesses who have a valid income tax PAN associated with their excise or service tax registration.

In some cases, an assessee may not be provided a provisional ID. Possible reasons for this include:

1. PAN associated with the registration not being valid
2. The PAN being registered with state tax authority and provisional ID having been provided by the said state tax authority (e.g. state VAT department)

3. There being multiple central excise or service tax registrations on the same PAN in a state. In such a case only one provisional ID would be issued for the 1st registration

The assesses need to use this Provisional ID and Password to login to the GST Common Portal where they would be required to fill and submit the Form 20 along with necessary supporting documents

4.2.2 Supply of Goods & Services:

Goods as well as services have been defined in the GST law. "Goods" has been defined as every kind of movable property other than money and securities but includes actionable claim, growing crops, grass and things attached to or forming part of the land which are agreed to be served before supply or under contract of supply.

“Services" means anything other than goods, money and securities but includes activities relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination, to another form, for which a separate consideration is charged. The expression 'Services" includes facilitating or arranging transactions in securities.

Thus, securities are excluded from the definition of goods as well as that of services. Money is also excluded from the definition of goods as well as services. However, activities relating to use of money or its conversion by cash or by any other mode from one form, currency or denomination, to another form, currency or denomination for which a separate consideration is charged are included in services.

4.2.3 Scope of Supply:

The taxable event in GST is supply of goods or services or both. Various taxable events like manufacturer, sale, rendering of service, purchase, entry into a territory of state etc. have been done away with in favor of just one taxable event i.e. supply. The constitution defines "goods and services tax" as any tax on supply of goods or services or both except taxes on the supply of the alcoholic liquor for human consumption.

The central and State governments have simultaneous powers to levy GST on intra-state supply. However, the parliament alone has exclusive power to make laws with respect to levy of goods and services tax on inter-state supply.

The term, "supply" has been inclusively defined in the Act. The meaning and scope of supply under GST can be understood in terms of following parameters, which can be adopted to characterize a transaction as supply:

1. Supply of goods or services or both (supply of anything other than goods or services does not attract GST)
2. Supply should be made for a consideration.
3. Supply should be made in the course or furtherance of business.
4. Supply should be a taxable supply.

While these parameters describe the concept of supply, there are few exceptions to the requirement of supply being made for a consideration involving supply being made for a consideration and in the course of business. Any transaction involving supply of goods or services without consideration is not a supply, barring few exceptions, in which a transaction is deemed to be supply even if it is without consideration. Further import of services for a consideration, whether or not in the course of business is treated as supply.

4.2.4 Place of Supply:

A) Place of Supply of Goods:

Usually, in case of goods the place of supply is where the goods are delivered. So, the place of supply of goods is the place where the ownership of goods changes. What if there is no movement of goods. In this case, the place of supply is the location of goods at the time of delivery to the recipient. Place of supply in cases where goods that are assembled and installed will be the location where the installation is done.

E.g. In case of sales in a supermarket, the place of supply is the supermarket itself.

Place of supply in cases where goods that are assembled and installed will be the location where the installation is done.

E.g. A supplier located in Kolkata supplies machinery to the recipient in Delhi The machinery is installed in the factory of the recipient in Kanpur. In this case, the place of supply of machinery will be Kanpur.

B. Place of Supply for Services:

Generally, the place of supply of services is the location of the services recipient. In case where the services are provided to an unregistered dealer and their location is not available in the location of services provider will be the place of provision of service.

Special provisions have been made to determine the place of supply for the following services:

1. Services related to immovable property
2. Restaurant services
3. Admission to events
4. Transportation of goods and passengers
5. Telecom services
6. Banking, Financial and Insurance services

In case of services related to immovable property, the location of the property is the place of provision services.

The term 'Place of supply' has the vital role in the GST. To know the nature of supply wheaten the supply is inter-state supply or intra- state supply, one should know the place of supply to determine the nature of supply.

4.2.5 Value of Supply of Goods or Services:

Value of supply means the money that a seller would want to collect the goods and services supplied.

The amount collected by the seller would want to collect the goods and services supplied. The amount collected by the seller from the buyer is the value of supply.

But where parties are related and a reasonable value may not be charged, or transaction may take place as a barter or exchange; the GST law prescribes that the value on which GST is charged must be its 'transactional value.

This is the value at which unrelated parties would transact in the normal course of business. It makes sure GST is charged and collected properly, even though the full value may not have been paid.

To generate GST compliant invoices and file GST Returns are our Clear Tax GST software.

4.2.6 Mixed Supply and Composite Supply:

Mixed supply means two or more individuals supplies of goods or services or any composition thereof, made in conjunction with each other by taxable person for a single price where such supply does not constitute a composite supply. The highest tax rate of any supply in the mixed supply will apply for all the supplies. Gift boxes consists different products having different rates.

A mixed supply has to comply with the following condition to be called as mixed supply-

1. Two or more individual supplies – There should be two or more individual supplies whether these are taxable supplies or exempted supplies or any combination thereof. Unlike in case of composite supply there is need that all the supplies of bundle should be a taxable supply. The supplies could be that be of goods or services or both or any combination of these two.
2. Provided in conjunction of each other – Like in case of composite supply should also be provided at the same time or as a bundle or package of multiple supplies.
3. Single price: – There should be a single price for multiple supplies forming a combination.
4. Does not constitute a composite supply – A supply could only become a mixed supply when it fails to get the character of a composite supply. All the necessary conditions of a composite supply are not present in the combination. Meaning thereby the combination offered for a single price should not be naturally bundled and should not be provided in ordinary course of business. The combination has to fail these two tests for calling a mixed supply.

In short the mixed supply is a combination of multiple supplies which are independent from each other. The combination is not sold by the trade in normal trade practice. The constituent supply of combination can be sold independently. The consumer does not generally expect the combination to be provided in conjunction with each other. E.g. Toilet cleaner sold with toilet brush for a single price. Another one is Diwali gift packs containing sweets, chocolates, namkeen and juices etc.

A composite supply means a supply made by a taxable person to a recipient comprising two or more taxable supplies of goods or services or any combination thereof, which are naturally bundled and supplied in conjunction with each other in the ordinary course of business, one of which is a principal supply.

E.g. For instance, a travel ticket from Mumbai to Delhi may include service or food being served on board, free insurance, use of airport lounge. In this case, transport of passenger, constitutes the pre-dominant element of the composite supply, and is treated as the principal supply and all other supplies are ancillary.

Composite supply is the bundle of two or more taxable supplies which are provided by the traders or service providers to their consumers as a normal trade practice normally for a single price and consumers also become habitual of getting those multiple supplies together.

One of which is a main supply is considered as principal supply. The tax rate of principal supply will apply to other supplies also. Goods supplied along with transportation services. Goods are the principal supply.

4.2.7 Accounting for return goods

A goods return is a transaction where the buyer of inventory or other items sends these goods back to the seller. It may be due to various reasons such as poor quality, defective items or extra items being ordered.

4.7.1 Sales Return:

A Return inward journal or sales returns journal or sales credit daybook is a prime entry book or a daybook which is used to record sales returns. To put it in other words, it is the journal which is used to record the goods which are returned by the receiver or goods. The primary document which is used as evidence in recording transactions into sales returns journal is the Credit note.

Reasons for Sales Returns:

1. Damages
2. Expiration of Products/ outdated
3. Different Brands
4. Out of the order
5. Delays in receipts

4.7.2 Purchase Return:

Purchase Returns: A Return outwards journal or purchase returns journal or purchase debit day book is a prime entry book or a daybook which is used to record purchase returns. To put it in other words, it is the journal which is used to record the goods which are returned to the suppliers. The primary document which is used as evidence in recording transactions into purchase returns journal is the Debit Note.

Reasons for Sales Returns:

1. Damages
2. Expiration of Products/ outdated
3. Different Brands
4. Out of the order
5. Delays in receipts

4.7.3 Debit Note:

A debit note in GST is a document issued by the supplier in the following cases:

1. Increase in Taxable Value

When supplier requires to increase the taxable value of a supply, he / she has to issue a debit note to the recipient

2. Increase in GST charged in invoice

When a supplier requires to increase the rate or value of GST charged in an invoice, he/she has to issue a debit note to the recipient.

Meaning:

Debit Note is issued when any money is OWED to the issuer. (Means issuer will receive some money from the buyer/ service Receiver)

Example:

If the supplier charges a penalty for the delayed payment of consideration, the supplier would issue a debit note for the amount of penalty.

Note 1: Now the original amount due PLUS the debit note amount is the revised value of supply that the customer pays the supplier.

Note 2: To this Extent the GST thereon would also stand increased.

Note 3: Debit Note will be issued when tax charged in the original tax invoice is lower than that tax applicable on the Actual supply (Value of original tax invoice + value of debit Note)

Note 4: Actual value of supply is higher than that value stated in the original tax invoice in case of debit Note.

4.7.4 Credit Note:

A Credit Note in GST is a document issued by the supplier in the following cases:

1. Supplies are returned or found be deficient by the recipient-

When goods supplied are returned by the recipient of goods / services supplied are found to be deficient by recipient the supplier should issue a Credit Note. The credit note serves the purpose of reducing the value of the original supply.

2. Decrease in taxable value:

When a supplier requires to decrease the taxable value of a supply, he /she has to issue a credit note to the recipient.

3. Decrease in GST charged in invoice:

When a supplier requires to decrease the rate or value of GST charged in an invoice, he/she has to issue a credit note to the recipient.

Meaning:

Credit Note is issuer owes money to someone (means issuer has to give money to someone)

Someone here means the person to whom the tax invoice has been issued.

Example:

When a cash discount is allowed at the time of collecting payment from a customer in terms of an agreement entered into prior to the supply, then supplier will issue a credit note to the customer to the extent of such cash discount.

Now (original Amount Due-Credit Note) is the revised value of supply that the customer pays to the supplier.

Note 1: To this extent the GST would also stands reduced.

Note 2: In case of sales return also Credit Note can be issued by the supplier.

4.2.8 GST on Services:

Government has also imposed GST on Services with the same 4-tier tax structure as of goods. GST rates on services comprising of 5%, 12%, 18% and 28%

comes with various pros and cons for the consumers. However, government has exempted healthcare and educational services from the purview of the GST.

The Goods and Services Tax council has passed the rate slabs at NIL, 5%, 12%, 18%, 28%.

Nil GST

Chargeable services offered on Basic Savings Bank Deposit (BSBD) account opened under the PMJDY (Pradhan Mantri Jan Dhan Yojana)

Hotel accommodation for transaction value per unit per day being Rs. 1000 or less

5% Tax Slab

1. Working for printing of newspapers
2. Goods transported in a vessel from outside India
3. Renting a motor cab without fuel cost
4. Transport services in AC contract/stage or radio taxi
5. Transport by air (scheduled)/air travel for purpose of pilgrimage via chartered/non-scheduled flights
6. Tour operator services
7. Leasing of aircrafts
8. Print media ad space

12% Tax Slab

1. Rail transportation of goods in containers from a third party other than Indian Railways
2. Air travel excluding economy
3. Food /drinks at restaurants without AC/heating or liquor license
4. Renting of accommodation for more than Rs.1000 and less than Rs.2500 per day
5. Railway wagons, coaches, rolling stock (without refund of accumulated Input Tax Credit/ITC)
6. Construction of building for the purpose of sale
7. IP rights on a temporary basis

8. Movie Tickets less than or equal to Rs. 100
9. Chit fund services by foremen
10. Hotel accommodation for transaction value per unit per day ranging between Rs. 1001 to 7500

18% Tax Slab

1. Food/drinks at restaurants with liquor license
2. Food /drinks at restaurants with AC/heating
3. Outdoor catering
4. Renting for accommodation for more than Rs.2500 but less than Rs.5000 per day
5. Hotel accommodation for transaction value per unit per day being Rs. 7501 or more
6. Circus, Indian classical, folk, theatre, drama
7. Supply of works contract
8. Movie Tickets over Rs. 100
9. Supply of food, shamiyana, and party arrangement

28% Tax Slab

1. Entertainment events-amusement facility, water parks, theme parks, joy rides, merry-go-round, race course, go-carting, casinos, ballet, sporting events like IPL
2. Race club services
3. Gambling
4. Food/drinks at AC 5-star hotels

4.2.9 GST Reports & Returns

Where we can access the GST returns in Tally.

1. From Gateway of Tally, go to Display.
2. From the Display Menu, select Statutory Reports.
3. Select GST.
4. Select GSTR-1

As soon as we select GSTR-1, We will see the whole return in front of We already prepared. We can check the return and edit the details if something is wrong.

We can also export the file of the return in the Excel Format by pressing CTRL+E from the GSTR-1 report.

As soon as we press CTRL+E, it will ask for exporting options. Look at the location of the computer at which our file will be located. Then just press Enter and when we are asked to accept, press Enter once again and we are done.

We have successfully exported the Excel file which we can upload to the Offline Utility tool of GST and file eventually file the GSTR-1.

Similarly, we can also prepare GSTR-2. The only difference will be that instead of Sales, We need to enter the Purchases and instead of Sundry Debtors, We have to select Sundry Creditors while creating a ledger for the person from whom we are purchasing.

GSTR-3B can also be easily exported in the similar way and for that, we do not need to do anything as it is automatically prepared from the information of GSTR-1 and GSTR-2.

4.3 Summary

We can record purchase returns against an interstate purchase by selecting the relevant party, purchase ledger, and integrated tax ledger.Under GST invoicing rules, issuing of supplementary invoice has not been defined. We can record the adjustment to purchases using debit/credit note. Overall we can use Debit/Credit Notes easily in Tally to record Purchase return and Sales and as per recording we can get all GST reports with returned goods and services.

Practical

In this practical we will learn following terms in Tally

1. Company set up
2. Enabling GST
3. Ledger Creation
4. Stock Item Creation
5. Voucher Entry
    a. Purchase

b. Sales

c. Printing Sales Invoice

d. Sales Return (Credit Note)

e. Purchase Return (Debit Note)

f. GST on Services

6. GST Reports

a. Tax Payment

b. GSTR-1

c. GSTR-2

d. GSTR-3B

e. Time line for GST tax

f. Mode of payment

g. Challan Reconciliation

h. Exporting & Uploading to GSTIN

Illustration

1. Purchased following material from Vaibhav Traders (RD from Karnataka) on credit, @ 2% Discount, Invoice No. 136, GST @ 18%

   a. 18.5" Monitor - 50 Qty. - 3800/- each

   b. 19.5" Monitor - 50 Qty. - 4100/- each

2. Sold following material to Maruti Traders (RD from Maharashtra) on credit, @ 2% Discount, Invoice No. 613, GST @18%

   a. 18.5" Monitor - 50 Qty. - 4350/- each

   b. 19.5" Monitor - 50 Qty. - 4650/- each

3. Rejected following material returned from Maruti Traders against Invoice No. 613

   a. 18.5" Monitor - 3 Qty.

   b. 19.5" Monitor - 2 Qty.

4. Rejected following material returned to Vaibhav Traders against Invoice No. 136

   a. 18.5" Monitor - 3 Qty.

   b. 19.5" Monitor - 2 Qty.

5. Raj Hotels (RD from Maharashtra) provided catering services of 50000/- for annual sales event Invoice No. 78, GST @ 12%

6. Computer IT & Network Services of Rs. 75000/- provided to Vishnu Computer Education (Consumer from Karnataka) Invoice No. 98, GST @ 12%

Working Notes & Entries

1. In the above Transaction No. 1 Material purchased from Vaibhav Traders who is from Karnataka i.e. purchase made from interstate therefore IGST is applicable and 2% discount on assessable value which is to be deducted.

Purchase 1. 18.5" Monitor 50 X 3800 = 1,90,000.00 2. 19.5" Monitor 50 X 4100 = 2,05,000.00	3,95,000.00
Less – Discount Received (2% on 3,95,000.00)	7,900.00
Add – IGST (18% on 3,95,000.00)	71,100.00
Vaibhav Traders	4,58,200.00

Entry

Purchase A/c	Dr.	3,95,000.00
IGST A/c	Dr.	71,100.00
To Vaibhav Traders A/c		4,58,200.00
To Discount Received A/c		7,900.00

2. In the above Transaction No. 2 Material sold to Maruti Traders who is from Maharashtra i.e. sale made in intrastate therefore CGST & SGST are applicable and 2% discount on assessable value which is to be deducted.

Sales 1. 18.5" Monitor 48 X 4350 = 2,08,800.00	4,32,000.00

2. 19.5" Monitor 48 X 4650 = 2,23,200.00	
Less – Discount Received (2% on 4,32,000.00)	8,640.00
Add – CGST (9% on 4,32,000.00) Add – SGST (9% on 4,32,000.00)	38,880.00 38,880.00
Vaibhav Traders	5,01,120.00

Entry

Maruti Traders A/c	Dr.	5,01,120.00
Discount Allowed A/c	Dr.	8,640.00
To Sales A/c		4,32,000.00
To CGST A/c		38,880.00
To SGST A/c		38,880.00

In the above Transaction No. 3 sold material returned from Maruti Traders against Invoice No. 613 therefore we have to calculate all amounts such as Sales Return, Discount Allowed, GST & Party amount

Sales Return 1. 18.5" Monitor 03X 4350 = 13,050.00 2. 19.5" Monitor 02 X 4650 = 9,300.00	22,350.00
Less – Discount Received (2% on 22,350.00)	447.00
Add – CGST (9% on 22,350.00) Add – SGST (9% on 22,350.00)	2,011.50 2,011.50
Maruti Traders	25,926.00

Entry

Sales Return A/c	Dr.	22,350.00
CGST A/c	Dr.	2,011.50
SGST A/c	Dr.	2,011.50
To Maruti Traders		25,926.00
To Discount Allowed A/c		447.00

3. In the above Transaction No. 4 purchased material returned to Vaibhav Traders against Invoice No. 136 therefore we have calculate Purchase Return, Discount Received, GST & Party amount

Purchase Return 1. 18.5" Monitor 03 X 3800 = 11,400.00 2. 19.5" Monitor 02 X 4100 = 8,200.00	19,600.00
Less – Discount Received (2% on 19,600.00)	392.00
Add – IGST (18% on 19,600.00)	3,528.00
Vaibhav Traders	22,736.00

Entry

Vaibhav Traders A/c Dr. 22,736

Discount Received A/c Dr. 392.00

To Purchase Return A/c 19,600.00

To IGST A/c 3,528.00

4. In the above Transaction No. 5 received catering services form Raj Hotels who is from Maharashtra therefore CGST & SGST is applicable

Catering Services (Purchases)	50,000.00
Add – CGST (6% on 50,000.00)	3,000.00
Add – SGST (6% on 50,000.00)	3,000.00
Raj Hotels	56,000.00

Entry

Catering Services A/c Dr. 50,000.00

CGST A/c Dr. 3,000.00

SGST A/c Dr. 3,000.00

To Roj Hotels

5. In the above Transaction No. 6 provided Computer IT & Network Services to Vishnu Computer Education who is from Karnataka therefore IGST is applicable

Computer IT & Network Services (Sales)	75,000.00
Add – IGST (12% on 75000.00)	9,000.00
Vishnu Computer Education	84,000.00

Entry

Vishnu Computer Education A/c Dr. 84,000.00

To Computer IT & Network Services 75,000.00

To IGST A/c 9,000.00

Tax Payment

Particulars	Amount	Amount	Amount
Tax Collection			82,737.00
Tax on Sales		86,760.00	
1. IGST	9,000.00		
2. CGST	38,880.00		
3. SGST	38,880.00		
Less – Tax on Sales Return		4,023.00	
1. IGST	00.00		
2. CGST	2,011.50		
3. SGST	2,011.50		
Input Tax Credit			73,572.00
Tax on Purchase		77,100.00	
1. IGST	71,100.00		
2. CGST	3,000.00		
3. SGST	3,000.00		
Less - Tax on Purchase Return	3,528.00	3,528.00	
1. IGST	00.00		
2. CGST	00.00		

3. SGST			
Tax Payment			**9,165.00**

Following is the procedure to solve above given illustration in tally

1. Create a company
2. Set Accounting Features to 'Yes'
   a. Use Debit and Credit Notes – Yes
   b. Record Credit Notes in invoice mode – Yes
   c. Record Debit Notes in invoice mode – Yes
3. Set GST Features to 'Yes'
   a. Goods & Services Tax – Yes
   b. Set/Alter GST options –Yes
   4. Create Ledgers
   a. Purchase – Purchase Account
   b. Sales – Sales Account
   c. Sales Return – Sales Account
   d. Purchase Return – Purchase Account
   e. Discount Received – Indirect Incomes
   f. Discount Allowed – Indirect Expenses
   g. Vaibhav Traders – Sundry Creditors
   h. Maruti Traders – Sundry Debtors
   i. IGST – Duties & Taxes
   j. CGST – Duties & Taxes
   k. SGST – Duties & Taxes
   l. Catering Services – Indirect Expenses
   m. Computer IT & Network Services – Indirect Incomes
   n. Raj Hotels – Sundry Creditors
   o. Vishnu Computer Education – Sundry Debtors

5. Create Stock Item

    a. 18.5” Monitor

    b. 19.5” Monitor

    (Note – before creating stock item we should create ‘Units of Measure’)

6. Voucher Entry

    a. Purchase Voucher – F9

    b. Sales Voucher – F8

    c. Credit Note – Ctrl+F8

    d. Debit Note – Ctrl+F9

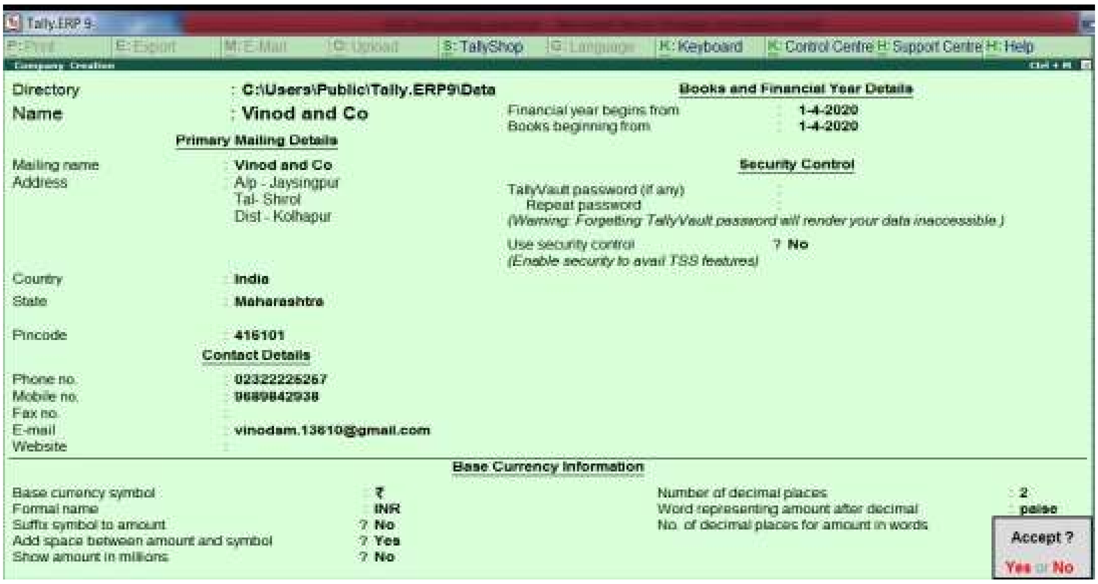
7. Reports

    a. Tax Payment (As per above calculation)

    b. GST Reports

<u>Company Creation</u>

Go to Gateway of Tally screen → Press Alt+F1 → Select Create option



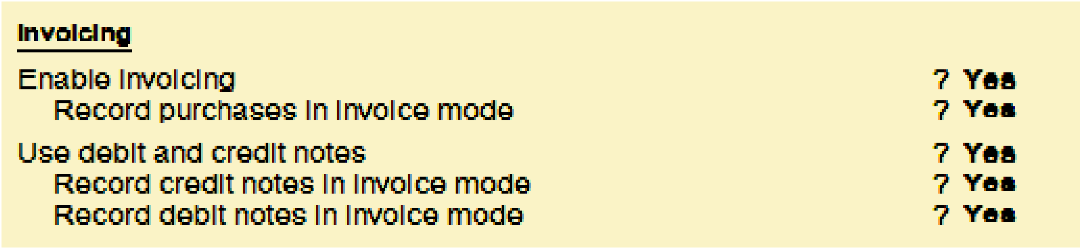
Fill up all required detail and save this

<u>Accounting Features</u>

Set Accounting Features to ‘Yes’

1. Use Debit and Credit Notes – Yes
2. Record Credit Notes in invoice mode – Yes
3. Record Debit Notes in invoice mode – Yes

To activate above accounting features we have to go on Gateway of Tally Screen → Press F11 → Select Accounting Features option → Set above option to 'Yes'



GST features

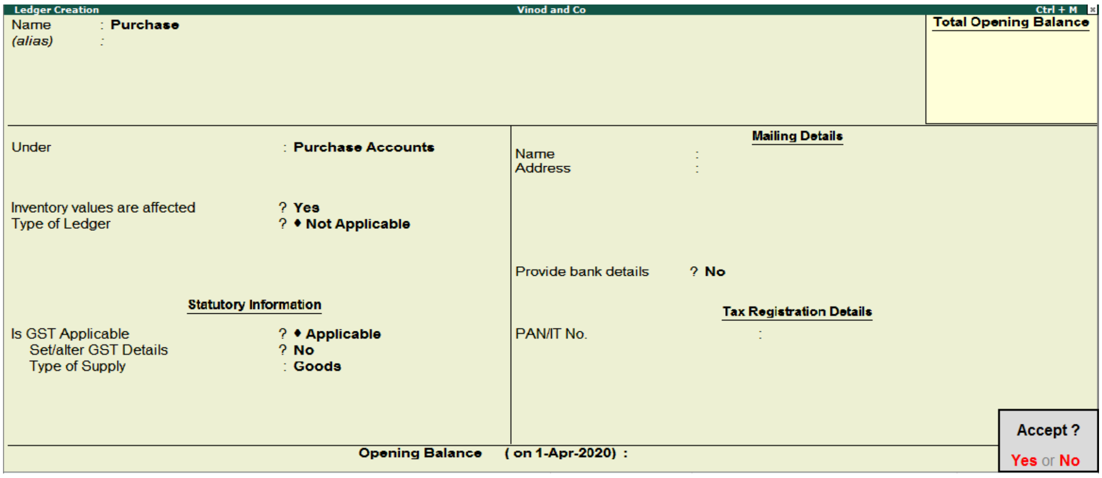
To activate GST Go to Gateway of Tally screen → Press F11 → Select Statutory & Taxation → Set GST options to 'Yes' which is shown as below

Fill all required information and save this

Ledger Creation

To create ledger Go to Gateway of Tally screen → Enter into Accounts Info option → select Ledger → Select Create option to create new ledgers

Purchase ledger



Name – Purchase

Under – Purchase Account

Inventory values are affected – Yes

Type of ledger – Not Applicable

Statutory Information

Is GST Applicable – Applicable

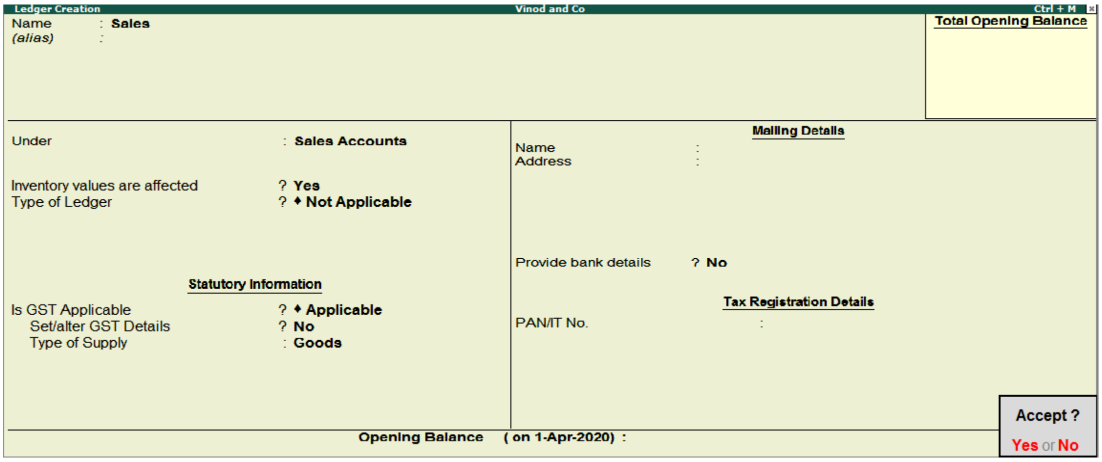
Set/Alter GST Details – No

Type of supply – Goods

After filling above all information we have to save this

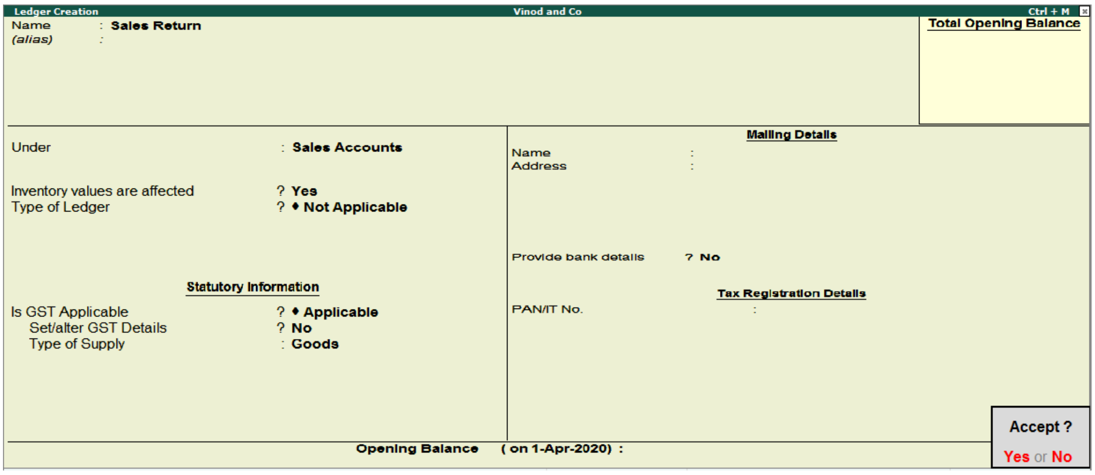
Sales ledger

Fill all information as per Purchase ledger just we have to change Group i.e. Sales Account which is shown in below image.



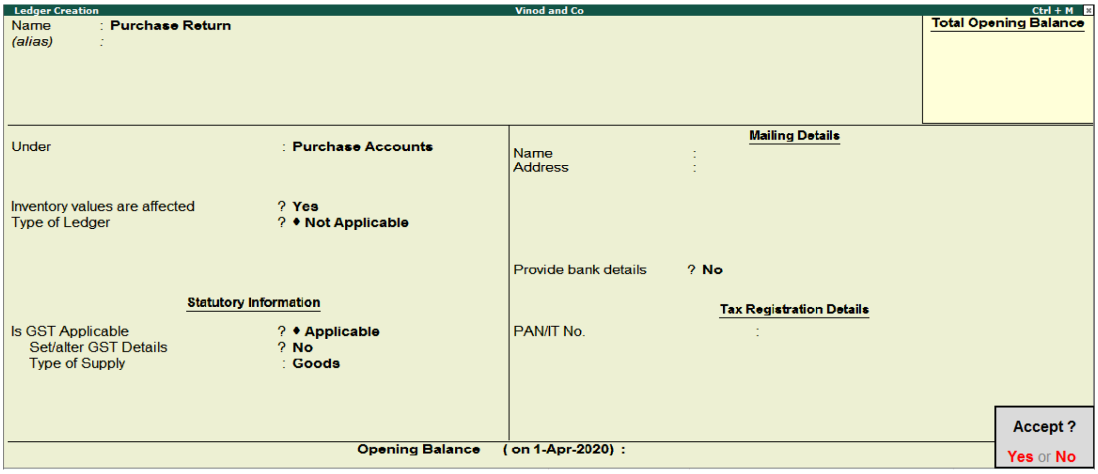
Sales Return

Fill all information as per Sales ledger just we have to change Name "Sales Return" which is shown in below image.

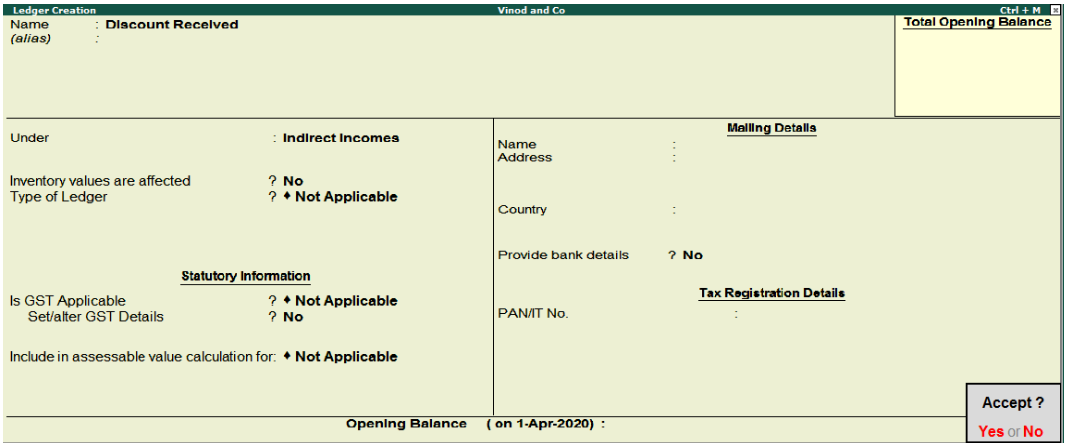


Purchase Return

Fill all information as per Purchase ledger just we have to change Name "Purchase Return" which is shown in below image.



Discount Received



Name – Discount Received

Under – Indirect Incomes

Inventory values are affected – No

Type of ledger – Not Applicable

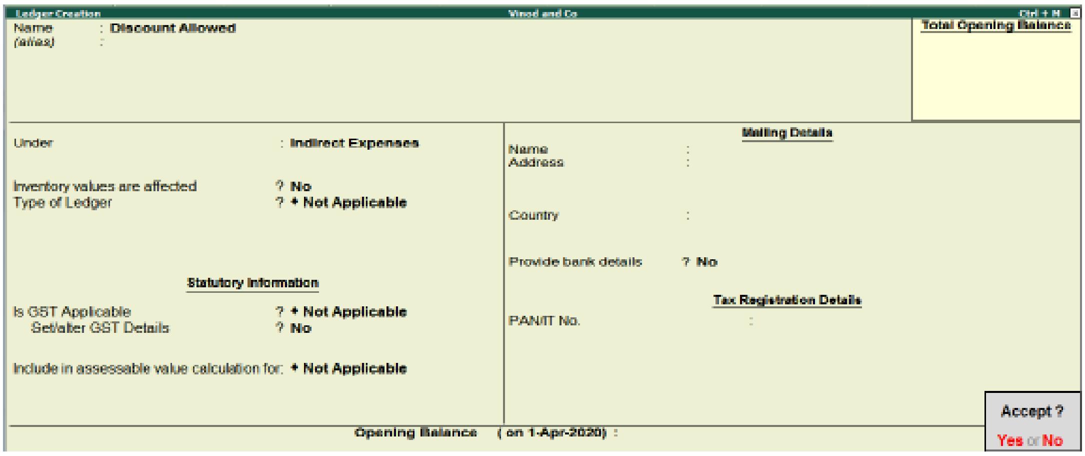
<u>Statutory Information</u>

Is GST Applicable – Not Applicable

Set/Alter GST Details – No

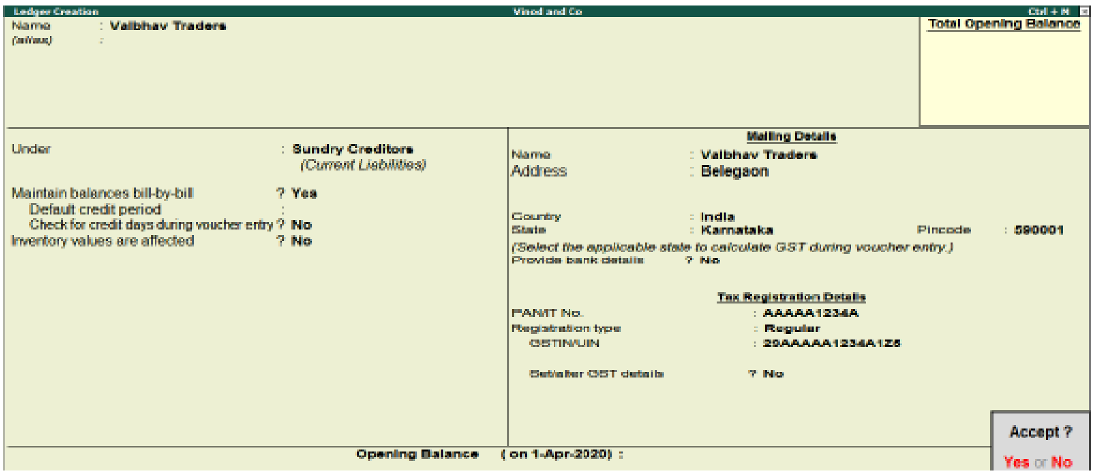
Include in assessable value calculation for – Not Applicable

<u>Discount Allowed</u>



Fill all information as per Discount Received ledger just we have to change Group i.e. Indirect Expenses which is shown in above image.

Vaibhav Traders



Name – Vaibhav Traders

Under – Sundry Creditors

Maintain balance bill by bill - Yes

Default credit period – leave blank

Check for credit days during entry – No

Inventory values are affected – No

<u>Mailing Details</u>

Name – Vaibhav Traders

Address – Belgaon

Country – India

State – Karnataka (Note – GST code start with 29 for Karnataka)

Pincode – 590001

Provide bank details – No

<u>Tax Registration Details</u>

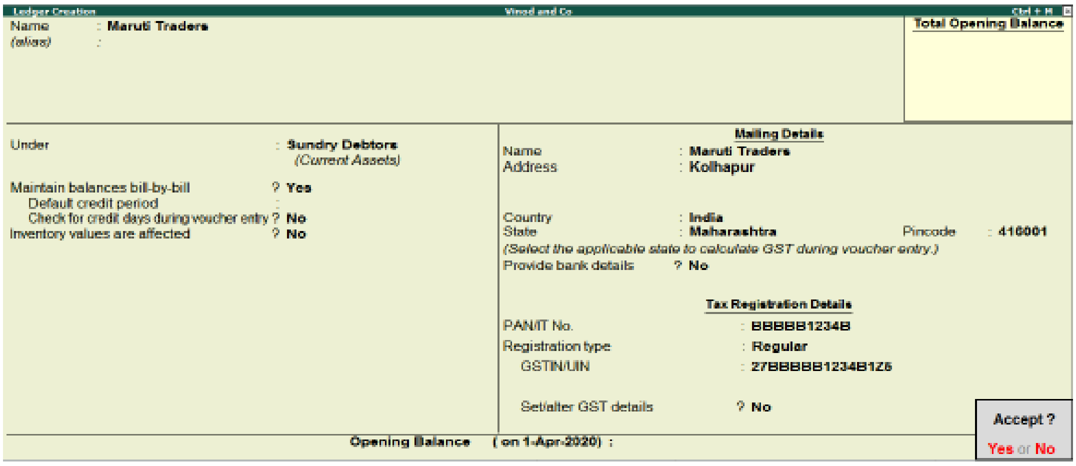
PAN/ IT No. – AAAAA1234A

Registration Type – Regular (as given in illustration)

GSTIN/UIN – 29AAAAA1234A1Z5

Set/Alter GST details – No

<u>Maruti Traders</u>



Fill up all information same as above Vaibhav Traders just we have make little changes which are shown below

Name – Maruti Traders

Under – Sundry Debtors

State – Maharashtra (GST code start with 27 for Maharashtra)

<u>Tax Registration Details</u>

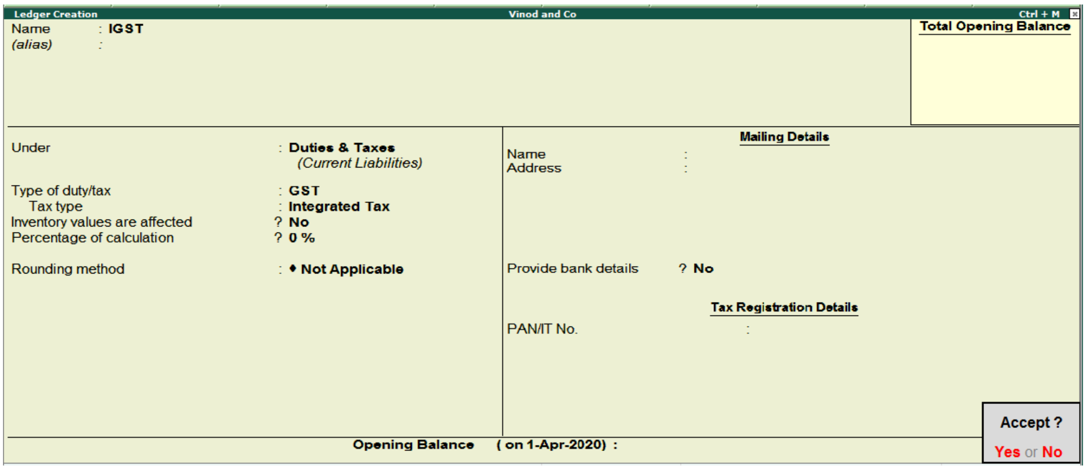
PAN/ IT No. – AAAAA1234A

Registration Type – Regular (as given in illustration)

GSTIN/UIN – 29AAAAA1234A1Z5

Set/Alter GST details – No

<u>IGST ledger</u>



Name – IGST

Under – Duties & Taxes

Type of Duty/Tax – GST

Tax Type – Integrated Tax

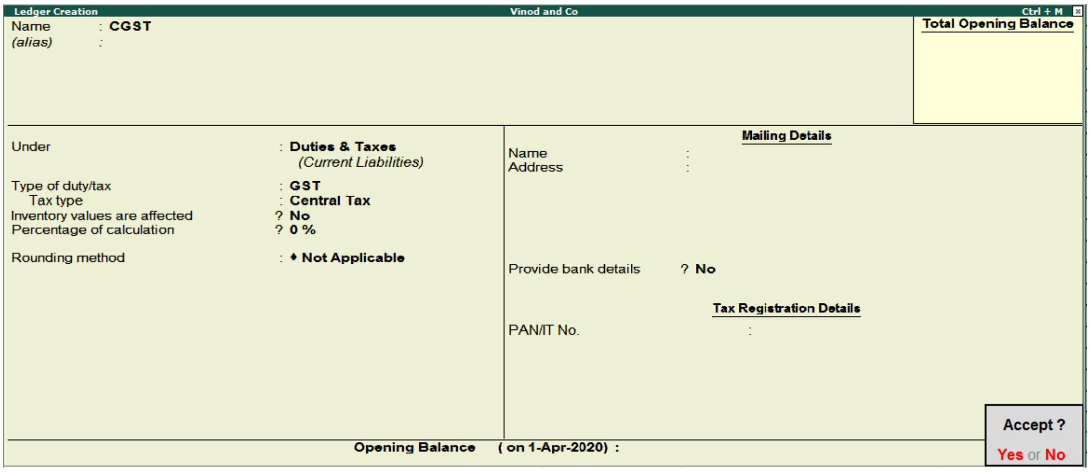
Inventory Values are affected – No

Percentage of calculation – 0%

Rounding Method – Not Applicable

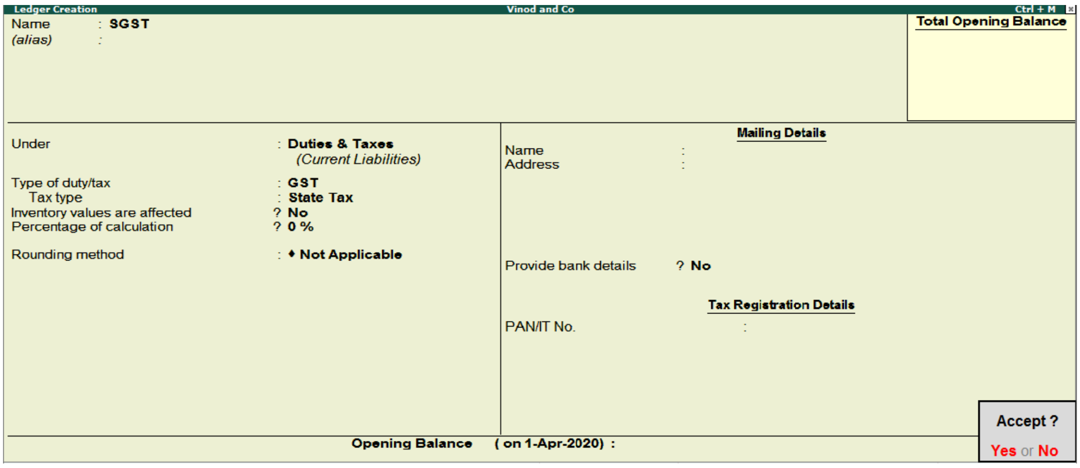
After filling all details we have to save this

CGST ledger



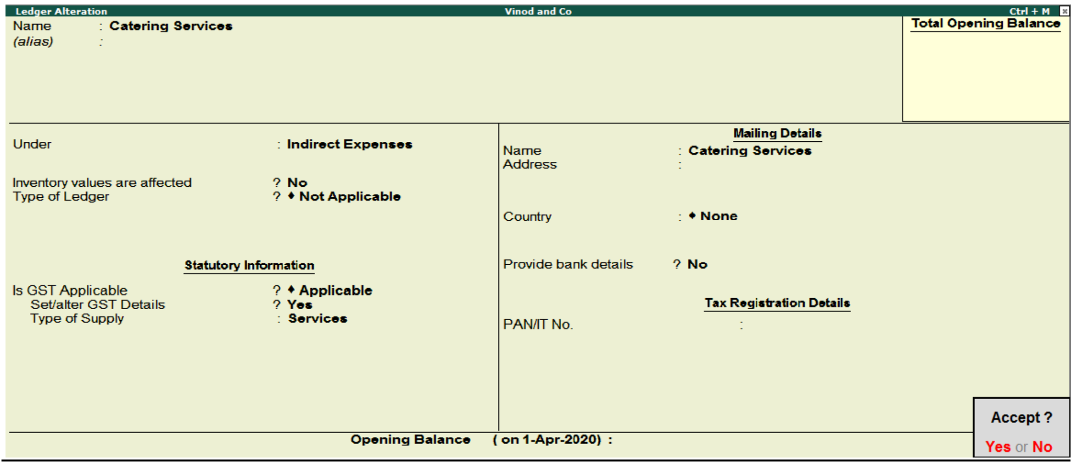
Fill up all details same as above IGST ledger just we have change Tax type to Central Tax

SGST ledger



Again here we have to create SGST ledger same as above two tax ledgers just we have to change Tax type to State Tax.

Catering Service ledger



Name – Catering Services

Under – Indirect Expenses

Inventory Values are affected – No

Type of Ledger – Not Applicable

Statutory Information

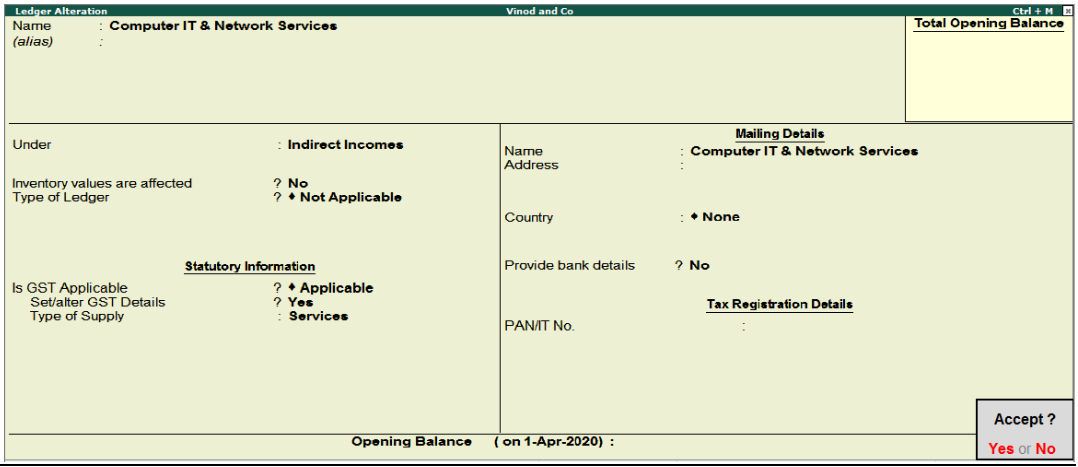
Is GST Applicable –Applicable

Set/Alter GST Details – Yes (and set GST @ 12%)

Type of Supply – Services

After filling all above details save this

Computer IT & Network Services



Name – Computer IT & Network Services

Under – Indirect Incomes

Inventory Values are affected – No

Type of Ledger – Not Applicable

Statutory Information

Is GST Applicable –Applicable

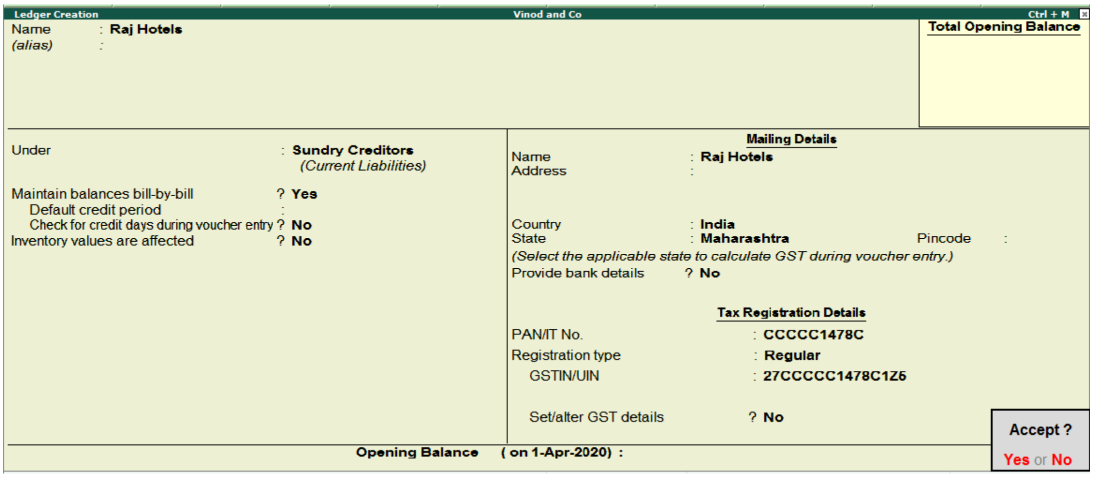
Set/Alter GST Details – Yes (and set GST @ 12%)

Type of Supply - Services

After filling above all information save this

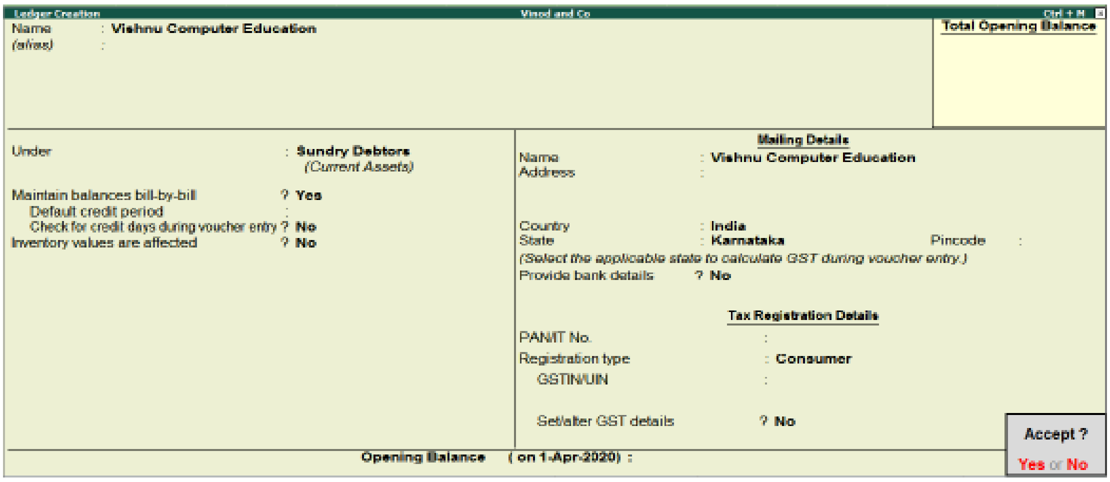
Raj Hotels

Create this ledger before we created same like Sundry Creditors ledger, fill all required details and save

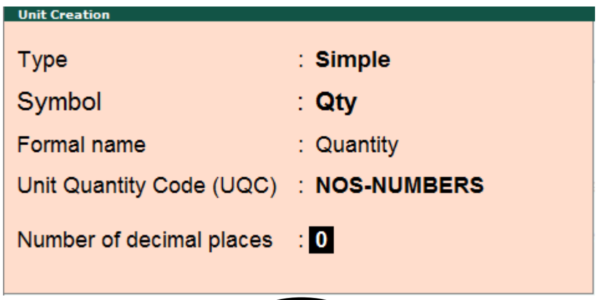


Vishnu Computer Education ledger

Create this ledger before we created same like Sundry Debtors ledger, fill all required details and save

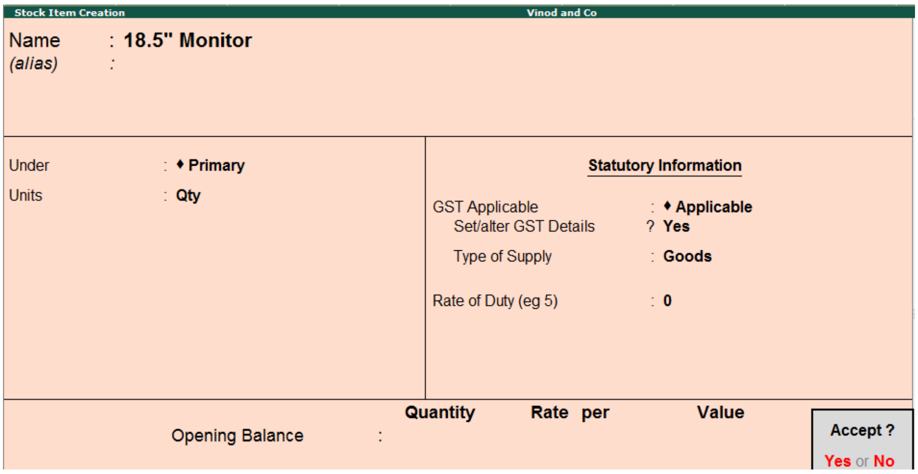


After creating all ledgers we have to create Stock Item but before creating Stock Item we have to create Units first. To create Units Go to Gateway of Tally screen → Select Inventory Info → Select Units of Measure → Create



After filling above all details we have to save this

<u>Stock Item</u>


Stock Item Creation   Vinod and Co

Name : 18.5" Monitor
(alias) :

Under : ♦ Primary
Units : Qty

Statutory Information

GST Applicable : ♦ Applicable
Set/alter GST Details ? Yes
Type of Supply : Goods

Rate of Duty (eg 5) : 0

Quantity   Rate per   Value
Opening Balance :

Accept ?
Yes or No

Name – 18.5” Monitor

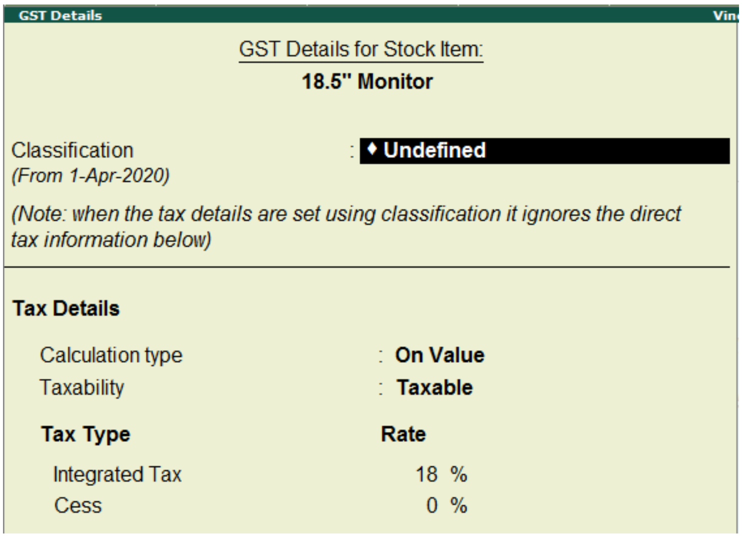
Under – Primary

Units – Qty

Statutory Information

GST Applicable – Yes

Set/Alter GST details – Yes (and fill all details shown as in below image)


GST Details   Vin

GST Details for Stock Item:
18.5" Monitor

Classification : ♦ Undefined
(From 1-Apr-2020)

(Note: when the tax details are set using classification it ignores the direct tax information below)

Tax Details

Calculation type : On Value
Taxability : Taxable

Tax Type	Rate
Integrated Tax	18 %
Cess	0 %

Type of supply – Goods

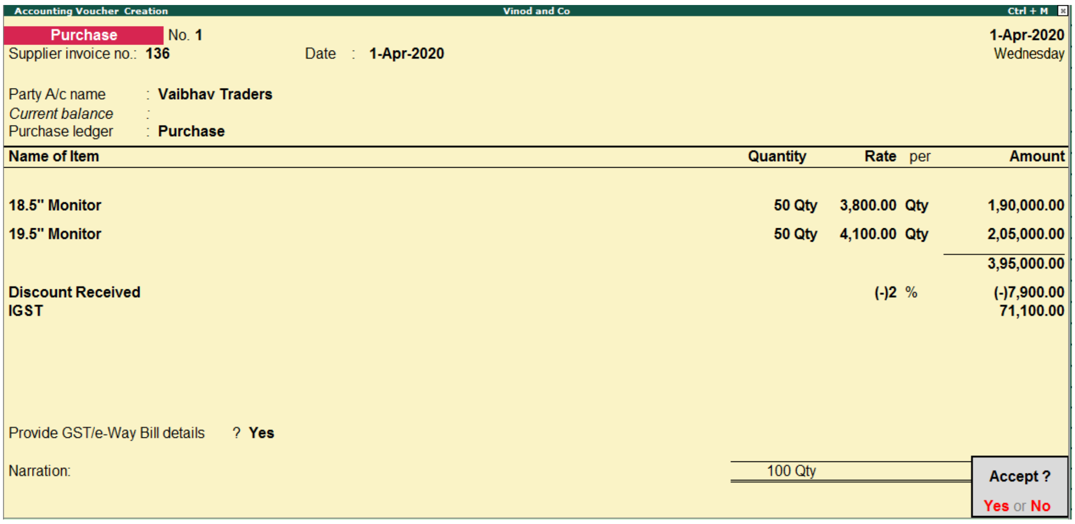
Rate of duty – 0%

After filling above all details we have to save this and create remaining stock item by same way

After creating all Masters we will learn how to record GST transactions in Tally which are shown below

To make Purchase entry in Tally Go to Gateway of Tally Screen → Select Accounting Vouchers → Press F9 (Purchase Voucher)

<u>Purchase entry</u>



Suppliers Invoice No – 136

Date – 1-Apr-2020

Party Name – Vaibhav Traders

Purchase ledger – Purchase

Then select Stock Item, quantity and rate

Then select Discount Received ledger and Press '-2' which amount will calculate automatically

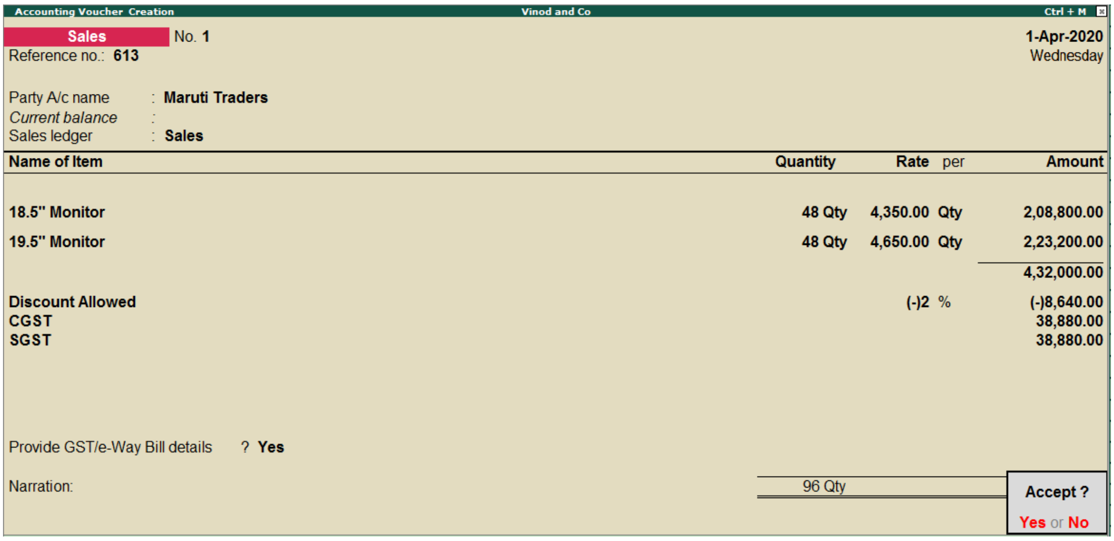
After that also select IGST ledger and amount of IGST will calculate as per given rate which is defined while creating stock item

Then provide GST/e-Way Bill details – Yes

After filling above all details we have to save this

To make Sale entry press F8 (Sales Voucher)

<u>Sales entry</u>



Reference No – 613

Party A/c Name – Maruti Traders

Sales Ledger – Sales

Then select Stock Item, quantity and rate

Then select Discount Allowed ledger and Press '-2' which amount will calculate automatically

After that also select CGST & SGST ledgers and amount of CGST & SGST will calculate as per given rate which is defined while creating stock item

Then provide GST/e-Way Bill details – Yes

After filling above all details we have to save this

To print sales invoice we need to follow below steps

Display →DayBook→ Sale entry →Alt+P (Alt+I for Preview)

Tax Invoice

Vinod and Co A/p - Jaysingpur Tal- Shirol Dist - Kolhapur GSTIN/UIN: 27AAAAA1234A1Z5 State Name : Maharashtra, Code : 27 E-Mail : vinodsm.13610@gmail.com	Invoice No. e-Way Bill No. **1**	Dated **1-Apr-2020**
	Delivery Note	Mode/Terms of Payment
	Supplier's Ref. **613**	Other Reference(s)
Buyer **Maruti Traders** Kolhapur GSTIN/UIN : 27AADCB2230MTZ1 State Name : Maharashtra, Code : 27	Buyer's Order No.	Dated
	Despatch Document No.	Delivery Note Date
	Despatched through	Destination
	Terms of Delivery	

Sl No.	Description of Goods	HSN/SAC	Quantity	Rate	per	Amount
1	**18.5" Monitor**	123456	**48 Qty**	4,350.00	Qty	**2,08,800.00**
2	**19.5" Monitor**	123457	**48 Qty**	4,650.00	Qty	**2,23,200.00**
						4,32,000.00
	Less : ***Discount Allowed***			(-)2	%	**(-)8,640.00**
	CGST					**38,880.00**
	SGST					**38,880.00**
	Total		**96 Qty**			**₹ 5,01,120.00**

Amount Chargeable (in words) E. & O.E

INR Five Lakh One Thousand One Hundred Twenty Only

HSN/SAC	Taxable Value	Central Tax		State Tax		Total Tax Amount
		Rate	Amount	Rate	Amount	
123456	2,08,800.00	9%	18,792.00	9%	18,792.00	37,584.00
123457	2,23,200.00	9%	20,088.00	9%	20,088.00	40,176.00
Total	**4,32,000.00**		**38,880.00**		**38,880.00**	**77,760.00**

Tax Amount (in words) : **INR Seventy Seven Thousand Seven Hundred Sixty Only**

Declaration

We declare that this invoice shows the actual price of the goods described and that all particulars are true and correct.

for Vinod and Co

Authorised Signatory

This is a Computer Generated Invoice

To make Sales Return entry press Ctrl+F8 (Credit Note Voucher)

Sales Return entry

Accounting Voucher Creation — Vinod and Co — Ctrl + M

Credit Note No. **1** — **1-Apr-2020** Wednesday

Original invoice no.: **613** Date : **1-Apr-2020**

Party A/c name : **Maruti Traders**
Current balance : ***5,01,120.00 Dr***
Sales ledger : **Sales Return**

Name of Item	Quantity	Rate	per	Amount
18.5" Monitor	3 Qty	4,350.00	Qty	13,050.00
19.5" Monitor	2 Qty	4,650.00	Qty	9,300.00
				22,350.00
Discount Allowed		(-)2	%	(-)447.00
CGST				2,011.50
SGST				2,011.50

Provide GST details ? **Yes**

Narration: 5 Qty

Accept ? Yes or No

To make Purchase Return entry press Ctrl+F9 (Debit Note Voucher)

Purchase Return entry

Accounting Voucher Creation — Vinod and Co — Ctrl + M

Debit Note No. **1** — **1-Apr-2020** Wednesday

Original invoice no.: **136** Date : **1-Apr-2020**

Party A/c name : **Vaibhav Traders**
Current balance : ***4,58,200.00 Cr***
Purchase ledger : **Purchase Return**

Name of Item	Quantity	Rate	per	Amount
18.5" Monitor	3 Qty	3,800.00	Qty	11,400.00
19.5" Monitor	2 Qty	4,100.00	Qty	8,200.00
				19,600.00
Discount Received		(-)2	%	(-)392.00
IGST				3,528.00

Provide GST details ? **Yes**

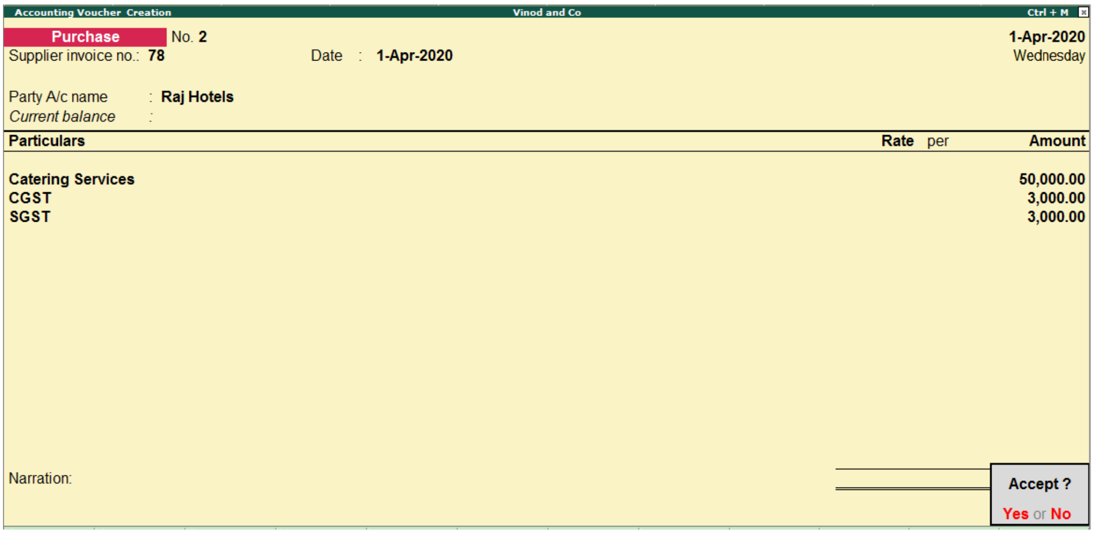
Narration: 5 Qty

Accept ? Yes or No

Accounting for GST on Services which is shown below

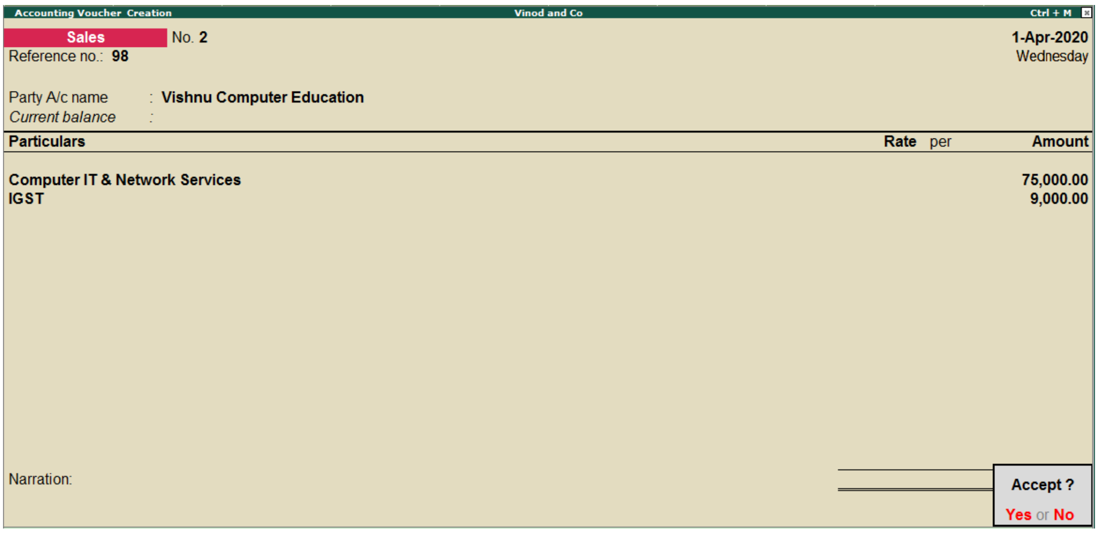
For recording of Purchases of Services transaction in Tally press F9 (Purchase Voucher) then Press **Alt+I for Accounting Invoice** then fill all required details and save which is shown in below image

Purchase of Service entry



For recording of Sals of Services transaction in Tally press F8 (Sales Voucher) then Press **Alt+I for Accounting Invoice** then fill all required details and save which is shown in below image

Sales of Service entry



Tax Payment as per above working note calculation

Balance Sheet	Vinod and Co		Ctrl + M
Liabilities	**Vinod and Co** as at 1-Apr-2020	**Assets**	**Vinod and Co** as at 1-Apr-2020
Capital Account		**Current Assets**	**5,74,994.00**
Loans (Liability)		*Closing Stock* *15,800.00*	
Current Liabilities	**5,00,629.00**	Sundry Debtors *5,59,194.00*	
Duties & Taxes *9,165.00*		Cash-in-Hand	
Sundry Creditors *4,91,464.00*			
Profit & Loss A/c	**74,365.00**		
Opening Balance			
Current Period *74,365.00*			
Total	**5,74,994.00**	**Total**	**5,74,994.00**

GST Reports

GSTR-1 (Display →Statutory Reports→GST→GSTR-1)

GSTR-1	Vinod and Co				Ctrl + M
GSTR-1					**1-Apr-2020 to 30-Jun-2020**
Returns Summary					
Total number of vouchers for the period					6
Included in returns					3
Included in HSN/SAC Summary	*2*				
Incomplete HSN/SAC information (to be provided)	*1*				
Not relevant for returns					3
Incomplete/Mismatch in information (to be resolved)					0

Sl No.	Particulars	Voucher Count	Taxable Value	Tax Amount	Invoice Amount
1	B2B Invoices - 4A, 4B, 4C, 6B, 6C	1	4,32,000.00	77,760.00	5,01,120.00
	Taxable Sales		*4,32,000.00*	*77,760.00*	*5,01,120.00*
	Reverse charge supplies				
2	B2C(Large) Invoices - 5A, 5B				
3	B2C(Small) Invoices - 7	1	75,000.00	9,000.00	84,000.00
4	Credit/Debit Notes(Registered) - 9B	1	(-)22,350.00	(-)4,023.00	(-)25,926.00

GSTR-2 (Display →Statutory Reports→GST→GSTR-2)

GSTR-2	Vinod and Co		Ctrl + M
GSTIN/UIN	: 27AAAAA1234A1Z5		**1-Apr-2020 to 30-Apr-2020**
Returns Summary			
Number of vouchers for the period			6
Included in returns			3
Invoices ready for returns	*0*		
Invoices with mismatch in information	*3*		
Not included in returns due to incomplete information			0
Not relevant for returns			3
Incomplete HSN/SAC information (to be provided)			0

Particulars	No. of Invoices	Taxable Value	Total Tax	Total ITC Available	Reconciliation Status
To be reconciled with the GST portal					
B2B Invoices - 3, 4A	2	4,45,000.00	77,100.00	77,100.00	
Credit/Debit Notes Regular - 6C	1	(-)19,600.00	(-)3,528.00	(-)3,528.00	

GSTR-3B(Display →Statutory Reports→GST→GSTR-3B)

GSTR-3B | Vinod and Co | Ctrl + M

GSTR-3B **1-Apr-2020 to 30-Apr-2020**

Returns Summary

Total number of vouchers for the period			**6**
Included in returns			6
Participating in return tables	*6*		
No direct implication in return tables	*0*		
Not relevant for returns			0
Incomplete/Mismatch in information (to be resolved)			0

Table No.	Particulars	Taxable Value	Tax Amount
3.1	**Outward supplies and inward supplies liable to reverse charge**	**4,84,650.00**	**82,737.00**
a	Outward taxable supplies (other than zero rated, nil rated and exempted)	4,84,650.00	82,737.00
b	Outward taxable supplies (zero rated)		
c	Other Outward supplies (Nil rated, exempted)		
d	Inward supplies (liable to reverse charge)		
e	Non-GST outward supplies		
3.2	**Of the supplies shown in 3.1 (a) above, details of inter-state supplies made to unregistered persons, composition taxable persons and UIN holders**	**75,000.00**	**9,000.00**

GSTR-3B | Vinod and Co | Ctrl + M

GSTR-3B **1-Apr-2020 to 30-Apr-2020**

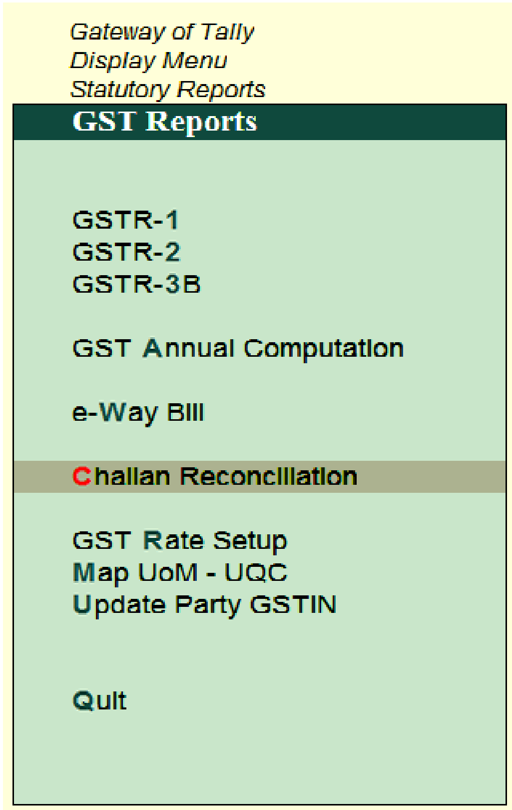
Returns Summary

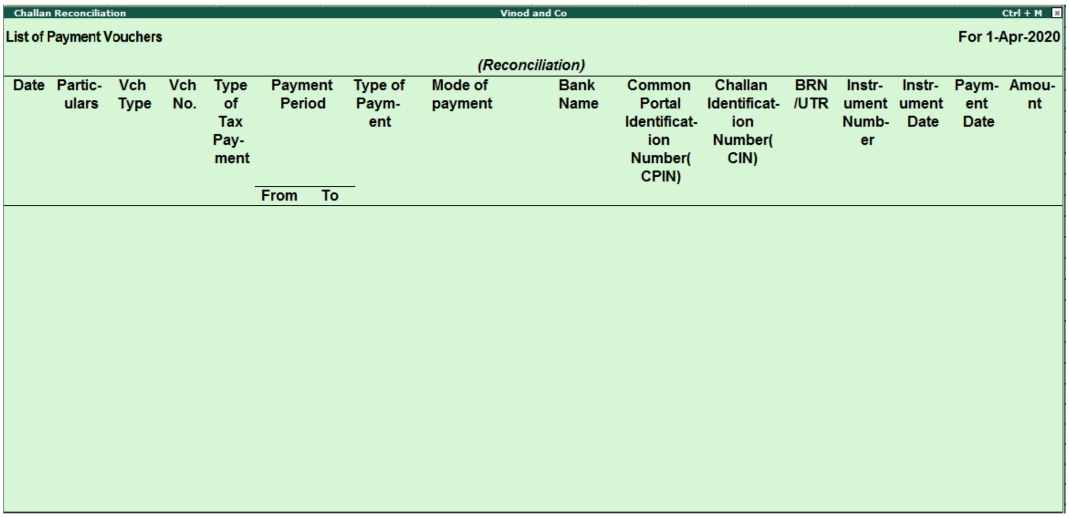
Total number of vouchers for the period			**6**
Included in returns			6
Participating in return tables	*6*		
No direct implication in return tables	*0*		
Not relevant for returns			0
Incomplete/Mismatch in information (to be resolved)			0

Table No.	Particulars	Taxable Value	Tax Amount
↑ ... 5 more			
e	Non-GST outward supplies		
3.2	**Of the supplies shown in 3.1 (a) above, details of inter-state supplies made to unregistered persons, composition taxable persons and UIN holders**	**75,000.00**	**9,000.00**
	Supplies made to Unregistered Persons	75,000.00	9,000.00
	Supplies made to Composition Taxable Persons		
	Supplies made to UIN holders		
4	**Eligible ITC**		**73,572.00**

Challan Reconciliation

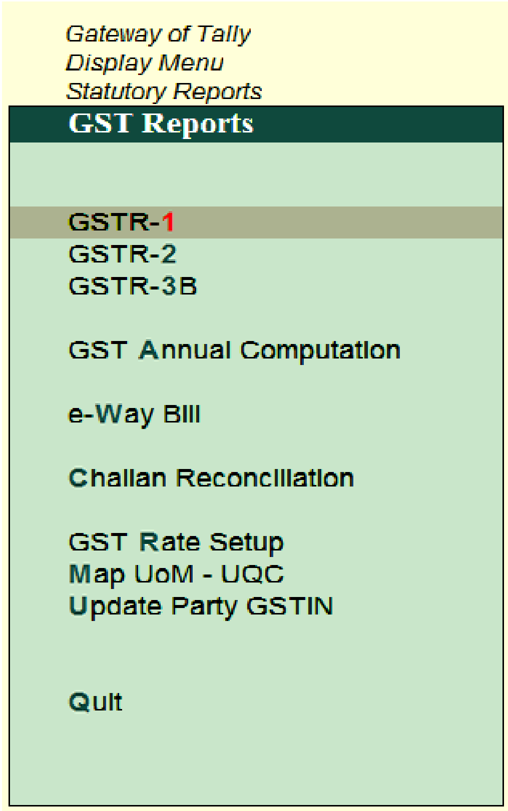
For Challan Reconciliation Go to Gateway of Tally Screen → Display → Statutory Reports → GST → and Select Challan Reconciliation shown in below image


Gateway of Tally
Display Menu
Statutory Reports
GST Reports
GSTR-1
GSTR-2
GSTR-3B
GST Annual Computation
e-Way Bill
Challan Reconciliation
GST Rate Setup
Map UoM - UQC
Update Party GSTIN
Quit

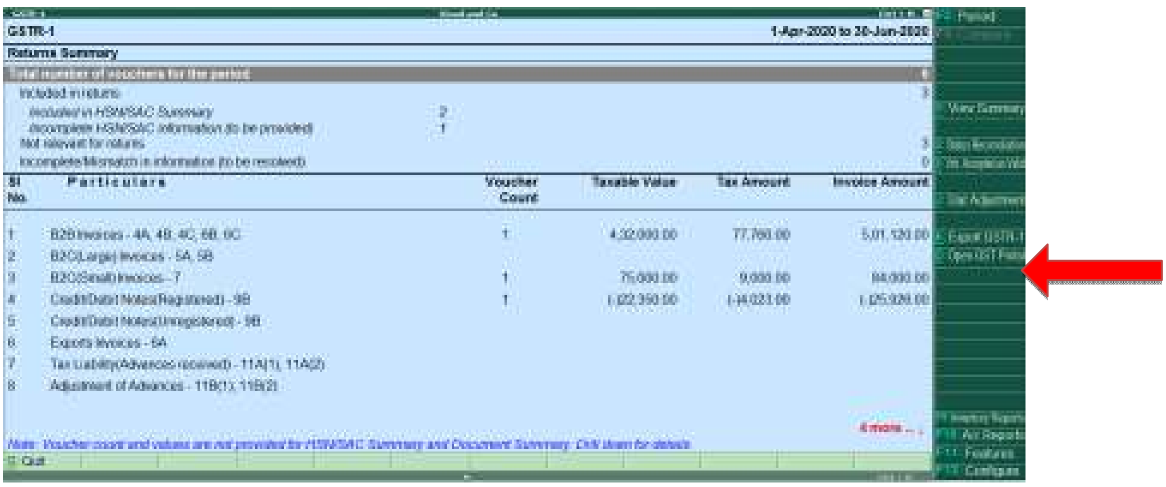

Challan Reconciliation
Vinod and Co
Ctrl + M
List of Payment Vouchers
For 1-Apr-2020
(Reconciliation)
Date
Partic-ulars
Vch Type
Vch No.
Type of Tax Pay-ment
Payment Period
From
To
Type of Paym-ent
Mode of payment
Bank Name
Common Portal Identificat-ion Number(CPIN)
Challan Identificat-ion Number(CIN)
BRN /UTR
Instr-ument Numb-er
Instr-ument Date
Paym-ent Date
Amou-nt

Exporting & Uploading to GSTIN

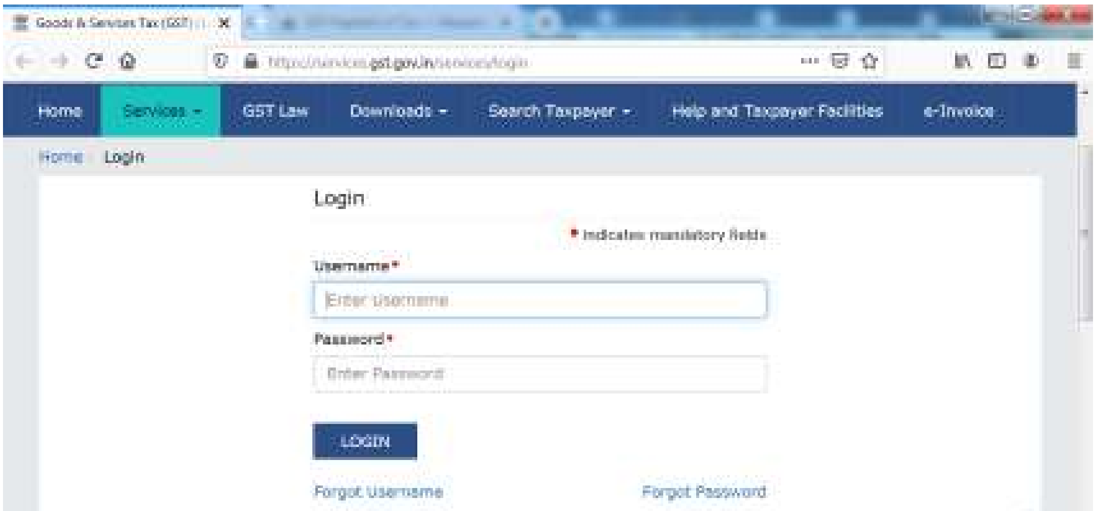
To export GSTR-1 Go to Gateway of Tally Screen → Display → Statutory Reports → GST → GSTR-1

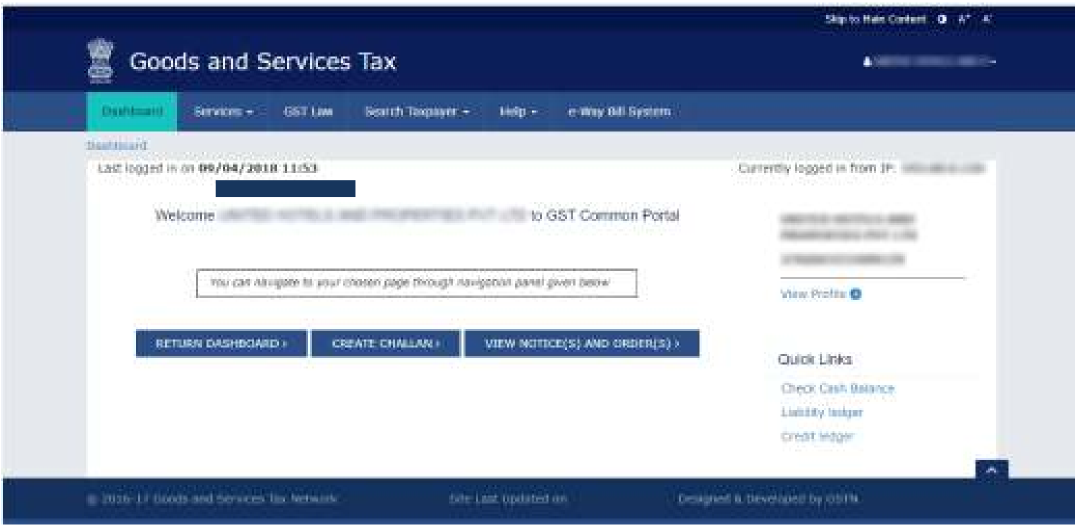


And press the key Ctrl+E to export & Ctrl+O to upload GSTR-1 which is shown in below image



To upload GSTR-1 we need USERNAME & PASSWORD for login then we can upload GST Returns





Problems for Practice

Problem No. 1

1. Purchased following material from A Traders (RD from Maharashtra) on credit, @ 3% Discount, Invoice No. 152, GST @ 12%

a. Single Line Note Book 100 pgs 1000 Qty. 27/- each

b. Single Line Note Book 200 pgs 1000 Qty. 52/- each

c. Double Line Note Book 100 pgs 1000 Qty. 29/- each

d. Double Line Note Book 200 pgs 1000 Qty. 56/- each

2. Sold following material to B Traders (RD from Karnataka) on credit, @ 3% Discount, Invoice No. 522, GST @12%

a. Single Line Note Book 100 pgs 1000 Qty. 27/- each

b. Single Line Note Book 200 pgs 1000 Qty. 52/- each

c. Double Line Note Book 100 pgs 1000 Qty. 29/- each

d. Double Line Note Book 200 pgs 1000 Qty. 56/- each

3. Rejected following material returned from B Traders against Invoice No. 522

a. Single Line Note Book 100 pgs 11 Qty.

b. Single Line Note Book 200 pgs 08 Qty.

c. Double Line Note Book 100 pgs 13 Qty.

d. Double Line Note Book 200 pgs 15 Qty.

4. Rejected following material returned to A Traders against Invoice No. 152

a. Single Line Note Book 100 pgs 11 Qty.

b. Single Line Note Book 200 pgs 08 Qty.

c. Double Line Note Book 100 pgs 13 Qty.

d. Double Line Note Book 200 pgs 15 Qty.

Problem No. 2

1. Purchased following material from X Traders (RD from Karnataka) on credit, @ 5% Discount, Invoice No. 2254, GST @ 18%

a. 32" LED TV 10 qty . 8560/- each

b. 40” LED TV 10 qty . 16350/- each

c. 32” Smart LED TV 10 Qty. 10280/- each

d. 40” Smart LED TV 10 Qty. 18940/- each

2. Sold following material to Y Traders (RD from Karnataka) on credit, @ 5% Discount, Invoice No. 6521, GST @ 18%

a. 32” LED TV 05 Qty. 9150/- each

b. 40” LED TV 05 Qty. 16850/- each

c. 32” Smart LED TV 05 Qty. 10900/- each

d. 40” Smart LED TV 05 Qty. 19450/- each

3. Sold following material to Z Traders (RD from Maharashtra) on credit, @ 5% Discount, Invoice No. 6522, GST @ 18%

a. 32” LED TV 05 Qty . 9150/- each

b. 40” LED TV 05 qty . 16850/- each

c. 32” Smart LED TV 05 Qty. 10900/- each

d. 40” Smart LED TV 05 Qty. 19450/- each

4. Rejected following material returned from Y Traders against Invoice No. 6521

a. 32” LED TV 01 Qty.

b. 40” Smart LED TV 01 Qty.

5. Rejected following material returned from Y Traders against Invoice No. 6522

a. 40” LED TV 01 Qty.

b. 32” Smart LED TV 01 Qty.

6. Rejected following material returned to X Traders against Invoice No. 2254

a. 32” LED TV 01 Qty.

b. 40” LED TV 01 Qty.

c. 32” Smart LED TV 01 Qty.

d. 40” Smart LED TV 01 Qty.

Problem No. 3

1. Consultancy Charges bill of Rs. 25000/- received from RA Chartered Accountant (RD from Maharashtra) Bill No. 123, GST @ 12%
2. Advertising Services of Rs. 60000/- provided to RAM & Co (RD from Maharashtra) Invoice No. 456, GST @ 12%

4.3 Summary

We can record purchase returns against an interstate purchase by selecting the relevant party, purchase ledger, and integrated tax ledger. Under GST invoicing rules, issuing of supplementary invoice has not been defined. We can record the adjustment to purchases using debit/credit note. Overall we can use Debit/Credit Notes easily in Tally to record Purchase return and Sales and as per recording we can get all GST reports with returned goods and services.

4.4 Check your progress:

1. The Goods and Service Tax Act was passed in the Parliament on 29th March 2017 and came into effect on ………………..
   a. 1st July 2017
   b. 1st April, 2017
   c. 1st January, 2017
   d. None of these
2. Goods and Services Tax (GST) is an …………….. tax used in India
   a. Direct
   b. Indirect
   c. Individual
   d. Indian
3. GST registration is mandatory for businessmen whose turnover exceeds ………
   a. 20 Lakhs
   b. 10 Lakhs
   c. 40 Lakhs
   d. 30 Lakhs

4. Rates of GST on Goods & Services ……………..

   a. 5%, 12%, 18% & 28%

   b. 5%, 12%, 15% & 28%

   c. 5%, 12%, 15% & 25%

   d. 5%, 12%, 25% & 28%

5. Sales Return is recorded in ……………. voucher in Tally

   a. Debit Note

   b. Sales

   c. Credit Note

   d. Purchase

4.5 Terms to remember

1. Tax on Supply
2. Place of Supply
3. Value of Supply
4. Mixed Supply
5. Composition Supply
6. Debit Note
7. Credit Note

4.6 Answers to check your progress:

MCQ – (1- a, 2-b, 3-c, 4-a, 5-c)

4.7 Exercise

a) Broad Question

1. What is GST in India? Explain the types of GST
2. Explain Mixed Supply & Composition Supply
3. What is Place of Supply in GST System?
4. Explain the GST on Services with various GST rates

b) Short Notes:

1. Explain Scope of Supply
2. Explain Mixed Supply
3. Explain Composition Supply
4. Explain Time of Supply
5. Explain Place of Supply

4.8 References

1. Vineet chouhan, Pushapkant Shakdwipee, Shagufta khan (2017) Measuring awareness about implementation of GST: "Survery of small Buusiness owners of Rajasthan"-Pacific business Reviw international.
2. Rajeev chari (2017) "GST impact on service providers" impact on service providers with implementation of GST- Numberz.in
3. R. Rupa – (2017) "GST in India an overview" international education and research journal (IERJ)-E-ISSN No:2454-9916/volume-31issue:2017
4. Shefali Dani-(2016)"A research paper on an impact of goods and service tax on India economy." Business and economics Journal. Dani bus eco j 20167'4 DOI-10,4172/2151-6219-1000026

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